

Address to the Challenge of Change:
Driving Governance and Accountability
CPA Forum 2004

**Financial Management in the
Public Sector – How Accrual
Accounting and Budgeting
Enhances Governance and
Accountability**

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Financial Management in the Public Sector – how accrual accounting and budgeting enhances governance and accountability

I. Some Introductory Remarks

I appreciate the opportunity to speak at this session of the CPA Forum 2004 on financial management in the public sector. Encouraging improvement in key areas of Australian government public administration is an underlying theme in many of the Australian National Audit Office's (ANAO's) audits, with a strong emphasis on the operational aspects of financial management and reporting, including the related control and accountability issues. As the Queensland Deputy Premier observed recently '*A commitment to strong financial management and accountability is driving continual improvement in governance in ...public sector agencies and government-owned corporations*'.¹

Patrick Weller in his book *Australia's Mandarins*² makes the valid observation that the old 'traditional' image of the Australian Public Service (APS) was one committed to procedure, or process, at the expense of effective outcomes. Due process was paramount, control emanated from the centre to ensure consistency (in theory at least) between departments and prevent any irresponsible misuse of public funds. Moneys were appropriated annually for items of expenditure, not programs, with under-expenditure seen by parliamentary committees as a sign of inefficiency, or even incompetence.³

There were calls for reforms (often based on the view that the public sector should be organised more like the private sector) which borrowed heavily on the language of the private sector, not only for government business enterprises but also for departments that had no 'bottom line' or balance sheet. The new accrual accounting methods reflected accounting approaches taken in the private sector, with agencies responsible for their own operating statement and balance sheet,⁴ resulting in a shift to where:

*'Suddenly officials were required to give a service to the community, rather than provide entitlements to those fitting the criteria determined by legislation. Entrepreneurial managers were in demand. At the same time parliamentary committees became more demanding and inquisitive...'*⁵

This sectoral convergence, from the public sector's perspective, has occurred as a direct result of citizen demands for a more efficient and responsive delivery of government services and the introduction of a paradigm shift in public administration, the so called New Public Management (NPM). Dr Shergold, the head of Australia's Department of the Prime Minister and Cabinet, encapsulated the change as follows:

*'The last decade has seen much greater emphasis placed on value-for-money in [government] service provision; explicit focus on outputs and outcomes rather than input and process; the adoption and adaptation of new information technology; improved client focus; and the introduction of systematic measurement and evaluation of corporate and individual performance'*⁶.

The Australian government's financial framework is now firmly based on an accrual-based outcome and outputs model. It is designed to allow the Parliament to ascertain the real cost of delivering benefits to the Australian community (outcomes) and agency goods and services (outputs). The ANAO has observed that the key components of effective financial management include:

- ❑ access to relevant information;
- ❑ use of that information to enhance management standards; and
- ❑ assurance that the information is accurate, relevant and secure.⁷

Clearly, a fundamental pre-condition for the effective use of financial information is reliable and timely data. In that respect, the APS financial environment continues to require a high level focus on the control structures that facilitate Chief Executive Officers (CEOs) meeting their responsibilities under the *Financial Management and Accountability Act 1997*. The emphasis on significant business risks impacting on the APS financial operations, and on the evaluation of the design and effectiveness of those procedures identified to mitigate those risks, poses significant challenges for APS senior management.

With the shift to the new public management, Professor Weller⁸ raises some interesting questions which I will also touch upon in my talk today, namely: in what ways is the public sector the same as the private sector? are the demands on managers now greater than in the past? Do demands for accountability make the job so different that it does not really make sense to talk in terms of managing in the same way? is public management therefore a unique skill?

We have already heard from Phil Bowen, who has set the scene with his presentation on the challenges, benefits and opportunities associated with accrual accounting and budgeting. Against this backdrop, my 'brief' for today is to provide some thoughts and insights on how good financial management, including accrual accounting and budgeting, can be a *driver* to improve corporate governance and accountability in the public sector. I will try not to track over the ground already covered by Phil. I will address the brief in three parts, as follows:

First : *Accrual Accounting - a public service perspective.*

The introduction, by the Australian Government in the 1990s, of accrual accounting and budgeting systems was aimed at making the public sector more efficient and its processes more transparent. While many improvements have been achieved by the reforms, some commentators⁹ argue that significant concerns remain, claiming that in order to apply business accrual accounting concepts, government agencies have had to operate as if they were business entities — but they are not. Some have also argued that the accrual accounting systems adopted by government have distorted the nature of accounting measurement, particularly in areas where such measurement is difficult.

While, in my view, the adoption of an accrual based regime in the public sector, overall, has been positive (by enhancing efficiency, effectiveness, accountability and allowing the better costing of programs and services provided by government) the enabling systems must be tailored to suit that environment. Clearly, much of the framework has been completed but there is more work needed in the financial

reporting arena (particularly with the harmonisation of accounting standards) and, importantly, to ensure that the accrual budgeting and financial management framework forms part of the normal public sector operating environment (that is, financial resources, including decision-making, accountability and good governance) and not simply seen as ‘an add on’ or something that is undertaken just to comply with government requirements. This is a sentiment recently echoed by the Canadian Auditor General:

*Departments and agencies must now improve the use of accrual financial information in their decision making and management and reporting practice; otherwise accrual accounting will be seen as something that is undertaken only to comply with .. directives of government.*¹⁰

Second : *Accountability Enhanced.*

A generation ago the bureaucracy was largely seen as uncommunicative, a virtual ‘black box’. Information was restricted and Parliamentary review ‘*was no antidote.*’¹¹ With changes in society there were calls for new accountability requirements with the expectations of the public seeking a more transparent and open government. Much of the pressure for increased accountability has been external – even today there is a trend towards an ever-increasing demand for greater accountability, particularly transparency, with citizens wanting to know whether public resources are being properly used and what is being achieved with them. A common catch-cry is for a more ‘responsive’ public service. It is almost axiomatic that accrual accounting is able to produce better quality information for decision-makers and accountability mechanisms - a theme I will develop further in this part of my paper.

Third: *Public Sector Governance*

The general public is placing more importance on good governance within both sectors. However, in the public sector, they are concerned that government programs are well managed and meeting their objectives – this means greater openness and transparency. There is a desire to hold Parliament, Government, and public officials directly accountable for results – leading to demands for sound public sector governance frameworks not only to be established, but also to be functioning properly. Having sound financial management and reporting in the public sector is an important contributor in achieving greater transparency, accountability, fiscal responsibility and, hence, improved governance.

Having dealt with accountability which, in my view, is inextricably linked with the concept of corporate governance, I will discuss the complexity of the governance arrangements in the Australian public sector context and then focus on implementing sound governance principles with better practice. I will conclude with some general observations on the central issues of the topic.

II. Accrual Accounting – a Public Sector Perspective

In order to provide some contextual understanding of my later observations, the following is a brief overview of the extensive financial management reform process that has been undertaken in the Australian public sector over the last decade, focussing on the adoption of accrual accounting and other relevant new public management initiatives.

Adoption of Accrual Accounting

The adoption of accrual accounting as part of the Financial Management Improvement Program (introduced in 1984) received widespread support because, while the cash based system was seen to be necessary for government fiscal policy purposes, it could be manipulated, or provide a misleading picture, through the timing of transactions and through inconsistent treatment of budget and non-budget sector items. But, more importantly, the cash based system did not report a wide range of financial information required for the sound management of government activities and resources, and for performance assessment. The following are some examples:

- The full costs of programs and of departmental activities, as well as, more recently, of the whole-of-government activities, were not recorded. This information is necessary for determining budget priorities and for efficient management of operations, with the costs of using, for example, existing assets, running down inventories, and unfunded expenses such as staff superannuation costs, not being recognized.
- There was no systematic record of the stock of the government's non-cash assets and of its non-borrowing liabilities, for example, superannuation.
- There was no measurement and reporting to Parliament, and to the public, of the performance of management with respect to efficient cost control, asset and liability management, and service delivery - a serious shortfall in performance accountability. Performance measurement under the cash based system was basically restricted to budget expenditure compliance.¹²

Thus, the case for the adoption of accrual accounting by government to enhance operating efficiency, the management of non-cash assets and liabilities, and performance measurement and accountability, seemed an overwhelming one. However, there are other views on this issue. For example, a leading Australian academic (Professor Allan Barton of the Australian National University) makes the claim that '*Unfortunately for the public sector, the accrual accounting standards adopted by it were the ones prepared for use by the business sector*'¹³ which raises questions about differences between the public and private sectors, which I will return to later.

The New Public Management Reforms

Once the accrual accounting systems had been implemented, the next step in the reform process involved the re-modeling and reforming of departmental operations according to business principles and practices.

Perhaps the most definitive characteristic of the New Public Management (NPM) is the greater salience that is given to what has been referred to as the three 'Es' – economy, efficiency and effectiveness. NPM refers to the collection of tactics and strategies that seek to enhance the performance of the public sector, that is, to improve the ability of government agencies to produce results.¹⁴ This has seen the trend towards the greater outsourcing of public (so-called traditional) functions and the greater focus on the contestability of services in the public sector. As two Australian academic commentators have observed:

*NPM reform in the APS has been consistently grounded in, and developed and applied, on the basis of institutional economic theory, inspired by the rhetoric of rationalising public sector activities...Broadly, the reform programme is based on key principles [of]...separation of the contracting of services from service delivery; funding based on results (outputs and outcomes) as opposed to inputs in an environment permitting private-sector suppliers to determine the most effective and innovative ways to produce the contracted services; and a commitment to reducing the role of government in the direct provision of services.*¹⁵

These reforms are largely based on the premise that greater efficiency and lower costs can be achieved by applying private sector practices to public sector service delivery – that is the notion of market competition and associated management disciplines. Increasingly, governments have been exploring the potential benefits that can flow from private sector involvement with the delivery of government outcomes through public-private partnerships (PPPs), outsourcing, joined-up or collaborative government and private financing initiatives (PFIs). Their principal features include some (or all) of the following: the delivery of services normally provided by government, the creation of assets through private sector financing and ownership control, and government support through, say, contribution of land, capital works, and risk sharing. In some cases, this means that private sector management models have overlaid traditional public sector activity. In others, the private sector has become fully incorporated in the delivery of public services through contract, as well as through cooperative and partnering arrangements.

Accrual Accounting – a catalyst for change in the public sector

While being an important catalyst for change, as part of the NPM reforms, accrual accounting has, in turn, had significant influence on the direction of financial management and financial reporting across the public sector in Australia. The accrual based financial management reform has also been a 'driver' for other key initiatives, including:

- a shift from input to output based budgets and outcomes reporting;
- turning to market testing/benchmarking and outsourcing for the delivery of government services;

- the evolution of performance measurement and management using the balanced score card approach;
- recognition of the importance of ownership and management; and
- the preparation of whole of government financial statements.¹⁶

The APS move from cash to accrual accounting was a significant development, not just for accounting systems and financial reporting, but also for the way in which resources were being managed and accounted for. As well, in the latter part of the 1990s, a series of related principles-based legislative changes, budgetary reforms and reporting initiatives were introduced. Importantly, the resulting framework continued the devolution of authority from central to line agencies, including making the Chief Executive Officer responsible for the ethical, efficient and effective use of an agency's resources.

All Australian government agencies now operate on the basis of an outcomes and outputs framework (introduced in 1999-2000) where the Government delivers benefits or services to the Australian community (outcomes) primarily through administered items and agencies' goods and services (outputs) which are delivered against specific performance benchmarks or targets (indicators).¹⁷: The framework has the following features:

- the Government specifies, via outcome statements, the outcomes it is seeking to achieve in given areas;
- these outcomes are specified in terms of the impact government is aiming to have on some aspect of society, for example, Defence;
- Parliament appropriates funds, on an accrual basis, to allow the government to achieve these outcomes through administered items and departmental outputs;
- items such as grants, transfers and benefit payments are administered on the government's behalf by agencies, with a view to maximising their contribution to specified outcomes;
- agencies specify the nature and full accrual price of their outputs and manage them to maximise their contribution to the achievement of the Government's desired outcomes;
- performance indicators are developed to allow for scrutiny of effectiveness (that is, the impact of the outputs and administered terms on outcomes) and efficiency (especially in terms of the application of administered items and the price, quality and quantity of outputs); and
- agencies discuss in their annual reports their performance against their performance indicators.

To complete the picture of change, other major initiatives introduced in the late 1990s have included:

- principles of financial management reflected in the *Financial Management and Accountability (FMA) Act 1997* and the *Commonwealth Authorities and Companies (CAC) Act 1997*;
- principles of sound fiscal management for Government through the *Charter of Budget Honesty Act 1998*;
- broad reaching mandate for the Auditor-General and the Australian National Audit Office (ANAO) through the *Auditor-General Act 1997*;
- performance improvement cycles; and
- competitive pricing policies.

The over-arching thrust of these initiatives is aimed at cultivating a performance and accountability culture within the APS. They also reinforce the need for the Government to better use its resources and treat its citizens as clients or customers to improve their satisfaction with service delivery. A significant 'driver' was to require consideration whether the public sector is best placed to deliver the desired outputs (and outcomes), or whether the private sector could more economically and efficiently provide the same service – this has resulted in a degree of integration, and a growing recognition of common approaches, between the two sectors.

Clearly, these decisions must be based on the appropriate analysis of real costs, prices, and any savings involved. Obtaining a credible public sector 'comparator' is dependent, to large degree, on accrual based systems and an understanding of commercially based financial analysis, including derivation of comparable costs and prices. Accrual information has also been important in relation to longer term strategic planning, particularly in relation to capital and debt management, and identifying inter-generational inequities.

Accrual Accounting - Outcome Reporting

Under the *Financial Management and Accountability Act 1997 (FMA Act)* and the *Commonwealth Authorities and Companies Act 1997* agencies and other federal government bodies are required to prepare annual financial statements to be audited by the Auditor-General, who is required to report each year to the relevant Minister(s) on whether the entity's financial statements have been presented fairly in accordance with Accounting Standards and other mandatory professional reporting requirements.

In addition, at the close of each financial year, the Government prepares two key financial reports:

- the Consolidated Financial Statements of the Australian Government (CFS) which are prepared and audited pursuant to section 55 and 56 of the FMA Act, to present the financial results and financial position of the Commonwealth. The CFS is prepared on an accrual accounting basis in accordance with applicable Australian Accounting Standards (AAS), including AAS 31

Financial Reporting by Governments, and other mandatory professional reporting requirements in Australia and statutory requirements; and

- the Final Budget Outcome Report (FBO Report) which is prepared pursuant to section 18 of the *Charter of Budget Honesty Act 1998* (the Charter) to present Commonwealth budget sector and Commonwealth general government sector fiscal outcomes for a financial year. The FBO Report is based on the Australian Bureau of Statistics accrual Government Finance Statistics (GFS) framework as well as on the AAS. The Charter also requires that departures from applicable external reporting standards be identified. In this regard, the major differences between the GFS and AAS treatments of transactions are reconciled, as well as being included in the Budget Papers.

The *Charter of Budget Honesty Act 1998* requires periodical reviews of the Budget Estimates Framework to assess its accuracy, responsiveness and effectiveness in meeting the needs of the Government; and to identify areas where further refinements may be made, for the purposes of continuous improvement. This legislation is regarded as an important discipline on the budgetary framework and promotes greater confidence in the Output-Outcome information provided, as well as in the estimation processes and budget outcomes.

A recent review¹⁸ provided recommendations for the refinement of the accounting/budgetary framework, all of which were endorsed by the Government. Some of the particularly interesting recommendations include:

- progressively tighter reporting timeframes to facilitate eventual reporting of Final Budget Outcome within 45 days of end of financial year (currently 90 days);
- detailed financial information at a program level, including monthly cash and accrual reports; and
- additional cash information to supplement accrual budget and actual information.

Implementing these recommendations is an important part of the financial management challenges facing the APS. Two additional challenges are the adoption of international financial reporting standards (focused on the private sector but with the potential to flow on to the public sector) and the harmonisation of Australian generally accepted accounting principles and Government Financial Statistics (GFS).

Adopting International Financial Reporting Standards

In July 2002, the Financial Reporting Council (FRC) gave the Australian Accounting Standards Board (AASB) a strategic direction for Australia to adopt International Financial Reporting Standards (IFRSs) for reporting periods starting on, or after, 1 January 2005.

The reasons for adoption of IFRSs are explained in the Corporate Law Economic Reform Program initiative (CLERP) of which the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Bill 2003* (generally referred to as

CLERP 9) is the ninth paper in that series of Government proposals to amend Australia's corporate law. For the private sector, entities will be able to list on more than one stock exchange around the world and only prepare one set of financial statements. Additionally, the cost of capital will be positively influenced due to the need to prepare only one set of accounts. As Sir David Tweedie (the Chair of the International Accounting Standards Board) opined recently:

*The real objective is to have one single set of accounting standards, so it doesn't matter whether a transaction takes place in Brisbane, Beijing or Brussels or Boston, we'll account for it in the same way. At present we'll do it in four different ways, and that's just very confusing.*¹⁹

The benefits envisaged by the AASB include opening Australia up to the world investment markets, facilitating more meaningful comparisons of the financial performance, and financial position of Australian and foreign public sector reporting entities; and improving the quality of financial reporting in Australia to international best practice. However, an ongoing issue is also to clearly articulate some concept of measurement. This has been a long term challenge for accountants in Australia.

As in Europe,²⁰ there are reservations being expressed in Australia about harmonisation with, for example, requests being made to the AASB to allow an 'alternative treatment' for Australian Companies²¹. However, the Regulator (Australian Securities and Investments Commission) plans to take a tough stance on non-compliance. There is also some reported uncertainty between the AASB and the Regulator as to who is responsible for interpreting accounting standards²². This is clearly of interest to both the private and public sectors.

It is proposed by the AASB that the new standards will be sector neutral, (that is, the standards will be equally applicable to all sectors) although further disclosure requirements may be added for the public sector. Newberry²³ questions the concept of sector neutrality and the virtues of applying private sector-like practices in the public sector and argues that the public and private sectors have vastly different accountability, governance, reporting goals, and operating motives.

Whether true sector neutrality exists within the International Accounting Standards Board's (IASB's) conceptual framework has also come into question. In their updated plan for adopting IASB standards, the AASB have noted '*...it's necessary to adopt the IASB Framework when adopting IASB standards because the standards are based on that Framework.*'²⁴ Jones and Wolnizer question whether the IASB's conceptual framework will be '*...equally applicable to the public sector and the private not-for-profit sector [as] currently, the IASB framework provides no guidance for public sector and not-for-profit entities.*'²⁵

Despite the on-going debate, rapidly approaching deadlines mean Australia will be held to the AASB's notion of sector neutral reporting standards.

Jones and Wolnizer also note concerns about Australia adopting the IASB's conceptual framework, posing the following questions for clarification and discussion²⁶:

- If the IASB's conceptual framework replaces the Australian conceptual framework, will it be of sufficient quality, scope and depth to provide adequate guidance for the standard setting process and serve the needs of users?
- If the IASB's conceptual framework is adopted, what will be the IASB's future program for the development of the conceptual framework, particularly on issues such as the reporting entity concept and accounting measurement?
- Can the IASB realistically develop a workable conceptual framework that will be acceptable on a global level?
- What will be the impediments and obstacles to the development of such a framework?
- Will the conceptual framework continue to serve the same standard setting objectives and priorities that it has traditionally performed in Australia?

The timing of the deadlines to implement IFRSs in Australia mean that such questions need to be answered sooner rather than later. Many would agree that it would be better to have a sector neutral conceptual framework that allowed for any differences relating, say, to small to medium size enterprises, not-for-profit organisations and the public sector to be covered within that framework. However, there would also be agreement with an observation by Professor Murray Wells that:

A conceptual framework that does no more than articulate a set of arbitrarily or politically motivated rules cannot and will not serve the legitimate interests of the stakeholders of business and Government enterprises.²⁷

The implementation timetable for IFRSs in Australia became clearer when the Australian Accounting Standards Board issued AASB 1 - *First Time Adoption of Australian International Financial Reporting Pronouncements* in December 2003. This standard outlines the transitional arrangements for IFRSs, including that of retrospective application. This requirement shifts implementation deadlines to be significantly earlier than initially thought. For example, an entity with a 30 June balance date (the most common date for the public sector) has had to prepare an internationally compliant opening balance sheet as at 1 July 2004, to adjust opening retained earnings. This balance sheet is being prepared, but not published, in readiness for recording accounting transactions for the 2004-2005 financial year. In effect, there are two sets of financial statements to be prepared for the 2004-2005 financial year. One set should be compliant with current Australian accounting standards for publication; the second set should be IFRS-compliant to form the comparatives for the 2005-2006 financial statements.

Changes that both sectors need to be aware of are those that require:

- recognition or de-recognition of assets or liabilities;
- new recognition criteria of revenues and expenses;
- different data to be collected in calendar 2004, financial year 2004-2005 and onwards;

- changes to systems; and
- changes in the information to be disclosed.

A broader issue to be considered is the impact of changes to accounting standards upon key performance indicators and other measures of success for outcomes and outputs – an issue of considerable relevance when cultivating a culture of performance and accountability. For example, changes to measurement may impact upon the calculation of a range of measures, such as key performance indicators and budgeted information. This may limit the comparability of information over time, due to the need to not only understand the accounting information being presented, but also the ways in which it has changed due to adoption of international standards. In a climate of assessing performance using accounting information, there is a danger that misleading analyses may be made without such full knowledge and understanding.

Setting a Single Framework – The harmonisation of Australian generally accepted accounting principles (GAAP) and Government Finance Statistics

Focus on the adoption of international financial reporting standards reflects the first strategic direction issued by the Financial Reporting Council (FRC). However, there was also a second direction issued in November 2002 relating specifically to public sector reporting, namely:

With regard to public sector reporting, the Board should pursue as an urgent priority the harmonisation of Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP) reporting. The objective should be to achieve an Australian accounting standard for a single set of Government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements.²⁸

As I have already mentioned, Australian public sector jurisdictions currently report outcomes using both the accounting framework developed by the International Monetary Fund for the production of national and government accounts (that is, Government Finance Statistics - GFS) and generally accepted accounting principles (GAAP) frameworks. The GFS reporting framework is a sophisticated statistical system, consistent with international statistical standards²⁹ and guidance published by the International Monetary Fund. This framework provides comprehensive statistical information and assessments for economic analysis of the public sector, and reflects the needs of fiscal analysts and other users interested in such analysis. This approach contrasts with Australian GAAP, which aims to provide users with sufficient information to evaluate the entity's financial performance and position, and its use of resources.

The current dual reporting regime contributes to a proliferation of aggregated measures in budget documents and other outcome reporting documents. This different presentation of financial information in turn leads users (who are many and varied) to find it complex and difficult to follow. Additionally, this dual reporting means that budgets are not always directly comparable across jurisdictions which impacts on the usefulness and relevance of the documents.³⁰ In addition to conceptual inconsistencies, there are a number of technical differences between GFS and

Australian GAAP relating to timing and so-called 'permanent' differences³¹, which lead to dissimilar net results and/or balance sheet presentation and outcomes.

Brett Kaufmann,³² from the Australian Department of Finance and Administration, makes two important points, namely:

- *Different business models drive the two sectors* - the budget is a key document in the public sector because taxpayers and the markets want to know what governments intend to do with their tax dollars and this allocation of these scarce resources is set out in the budget. This is a wealth redistribution business model as opposed to the wealth creation business model of the private sector with its focus on outcome statements in the form of general purpose financial reports (GPFRs).
- *Appropriate measures* - the performance of private sector entities is assessed through measures such as profit and loss, equity, earnings per share, and return on assets which are consistent with the wealth creation business model but not with the wealth creation model of the public sector. Where as the public sector exist to deliver goods and services to the community either directly by government agencies, through outsourcing to the private sector or through funding arrangements with the other two tiers of government.

The ASB has an ambitious GAAP/GFS conversion timetable³³, with an exposure draft scheduled for release in March 2005 for application of the new standard in 2005-2006. The AASB's GAAP/GFS convergence project is being undertaken in three phases:

Phase 1: whole of government (including sectors);

Phase 2: entities within General Government Sector (GGS) (including government departments); and

Phase 3: local governments and other public sector entities (including universities and government business enterprises).

The results will be implemented having regard to international activities, in particular, the work being undertaken and to be undertaken by the IASB, IFAC-PSC, IMF and OECD. The outcome of this project is to create an '*Australian accounting standard for a single set of Government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements.*'³⁴

Consequently, any changes to be taken in response to this new standard may well coincide with preparations being made for the implementation of harmonised accounting standards for reporting periods starting on, or after, 1 January 2005. This will accentuate the implementation complexity, not just in determining the implications for an organisation and for its financial reporting, but also for any systems changes that need to be made to reflect the impact of the new standards framework.

Despite all of the efforts being expended on this project, the question remains as to whether a harmonised framework can lead to better information and a better result for the public sector? Australian GAAP and GFS currently give different information to different audiences for different purposes. To harmonise these two incompatible frameworks might lead to compromises being made which undermine the quality of the very information being sought. One issue of concern raised is whether General Government Sector reporting will remain credible, transparent, understandable and comparable³⁵. Nevertheless, there are distinct advantages of transparency and better understanding, if successful harmonisation can be achieved.

The growing convergence of the public and private sectors in recent years may be assisted by Australia's commitment to adopt International Financial Reporting Standards from January 2005. This commitment may further blur the distinction between the public and private sectors as they will be largely using the same accounting principles and rules. However, it is still not clear as to the extent that international public sector accounting standards (under the control of the Public Sector Committee of the International Federation of Accountants - IFAC) will converge with those of the International Accounting Standards Board. Nevertheless, the financial reports will be more internationally comparable, being both prepared and audited using harmonised standards.

The presentation of public sector financial statements

Given this background, I will now move on to some issues associated with the accounting policies used in preparation of public sector financial statements which, in many ways, are more complex than those experienced in the private sector. Such issues can make the interpretation of those financial statements difficult and, if users do not understand the differences in the models and policies adopted, can lead to false expectations and erroneous conclusions in relation to the financial results. In part, some see any difficulty as being caused by the application of an accounting framework, designed primarily for private sector financial relationships, to the public sector. This is a view that has a degree of currency in a number of public forums, nationally and internationally. As a consequence, such differences could have important implications for governance and accountability in the public sector.

Professor Barton attributes the shortfalls in the accounting systems, where they occur, to two interrelated factors – the adoption of a business model of accrual accounting, and to a political ideology as expounded in the New Political Economy paradigm of 'marketisation' of public sector activities. He has expressed concerns about those reforms and practices which, in his view, detract from the integrity of accounting – which should provide information which is relevant and timely, reliable and have representational faithfulness, be understandable, and facilitate the making of comparisons.³⁶ I thought it may be useful to highlight two of his concerns, under the following headings, as they are of apparent interest to the public sector.

(a) The abolition of Cash Accounting and Budgeting System (CABS)

With the introduction of accrual budgeting in Australia in 1999, CABS was abolished and, with it, the direct recording of cash transactions and the requirement for all cash transaction to pass through the Consolidated Revenue Fund with cash budgets no

longer presented to Parliament. Professor Barton opines that CABS should be reinstated as a major component of a comprehensive accrual accounting system in the public sector; believing that the scrapping of CABS upon the introduction of accrual budgeting in 1999 was a grave mistake. Although cash flow outcome statements are published, they are prepared from the accrual financial statements by adding back the non-cash items, rather than being prepared directly from the cash transactions completed each day by Government.³⁷

Indeed, notwithstanding successes to date of the current accrual framework, there have been questions within the Parliament as to whether there should not be a greater focus on cash expenditures and whether there has been sufficient control of cash in the budget context. The ANAO's experiences have also served to reinforce the importance of effectively managing cash. I note that this is also a critical issue for the private sector with '*the trend towards seeing cash-flow management as a whole of organisation process*'³⁸

However, while meeting the Parliament's information needs is important to the APS, raising Parliamentarians' awareness and understanding of the benefits of accrual information for long term strategic planning and fiscal management should also become a priority. This would lead to not only a greater appreciation of the information provided, but also promote more extensive use of accrual information during the decision-making and review processes. However, consistent with all Commonwealth transactions, it is necessary to consider the 'appropriateness' of expenditure, as opposed to its 'accounting' treatment, for the efficient, effective and ethical use of resources as part of a robust governance framework with its primary focus on accountability for performance and results.

(b) *Use of a business model of accrual accounting for the public sector*

Professor Barton makes the case that the business model of accrual accounting adopted by the public sector is not suitable for core government activities and does not suit the unique, non-business environment of government - given that democratic governments do not sell their products to citizens nor endeavour to operate at a profit. To be useful, accounting information must satisfy the requirements of relevance, reliability, understandability and comparability and hence be tailored to suit the operating environment of government and the purposes for which it is required.

Professor Barton uses the Department of Defence in his article *The Department of Defence – Australia's Most Profitable Business?*³⁹ as an example of the apparently misleading nature of departmental financial statements, if considered in a private sector context. For the year ended 30 June 2002, the Department of Defence reported total revenues of \$18.99bn, a surplus \$4.41bn, capital-use charge paid \$4.6bn, net assets and equity \$45.59bn (comprising capital contribution \$1.3bn, asset revaluation reserves \$6.2bn, and retained surpluses \$38bn). On these figures, the Department appears to be a highly profitable enterprise – it generated a surplus of 23% on revenue, 340% on contributed capital and 9.7% on total equity. As well, it appears to be largely self-funded, as the asset revaluation reserve and retained surpluses contributed 97% of total equity.⁴⁰

Given the nature of the department's activities in providing defence services to the nation, and its reliance on budget appropriations to fund its activities, Barton raises the question 'how can Defence have such an impressive financial performance and strong financial position?'⁴¹ His major point is expressed as follows:

'..the department's financial statements do not faithfully report the reality of its financial operations even though they fully comply with Australian Accounting Standards (AAS) and government accounting requirements...the problems arise from ..having to operate as if they are pseudo-businesses under the New Public Management reforms which include using business accrual accounting standards'.⁴²

This view also created some resonance from a small agency perspective. The previous Inspector-General of Intelligence and Security (IGIS) argued that current reporting requirements for government agencies ensured 'no-one can understand the reports' except the accountants who produced them. The Office of the Inspector-General of Intelligence and Security (IGIS) is quite small. It has a full-time staff of four and an annual budget of about \$700 000.⁴³ The Inspector-General's comments stem from the application of the full force of the public sector accounting reforms. These include accrual accounting, and the many pronouncements of Australian Accounting Standards Boards. Another academic commentator observed that 'The financial statements that emerge from this cocktail are unedifying',⁴⁴ and he went on to draw the conclusion that:

The application of a business accrual model to a government funded body like IGIS is inappropriate. It leads to IGIS masquerading as if it was a legal entity in the private sector. It reports revenues from the sale of its services to government of about \$700 000 and an operating surplus (or profit) of \$66 719. But IGIS is not a private sector business and shouldn't account as if it was. IGIS provides non-commercial public goods to government for defence intelligence-related purposes in a competitor-free environment. It is funded from an appropriation by government based on the cost of the services it provides....The operating surplus or profit (\$66 719) is a contrivance for IGIS or any agency like it. While businesses in the private sector must produce a profit to survive, there is no such imperative for IGIS⁴⁵

These comments illustrate how essential it is to provide clear guidance and explanations as to just what the accrual concepts mean in the public sector both to preserve the underlying principles and to achieve real ownership of those principles and their application in a public sector context.

Balance Sheet Management in the Public Sector

There is one final issue that I wish to address – the balance sheet, which is a relatively new concept for the public sector and one not widely understood or managed. While accounting in the private sector has evolved over many decades, the public sector, as I have already mentioned, continued to record and report its resources and their application in terms of cash flows. This meant that the accounting for items such as assets, liabilities, revenues and expenses were not considered by the traditional public sector accountant nor, subsequently, by decision-makers.

With this in mind, CPA Australia undertook research specifically focused on the balance sheet to identify the extent to which it was actively managed in the public sector. The resulting report, *Striking the Balance*,⁴⁶ found a majority of Public Sector agencies did not actively manage their balance sheets and there was confusion on ultimate accountability for the balance sheet. *'The general consensus is that the public sector should be managing the balance sheet even though there is little incentive for agencies to do so. But the level at which this should occur is not clear, as in many jurisdictions it is only at the whole of government level that any impacts could be made'*.⁴⁷

CPA Australia's Director of Public Sector, Adam Awty, said, *'The research findings confirm that the Public Sector has made significant in-roads on the reporting side of balance sheets, the challenge now is for them to get better at managing the balance sheet'*, and *'Addressing the weaknesses will remove barriers that impede effective and efficient financial management within Government, which will ultimately provide the accountability, transparency and governance sought by the community at large'*.⁴⁸

The report, as well as identifying impediments towards effective balance sheet management, also provided advice on optimising the structure and composition of public sector balance sheets and better practice guidance. For many, it is more understandable to simply consider the notions of assets and liabilities and their management. The report does assist senior agency managers and CEOs to do that.

Accrual Accounting – some concluding comments – lifting the veil?

The foregoing discussion was not meant to leave the impression that accrual accounting should not be the general model of accounting used within the public sector but, rather, to suggest that, while there are particular challenges for the public sector, these are more in the nature of *'.. the need to modify and augment the practices so that they fit the peculiar circumstances and requirements of particular public sector institutions'*.⁴⁹ Clearly, the latter vary from organisations that largely provide only policy advice; those that undertake research; those that are regulatory in nature; those that deliver services without any charging; and those that are largely commercial, even in direct competition with private sector firms.

There are issues with the presentation of public sector financial statements that we still need to resolve. We are also being driven by external influences, such as the standards harmonisation issue, which seems to be driving us down the 'sector neutral' accounting standards philosophy. If so, we must convey to the users of public sector financial statements that, unlike private sector, the financial statements prepared by Australian Government agencies do not solely reflect agency performance with the operating result being a key performance measure. This interpretation is often supported by a misconception that revenues from appropriations are aligned with the delivery of outputs and outcomes. Mostly they are not, particularly for outcomes that may take some, or many, years to deliver fully.

There is no overall purchaser/provider model in place within the Australian federal arena where agencies are provided with a level of appropriation funding which is automatically adjusted for changes in either the cost, or quantity, of outputs delivered. Nevertheless, we do have examples of such arrangements, which are akin to a private

sector operation. For the most part, the appropriation funding is not a payment for services delivered, rather it is a payment in the nature of grant funding, which is not solely dependent upon the delivery of services. In that respect, agency management has a responsibility to meet the expected performance standards which go beyond financial results. There is no ‘matching’ of revenue and expenses required to reflect performance. The operating result reflects no more than the difference between the funding provided to an agency during the year and the amounts expensed. This may be a difficult principle to explain to many readers of the financial statements, a number of whom would be familiar with the traditional forms of private sector reporting where the operating result is a measure of performance and comes about as a result of the matching of revenues and expenses.

Notwithstanding these kinds of issues, the introduction of the outcome/output/accrual framework has lifted the veil, as it were, to show the true cost of delivering government programs and has provided a catalyst for change in the public sector, reflected in considerations of cost effectiveness, and ‘value for money’, and fostered a culture based more on performance and accountability for results. Drawing again on the observations of my Canadian counterpart, she makes the case thus:

*‘..the adoption of accrual accounting in summary financial statements was never intended to be an end in itself, but rather as part of a wider initiative to improve financial management and control in government... Accrual financial information is an integral component of good financial information in government...Accrual financial information helps users appreciate the full financial scope of government – the resources, obligations, financing, costs, and impacts of its activities, including the costs of consuming assets over time...This more complete picture enables legislators to hold the government more accountable for the stewardship of assets, the full cost of its programs, and its ability to meet short and long term financial obligations. Accrual financial information can also help improve decision making within departments. Managers will improve their focus on the stewardship of assets and liabilities under their control, consider the full periodic cost of providing services, and examine how the full range of costs might affect their use of public funds and assets’.*⁵⁰

The CPA Australia report, *Striking the Balance*, makes the point that one key advantage of accrual based reporting is that it offers the opportunity for governments to improve their management of assets and liabilities. This is critical in the public sector, particularly given that many of the significant assets are of a long-lived infrastructure nature that are vital to providing a foundation for sustainable growth. Under a cash based system, there is a tendency to focus primarily on whether or not to spend money on new assets. Under an accrual based system, the focus also extends to whether to retain, or upgrade, existing assets. That is, the accrual based reporting system focuses decision-makers on the broader range of options available for managing assets.⁵¹ I wish to stress the importance of asset control, noting the view, held by some in the public sector, that: ‘*There are no prizes for managing assets well in the Commonwealth*’.⁵² Also I should refer you to the guidance on asset management produced by the ANAO⁵³, which although published in 1996, it still is very much the ‘touch stone’ for good asset management practice.

In summary, accrual-based reporting provides useful information about the real level of a government's liabilities, relating to both debts and other obligations such as employee entitlements and the assets backing those entitlements. Governments cannot hope to govern in a sustainable way unless they are made aware of the liabilities created by the impact of current decisions.⁵⁴

III Accountability Enhanced

As Professor Weller has observed, public service accountability has improved dramatically in the last generation.⁵⁵ Australian public sector agencies now routinely provide public documents outlining goals and objectives, indicating corporate and business planning and reporting on outcomes and outputs. While annual reports may, on occasions, be criticised as unnecessarily detailed, and Portfolio Budgets Statements necessarily complex, the scrutiny of Parliamentary committees means that they have a 'life off the shelf'.⁵⁶ To set the scene, I thought it would be useful to canvass the requirements of accountability in the public sector before examining how accrual based information can be a driver for enhanced personal and agency accountability and improved transparency of the Australian government's financial position.

Accountability requirements of the public sector

A Canadian publication - *Modernizing Accountability Practices in the Public Sector* - offered the following definition of accountability that applies to a wide range of accountability relationships: between Ministers and Secretaries, between departments and central agencies, between public servants in a hierarchic relationship, between parties in a partnering arrangement, and between the federal government and Parliament. Each of these relationships is unique and has its own level of formality and complexity. This is expressed as:

'Accountability is a relationship based on obligations to demonstrate, review, and take responsibility for performance, both the results achieved in light of agreed expectations and the means used'.⁵⁷

This definition of accountability is consistent with managing for results; allows for accountability among partners who might be equal and/or independent; and includes obligations on all parties to the accountability relationship. It emphasizes the importance of accountability for results as well as for the means used to achieve them. It underlines the fact that effective accountability is not just simply about reporting performance; it also requires review (evaluation), including appropriate corrective actions, and the need to directly address likely and/or possible consequences for individuals.

Today, citizens are demanding clearer and greater accountability for the way the government makes decisions; spends their tax dollars; and uses its authority. But the traditional view and practice of accountability are challenged in a public sector where the focus is now much more on achieving results; where the public sector increasingly engages in partnering arrangements within and across levels of government and with outside organizations to determine and deliver public policy;

and where managers are encouraged to innovate and take reasonable risks that reflect the public interest.

Robert Behn in his book – *Rethinking Democratic Accountability*⁵⁸ sees accountability in terms of: accountability for finances, accountability for fairness, and accountability for performance.⁵⁹ He expands on this idea as follows:

Financial accountability - This is relatively straightforward. The managers and employees of any public organization have been entrusted with something valuable: taxpayers' money. They have the responsibility – the obligation – to use these funds wisely. They ought to be held accountable for doing so.

Accountability for Fairness - Here government organizations and their employees should be held accountable for more than simply handling the finances properly. We also want to hold them accountable for a variety of well-established norms of democratic government – specifically for fairness.

Accountability for the Use (or Abuse) of Power - Public servants award contracts, decide benefits, impose fines and exercise a lot of discretion and we seek to hold them accountable by imposing rules and regulations. However the accountability for power can be seen as accountability for finances and fairness.

Accountability for Performance - Accountability for finances and fairness reflect concerns for **how** government does what it does. But we also care **what** government does – what it actually accomplishes. Accountability for performance ought to cover the expectations of citizens; it ought to mean accountability to the entire citizenry.⁶⁰

Behn also makes the point that improved performance is important and that citizens certainly want improved performance, 'But we don't think you public managers can only get that improved performance by getting rid of the rules that ensure financial probity and guarantee fairness. Okay, the rules make it a little harder. But they don't make it impossible. They just mean that you have to be a little smarter, a little more persistent'.⁶¹ Accountability is really two tests – one for finances and fairness, the other for performance, that is, one for process, another for results. These two tests often seem to be in direct conflict, raising the issue of an appropriate balance between conformance and performance.

The accountability dilemma: getting the right balance - conformance and performance

Holding people accountable for performance while also holding them accountable for use of finances and fairness creates an *accountability dilemma*. In a more privatised public sector, what is a reasonable trade-off when, inevitably in a public sector environment, the perceived needs for accountability can impact adversely on economy and efficiency. A similar observation extends to the notion of effectiveness, particularly where that concept does not apparently embrace accountability concerns,

such as transparency, equity of treatment and probity in the use of public resources, including the application of public service values and codes of conduct.

The apparent accountability dilemma has been extensively commented on by, for example, Professor Richard Mulgan of the Australian National University, in many articles and presentations in recent years. The following is indicative:

'Contracting out inevitably involves some reduction in accountability through the removal of direct departmental and Ministerial control over the day-to-day actions of contractors and their staff. Indeed, the removal of such control is essential to the rationale for contracting out because the main increases in efficiency come from the greater freedom allowed to contracting providers'.⁶²

Hence, the ongoing challenge for public sector entities is achieving the 'right' balance between conformance and performance at particular points in time and over time. Many consider that this 'balance' is simply the outcome of sound risk management with proper identification, prioritisation and treatment of the myriad of risks confronting an organisation or, say, a public-private partnership. Nevertheless, the outcome is largely determined by leadership decisions, values and identified preferences and should be understood, and achieved, throughout the organisation as well as sound ethical values and good conduct practices are also meant to be. The notion of 'public interest' sets the bar quite high in these respects.

It is generally accepted that a degree of trade-off exists between conformance and performance imperatives which may well be largely a result of sound risk management as suggested above. For example, an undue emphasis on compliance breeds a risk-averse culture that inhibits exploitation of emerging opportunities. At the same time, it is apparent that a solid conformance control structure, embedded in risk-management, protects an entity from 'corporate governance delinquency'⁶³, and the possible severe impacts of this on individual and organisational performance. This is not simply, nor should be, a 'box-ticking' exercise of relevant principles or better practice. Nevertheless, reference to a check list of better practice can focus the mind on issues that need to be addressed, particularly when an organisation is under pressure to perform.

Most would agree that, in the past, the tendency in the public sector has been to focus primarily on ensuring conformance with legal and procedural (including budgetary and financial) requirements rather than single-minded striving for exceptional performance. At one extreme we have the following observation of Donald Savoie, a critique of the NPM⁶⁴:

'Public administration operates in a political environment that is always on the lookout for errors and that exhibits an extremely low tolerance for mistakes....In business it does not much matter if you get it wrong ten percent of the time as long as you turn a profit at the end of the year. In government, it does not much matter if you get it right 90 percent of the time because the focus will be on the 10 percent of the time you get it wrong'.⁶⁵

This concern has undoubtedly encouraged a risk-averse attitude among public servants in the past, which is said to have been reinforced by Parliamentary

expectations and attitudes expressed often in budget estimates examinations. It has also been observed that such an environment has largely focussed bureaucratic attention on administrative process rather than on achieving the stated objectives of governments. It is also said that there needs to be a cultural change in the public sector if public servants are to focus more on achieving required results and to be accountable for their performance, including effective management, rather than just avoidance, of risks in the future.

Put another way, the implied view is that the Australian Public Service (APS) could have been more effective in constructing robust control structures aimed at assuring achievement of defined outputs and outcomes, as well as being more responsive in providing more efficient client-oriented services. Attention is now being given to addressing government programs and services directly to public sector clients, as citizens, and not the other way around. The notion is to deliver services seamlessly to citizens, including across government levels. And this is being gradually achieved, particularly with the assistance of advances in information and communications technology and software for the operation of intranets and the Internet itself.

This concept of 'clients as citizens' demonstrates the particular challenges faced by public sector agencies in negotiating the changing governance environment. While it may be appropriate, even desirable, for citizens to be considered as clients in terms of service delivery, with all of the advantages that private sector models may offer in this regard, it is less desirable in terms of meeting the public sector's accountability requirements. There is generally a higher standard of accountability demanded of the public sector in relation to its clients – to whom it is ultimately responsible as citizens and taxpayers – than there is in the equivalent relationship between private sector entities and their clients. That is, there is more to client relationships than, say, a marketing imperative. A practical comment on the perceived trade-off has been provided by the former Canadian Auditor General, as follows:

The emphasis should not be solely on greater efficiency or on meeting accountability requirements.⁶⁶

An appropriate compromise may have to be sought, which may involve re-consideration by the Government and the Parliament as to the appropriate nature and level of accountability of both public and private organisations where there is shared responsibility, and even accountability for the delivery of public services to the citizen. In this latter respect, I am personally inclined to support the observation of Professor John Uhr, also of the Australian National University, that:

'Accountability and responsibility are two parts of a larger whole: whoever is 'responsible for' a policy or program is also 'accountable to' some authority for their performance within their sphere of responsibility'.⁶⁷

In the Australian context, there is no suggestion on the part of the Government or Parliament that accountability expectations will be downgraded; if anything, the reforms suggest that additional authority and flexibility require enhanced accountabilities, even where there may be an additional cost involved. Parliament's confidence in the accountability of public sector organisations is an on-going

challenge to our corporate governance frameworks. Nevertheless, in the words of a long time academic reviewer of the changing nature of governance in Australia:

*'With the advent of entrepreneurial government and the enterprising state, expressed most obviously in extensive forms of contracting-out, (these) organizational boundaries and identities are less able to contain or limit the accountability issue. Recent changes have stretched the elasticity of our received notions of accountability to the breaking point.'*⁶⁸

I take the view that accountability of public sector operations depends to a great extent on providing full information on the operations of agencies and other related bodies, including their decision-making. In some situations, because of the nature and complexity of public sector administration in an environment of ongoing reform 'Additional transparency provisions may be a cost that we have to meet to ensure an acceptable level of accountability'.⁶⁹ This leads me to transparency.

Transparency

*'Transparency is a sustaining element of effective accountability. It implies that one can see clearly into the activities of government.'*⁷⁰

Openness and transparency are essential elements of accountability, which is, rightly, at the heart of an effective public governance environment making it easier for those outside government to monitor and challenge the government's performance for consistency with policy intentions, for fairness, for propriety, and for sound stewardship. As the US Supreme Court Justice, Louis Brandeis, remarked: '*sunlight is the most powerful of all disinfectants*'⁷¹. Contemporary concerns about transparency are linked to those about integrity in public and business life. Transparency of management decisions in the public sector is a recipe for better corporate governance as summarised in the following observation:

*'Transparency is ...a key element ...and in vision of open executive government as a necessary entailment of democracy and legality. Transparency is central to contemporary discussions of both democratic governance and public sector reform, since open access to information and the elimination of secrecy is taken to be a condition for the prevention of corruption and promoting public accountability.'*⁷²

Also, Senator Hogg (a Member of the Committee of Public Accounts and Audit (JCPAA) when commenting on the need to maintain scrutiny of government operations, made the strong point that:

*'Public funds are not for the private purse of the government nor the bureaucrats to do what they like with. They are public funds for public purposes and should stand the test of public scrutiny by the Parliament.'*⁷³

What are the important elements of transparency in the public sector? I will touch on just two:

- (a) The ability to report openly

The Auditor-General, through the ANAO, provides an independent review of the performance and accountability of the federal government public sector agencies and entities. The *Auditor-General Act 1997* provides a legislative framework for our activities and establishes the Auditor-General as an *independent officer of the Parliament* – a title that symbolises the Auditor-General’s independence and unique relationship with the Parliament. My mandate extends to all Australian government agencies, authorities, companies and subsidiaries (with the exception of performance audits of GBEs and persons employed under the Members of Parliament Act 1994 – however, performance audits can be conducted of wholly owned GBEs at the request of the responsible Minister, the Finance Minister, or the JCPAA).⁷⁴

The increasing involvement of private sector entities in public sector activities has increased the complexity of undertaking our performance audits. There are three main interrelated concerns, namely: access to information, including transparent explanations; requirements of public accountability, particularly with the use of commercial-in-confidence arguments; and the possible consequences for a firm’s reputation and market situation of any adverse comments on public sector management and administrative practices. In all three cases, there is the addition of legal complexity, which also adds to the cost of the audits.

An important element supporting my ability to report, without fear or favour, is the application of Parliamentary privilege to performance and financial statement audit reports tabled in the Parliament.

*‘The provision of Parliamentary privilege is an essential element in protecting the office of the Auditor-General so that it may provide a fearless account of the activities of executive government’.*⁷⁵

Such privilege, in turn, allows the Auditor-General to report freely, openly and responsibly on matters examined in the course of audits. While the ANAO is sensitive to private sector concerns about commercial reputations, the Parliament expects full public accountability, particularly on issues of fair and ethical conduct and protection of the public interest. Conflicts of private and public interest are not new but their resolution in performance audit reports is a challenge for all parties without a genuine shared understanding of what constitutes public accountability. The ANAO is very sensitive to the notion of natural justice which it takes seriously as part of engendering public confidence in its reports. However, I stress that means natural justice for all parties involved.

(b) Freedom of information

An essential characteristic of accountability is access to information. Virtually all accountability relies on the ready availability of reliable and timely information. Indeed, it has been said that *‘information is the lifeblood of accountability’*.⁷⁶ Public access to reliable information is supported in each Australian jurisdiction by *Freedom of Information* (FOI) legislation.

Each public servant needs to understand clearly how their individual governance behaviour can be exposed under FOI requirements, and by the investigations of organisations such as the Ombudsman, the ANAO, the Privacy Commissioner and the Administrative Appeals Tribunal. In this regard, good record-keeping and good audit

and management trails are not 'bureaucratic' in a pejorative sense. To the contrary, they are a valuable management asset. They are also evidence of sound governance processes and practices. In particular, they demonstrate transparency and accountability to stakeholders. One important issue is the uncertainty of any responsibility of private sector providers under the relevant legislation, particularly when they are holding public records. Resolution is often not as simple as endeavouring to extend public sector accountability requirements to the private sector, for example, through contractual conditions.

Whole-of-Government Issues

With citizens demanding the delivery of government programs and services should be more coordinated and seamless, there has been push in Australia, and elsewhere, for a whole of government approach to be adopted. A very recent Australian Government report – *Connecting Government: Whole of Government Responses to Australia's Priority Challenges*⁷⁷ - defines whole of government in the APS as:

'Whole of government denotes public service agencies working across portfolio boundaries to achieve a shared goal and an integrated government response to particular issues. Approaches can be formal or informal. They can focus on policy development, program management and service delivery'.⁷⁸

Clearly defined accountability arrangements are important for successful whole of government initiatives. A particular challenge is to improve cross-agency coordination and collaboration while maintaining vertical accountability.⁷⁹ The new accountabilities and incentives encompass shared outcomes and reporting, performance measures engaging collegiate behaviour, and reward and recognition for horizontal management.⁸⁰

The introduction of accrual budgeting in 1999 improved the transparency of the Australian Government's financial position. This framework has been progressively refined and work has been undertaken to examine the scope for the framework to accommodate whole of government measures. Currently, outcomes are still determined by agencies and individual ministers and outcomes have not been disaggregated to the level of specific policy priorities as represented by individual funding initiatives. The ANAO has suggested that broad (or shared) outcomes are useful as they can involve contributions from a number of areas from within and outside an agency. The key challenge is to identify the agency's area of influence and acknowledge this in performance measurement and annual reporting,⁸¹ On the input side, accrual information is necessary to ensure these contributions are accurately measured and reflected in results.

Accountability to governance

Public sector organisations make decisions, every day, that significantly affect a nation's economic, social and cultural well-being. Also they manage significant taxpayers dollars and oversee the delivery of key services such as health, education, defence and welfare. Understandably, there has been increased focus on democratic control through enhanced accountability. In the public sector, the main drivers for

this have been the heightened expectations of citizens, an increased focus on results while retaining sound control systems, and a more robust scrutiny by parliament and its committees.

In short, all public bodies are required to be transparent, responsive and accountable for their activities. To borrow a term from Horace Rumpole⁸², *'the golden thread'* running through public sector accountability has been the importance of transparency. As Senator Abetz (Special Minister of State) has observed, *'While accountability is the foundation of good governance, transparency provides the windows. Transparency also provides answers to the critical issue of trust.'*⁸³ Accrual accounting is one key tool which supports enhanced accountability mechanism by providing a better quality of information for decision-making, as well as being an integral component of good financial information in government. The increased focus on results, as well as on performance based management by the public sector, and the emergence of alternative delivery approaches for government services, only reinforces the need for enhanced accountability underpinned by credible and timely information – accrual based information is a 'front row' contributor in this regard.

This *'golden thread'* runs through accountability to corporate governance, with good corporate governance embracing improved performance and enhanced accountability. I will now follow the *'golden thread'* through to its culmination – corporate governance – which, in turn, contributes to sound public sector management. As well, continuing with my broader theme, a key driver in corporate governance is the quality of information leading to effective decision-making and debate on significant decisions.

IV Public Sector Governance

As noted earlier, the shrinking gap between the public and private sectors, and other external trends, have added a new level of complexity to traditional accountability frameworks. This has reinforced the importance of implementing robust and responsive corporate governance frameworks. Andrew Podger, the Australian Public Service Commissioner, recently launched a \$A1.4 million research project – *Corporate Governance in the Public Sector: An Evaluation of the tensions, Gaps and Potential* – which aims to develop an integrated framework for corporate governance and tailor guidance according to the type of organisation.⁸⁴ The study will be undertaken by the University of Canberra and key government and industry partners – the ANAO is a partner in the study. Professor John Halligan, one of the academics undertaking the study, made the point at the launch that:

*'Good public corporate governance relies on keeping pace with best practice in the private sector corporate governance. That is, harnessing the potential that corporate governance principles can offer. Importantly, however, it also requires an understanding of the tensions and gaps that arise in the transposition of corporate governance from the private to the public sector, so that public sector corporate governance can be modified accordingly.'*⁸⁵

Fundamentally, good governance arrangements are essential for an organisation to be able to demonstrate to stakeholders that it can be trusted to do what it is established to

do. Such arrangements assist stakeholders to have confidence that APS organisations not only have the competence and expertise required, but that they have also established robust administrative arrangements that enable them to do so efficiently, effectively and ethically. Good governance generally focuses on two main requirements of organisations:

- ❑ **performance**, whereby the organisation uses its governance arrangements to contribute to its overall performance and the delivery of its goods, services or programs; and
- ❑ **conformance**, whereby the organisation uses its governance arrangements to ensure it meets the requirements of the law, regulations, published standards and community expectations of probity, accountability and openness.

Organisations need to achieve both sets of objectives, and not simply attempt to trade one off against the other. Using an integrated risk management framework will help develop an effective control environment and provide reasonable assurance that the organisation will achieve both objectives, within an acceptable degree of risk. As one commentator observed:

'The public-sector debate continues to be on how best to balance efficiency and value for money with the core values public-sector values of accountability and due process. New laws governing different types of Australian public-sector agencies have reflected this challenge. The private-sector focus has been on ensuring the drive for profit does not compromise standards of corporate behaviour. But what's also interesting is the similar change in the long-term focus of governance in both sectors.. the sectors clearly borrow ideas from each other. How they put these ideas into practice has an impact on the other sector'.⁸⁶

Notwithstanding this convergence of the two sectors what are the unique aspects of the public sector? A good starting point is the legislative framework (under which the Australian federal public sector operates) and the different types of entities that operate within that framework. This will, hopefully, put the following discussion into context.

The Australian Public Sector's Legislative Framework

The Australian government public sector has an extensive legal, regulative and policy framework that regulate the activities of the Australian Public Service, Boards, Chief Executive Officers and their staff. Importantly, that framework starts with the Australian Constitution, with the more detailed legal basis for governance in the APS is largely derived from the:

- ❑ *Financial Management and Accountability (FMA) Act 1997;*
- ❑ *Commonwealth Authorities and Companies (CAC) Act 1997;* and
- ❑ *Public Service Act 1999*

However, the formal framework for corporate governance goes beyond these three Acts to include the broader constitutional powers affecting public sector powers, appropriations and responsibilities as well as supporting legislation such as the

Workplace Relations Act 1996, *Administrative Arrangements Orders*, the *Remuneration Tribunal Act 1973*, any enabling legislation of an organisation and other legislation. This formidable body of law is depicted in the following diagram.

Figure 1: Legal elements affecting governance in the Federal Public Sector



Source: Department of Finance and Administration (2002)⁸⁷

In addition to this legislation, government entities are subject to a variety of regulations and policies which also impact on their governance, such as the budgetary outcomes and outputs reporting regime, the growing emphasis on risk management and insurable risk, and the need for effective coordination of Whole-of-Government and inter-agency issues as well as across levels of government, including the role of the Council of Australian Governments (COAG).

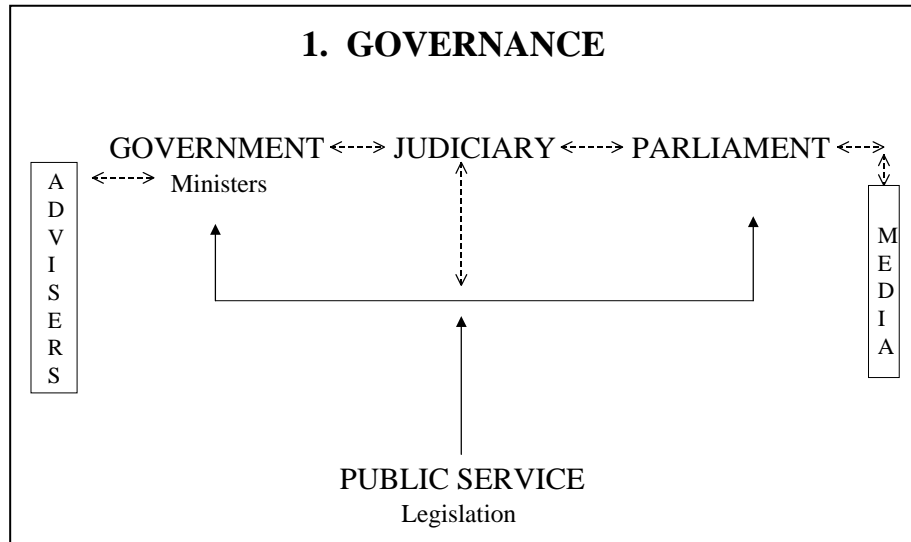
Dealing with the complexity of corporate governance in the public Sector

While the increasing convergence of the public and private sectors has drawn together many common concepts and approaches to sound corporate governance there are still inherent differences between the governance of private and public sector entities. In the public sector, quite complex relationships can exist between those with primary accountability responsibilities, especially the Parliament, Ministers, the CEO and boards. Consequently, there can be far greater management complexity in terms of stewardship, accountability and legislative requirements than is the norm in the private sector. In addition, the public sector typically has more explicit and stringent value systems that emphasise legislatively based notions of ethics and codes of conduct. For example, as observed by Professor Richard Mulgan of the Australian National University:

'...private sector companies operating under private law are not normally held to the same common law standards of rationality and fairness that the public law imposes on government agencies under the principles of administrative law'.⁸⁸

Public sector managers have a particular responsibility to the Government and to the Parliament to help ensure that accepted notions of responsibility, accountability and performance, including results, are being properly adhered to. This is a recognition of the supremacy of the Government and the Parliament in the governance framework. I have attempted to capture the concept of traditional accountability and interaction between the various players in the following simple diagram.

Figure 2: Governance Framework

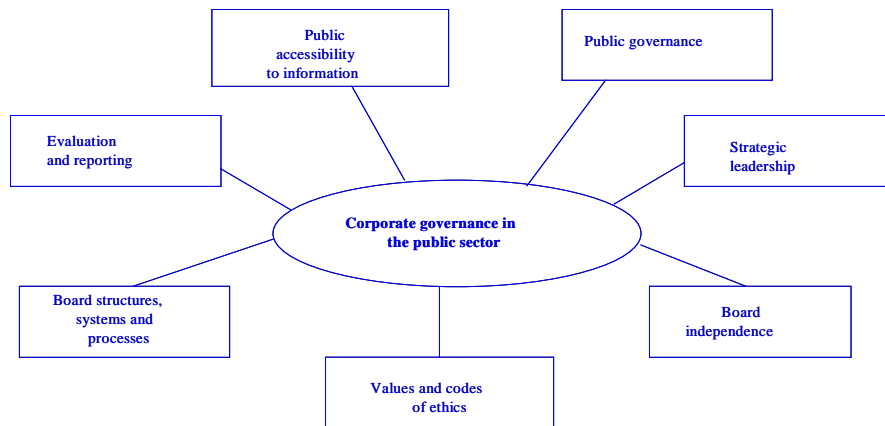


Source: ANAO ⁸⁹

The executive government is held accountable by the Parliament and by the voting public through elected members. Public servants are accountable to their Ministers and through them to the Parliament. The executive is also held accountable legally by an independent judiciary or other independent quasi-judicial bodies applying administrative law to the actions or decisions of the members of the executive.⁹⁰

In some ways corporate governance is often relatively more straightforward in the private sector as the roles and responsibilities are more clearly defined and generally involve a narrower range of active stakeholders and less complex objectives and strategies. To illustrate this proposition I have used the following two diagrams to show the main components and structures of corporate governance in the federal public sector. The first, Figure 3, is drawn from the state arena but provides a good representation of the components of public sector governance generally.

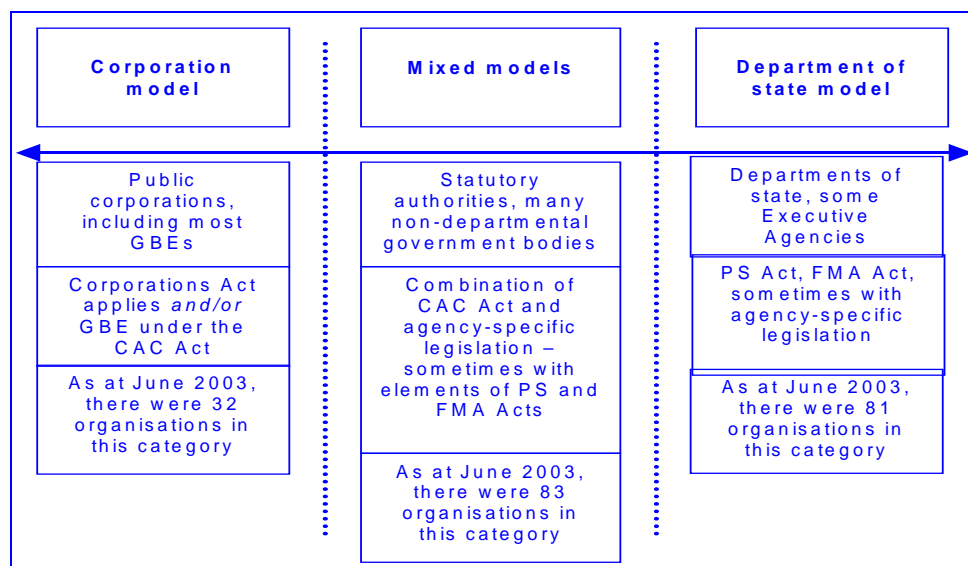
Figure 3: Components of public sector governance



Source: Victorian Public Accounts and Estimates Committee 2002, Issues Paper: *Inquiry into Corporate Governance in the Victorian Public Sector*, Melbourne, April, p. 8.

The second, Figure 4, indicates the main governance structures in the federal arena drawn from the ANAO’s widely acknowledged corporate governance Better Practice Guide,⁹¹ on which I will have more to say shortly.

Figure 4: Structures of governance in the federal public sector



SOURCE: DEPARTMENT OF FINANCE AND ADMINISTRATION, *LIST OF BODIES SUBJECT TO THE CAC ACT 1997 (AS AT SEPTEMBER 2002)* AND *LIST OF AGENCIES SUBJECT TO THE FMA ACT 1997 (MAY 2002)*.

For the *‘Department of State Model’* (FMA agencies) the governance arrangements differ significantly from those of private sector corporations. The *FMA Act* prescribes that CEOs of FMA agencies are ultimately accountable for the performance of the agency, generally making them effectively the CEO and Chairman of the Board. That is, the emphasis is on accountability residing with the chief executive and, as discussed previously, while the chief executive may choose to appoint an advisory board to help with the management of an agency, these boards support the CEO rather than the CEO being held accountable by the board. Instead, the CEO is responsible directly to the Minister, who is the shareholder or citizen representative, or ‘trustee’ in the view of some political commentators.

In contrast, the '*Corporation Model*' (GBEs and Commonwealth corporations) are subject to the *Corporations Act*, the *CAC Act* (and, for Commonwealth GBEs, *Governance Arrangements for Commonwealth Government Business Enterprises*) with the added complexity of Ministerial responsibilities and oversight. Whereas publicly-listed private companies are subject to the *Corporations Act* and tend to have much more clearly defined and unambiguous Board accountabilities and responsibilities. CAC type agencies are also often required to meet broader government policy objectives, such as delivering 'value-based' services, or prescribed services, to selected clients, in addition to meeting financial objectives. While convergence between the two sectors is lessening such differences, it nevertheless highlights the variations in modern governance demands across organisations, both within and across sectors of the economy.

Interposed between these two models is the '*Mixed Model*' which covers a large number of statutory bodies, mostly but not entirely subject to the CAC Act, that also operate under specific legislation. In many cases, this specific legislation dictates the structure, make-up, appointment arrangements, planning and reporting for the body, its board and/or its chief executive. This categorisation of Commonwealth organisations is not mutually exclusive. For example, some Commonwealth bodies subject to the CAC Act are also subject to provisions of the FMA Act relating to public money that they hold (as is the case with the Australian Securities and Investments Commission).

Principles of public sector governance

There is increasing evidence that behaviours consistent with good governance sustain improvements in organisational performance.⁹² This requires the application of effective governance principles by management and staff within each organisation to implement the designated governance frameworks, controls and guidelines.

The ANAO, in Better Practice Guide (BPG)⁹³, used the group of principles first articulated by the Nolan Committee of the UK in 1995.⁹⁴ They are:

- ❑ **accountability:** where public sector organisations and the individuals within them are responsible for their decisions and actions, and where they are subject to external scrutiny;
- ❑ **transparency, or openness:** is required to ensure that stakeholders have confidence in the decisions and actions of public sector organisations and the individuals within them;
- ❑ **integrity:** is based on honesty, objectivity, and high standards of propriety and probity in the stewardship of public funds and resources;
- ❑ **stewardship:** reflects the fact that public officials exercise their powers on behalf of the nation, and that the resources they use are held in trust and are not privately owned;
- ❑ **leadership:** is one of the more crucial principles. It sets the tone at the top of the organisation, and is absolutely critical to achieving an organisation-wide commitment to good governance; and

- **efficiency:** is about the best use of resources to achieve the goals of the organisation, and is also about being able to prove that the organisation has indeed made the best use of public resources.

The application of these principles, within an appropriate public sector governance framework tailored to the characteristics of each entity, will assist public sector entities to conform with all relevant legislation and policies, and moreover, perform strongly against their specified objectives and required results.

Public sector governance framework, processes and practices

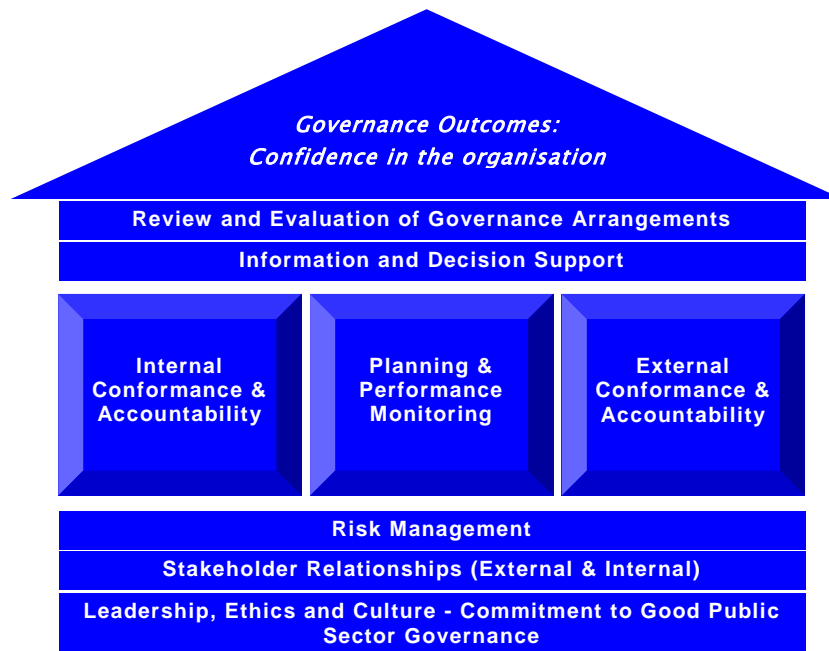
The legislative requirements outlined in Figure 1, together with requirements for high organisational performance, demand that public sector entities' establish and operate an extensive, but integrated system of governance.

To illustrate the key, generally accepted, organisational and process elements of good public sector governance, the ANAO's BPG adapted a model developed by the Queensland Department of Transport—'The House of Governance' (Figure 5). This is a broad-based model that recognises the elements of good public sector governance need to be applied within government frameworks that may differ considerably according to the size, complexity, structure and legislative background of the organisations concerned.

The model emphasises the progression from the foundation of leadership, ethical conduct and a culture that is committed to achieving good public sector governance, through good stakeholder management and development of a risk management culture, to the performance and conformance windows. On top of that, information and decision support, and review and evaluation of governance arrangements, impact heavily on the ability of the public sector organisation to achieve desired governance outcomes—relating to both conformance and performance.

Implementing, maintaining and enhancing the elements shown the following diagram maximises the chances that the organization will enjoy the confidence of its stakeholders, clients, staff and management and that it will be recognised as making sound, well informed and accountable decisions that lead to appropriate and effective actions and results. The foundations elements of leadership, ethical conduct and the development and existence of an organisational performance culture support and sustain the framework as a whole. Without them, there would be no solid foundation to build on. Stakeholder relationships influence the effectiveness of all three central components of the structure, that is, the 'windows' of internal conformance and accountability, external conformance and accountability, and planning and performance monitoring.

Figure 5: The house of public sector governance



Source: ANAO , Better Practice Guide on Public Sector Governance. Adapted from a model developed by the Queensland Department of Transport in its *Corporate Governance Framework for Queensland Transport and Main Roads: Final Report*, July 2001.

The ‘windows’ in the house represent the core activities of governance for government organisations. They are the elements on which governance boards and committees are focused. Each ‘window’ exerts an influence on the other two as follows:

- planning and performance monitoring underpin the management framework within which external and internal conformance and accountability processes take place - accountability is integral to the performance of public organisations;
- internal conformance and accountability needs to be aligned with, and generate the information required for, external conformance and accountability; and
- external conformance and accountability establishes the base line for required internal processes, as information required for external purposes should generally form a subset of what is required internally.⁹⁵

The challenge for many agencies is to find a credible way to integrate the various elements of public sector governance into a unified, mutually reinforcing complete structure. This involves a consistent, strategic approach to governance so that good governance practice is successfully integrated with, and supports, the way Australian Government entities do business.⁹⁶ Good governance should not only be found at the corporate level, it should also be apparent to all staff and evident in their behaviour and attitudes in the workplace at all levels of the organisation.

Recent initiatives to improve governance in both the public and private sectors

In response to the corporate governance failures in recent major corporate collapses, a number of high-profile efforts to improve corporate governance in Australia occurred in 2003. These included the Australian Stock Exchange (ASX) Corporate Governance Council's *Principles of Good Corporate Governance* released in March 2003⁹⁷, the HIH Royal Commission report in May 2003 and Standards Australia release of a new standard—AS 8000-2003 on *Good Governance Principles*⁹⁸ in July 2003. The Senate passed two bills to amend the *Corporations Act 2001*. The *Corporate Law Economic Reform Program (Audit Reform & Corporate Disclosure) Bill 2003*⁹⁹ (passed in June 2004) was introduced into Parliament on 4 December 2003 and John Uhrig completed his review into corporate governance of statutory and office holders (but still under consideration by government).¹⁰⁰ In addition, the ANAO published its BPG on 'Public Sector Governance' in July 2003.

Overseas, there has been the release (12 January 2004) of the *Review of the OECD Principles of Corporate Governance—Invitation to Comment* and the OECD's *Survey of Corporate Governance Developments in OECD Countries* (9 December 2003) as part of an assessment of OECD Principles of Corporate Governance requested by Ministers in 2002. With the increased questioning of, and emphasis on, good corporate behaviour and performance, we are likely to see a continuance of such interest both nationally and internationally.

In our sphere of influence, the ANAO looks to be proactive in providing on-going advice and support to agencies in establishing and maintaining a sound corporate governance framework. A significant challenge for the ANAO is ensuring the Australian Government's interests are protected and accountability is maintained for the expenditure of public funds in an environment where significant aspects of the delivery of public sector outcomes involve complex, long-term arrangements with the private sector.

Improving public sector governance

The ANAO has long recognised that governance practices often strongly influence the performance and accountability of APS agencies - we are in a key position to add value to the APS through the dissemination of better practices as part of its audit program. Specifically, the ANAO has provided a series of BPGs on public sector governance. The first such guide was released in 1997 and promoted governance principles and better practices in budget-funded agencies.¹⁰¹ A complementary guide was released in 1999, examining governance in Commonwealth authorities and companies.¹⁰² The third and latest guide¹⁰³ was released on 25 July 2003. It discusses better practice governance for all types of APS organisations.

The new guide is different in nature to the previous two, which were structured to address specific purposes. The first guide dealt with the application of governance in public sector agencies and, in particular, made the case for the establishment of executive boards for agencies. The ANAO issued the second guide as a discussion paper in 1999, which was designed to assist members of the boards and senior managers of CAC Act bodies to evaluate their governance frameworks and make them more effective.

With the publication of the third, and current, guide the scope has widened again - it provides more practical guidance. While the latest guide incorporates recent legislative changes and reflects current concerns, the previous two guides remain useful, as the practices and principles they endorse continue to provide the foundations of better practice public sector governance.

The ANAO has produced these guides on public sector governance to provide some clarity for organisations that may be audited, but also because there have been few alternative sources of better practice information on governance focussed on the public sector. While there has been quite a rapid increase in documented guidance on 'corporate governance', especially by professional bodies, such as the Australian Institute of Company Directors and the Institute of Chartered Secretaries (Australia), and by legal firms, these remain mainly directed towards private sector needs and requirements. The ANAO will continue to provide guidance on public sector governance in the future on major emerging governance issues.

Public Sector Governance - Leadership, ethics and culture

As with other commentators, I constantly emphasise the importance of leaders (Chief Executive Officers and Boards) to set the 'tone at the top' of organisations to positively influence good governance. While rules, systems and structures are certainly important, they are the vehicles by which crucial values and behaviours are applied.¹⁰⁴ Good governance is primarily a function of the behaviours and values of the organisation's leaders and is a manifestation of the overall culture of the organisation. In particular, it is important that leaders demonstrate an active commitment to the principles of good public sector governance, and vital that staff adopt good governance practices through their own behaviour and performance.

Establishing effective communication—both internally and externally—is therefore a primary function of leadership. It is through clear and consistent communication of the values and objectives of the organisation to staff, management and external stakeholders that an agency's leadership most effectively supports good governance outcomes and contributes to stakeholder confidence in the organisation.

It is also through consistent communication and personal actions that leaders support ethical behaviour in the organisation, thus influencing the culture necessary to support the objectives and strategic directions of the organisation and achieve the required results efficiently, effectively and ethically.

Public Sector Governance - Risk management and the control environment

Risk management is an integral component of good governance that underpins the organisation's approaches to achieving both performance and conformance objectives.

Risk management involves the identification, analysis, treatment, monitoring and communicating of risks. In the public sector, risks are generally taken to represent threats rather than opportunities. That is, risks are identified as events that may prevent the achievement of business objectives much more frequently than events that may provide the opportunity to achieve additional benefits. Organisations in the

public sector need to more frequently and comprehensively consider beneficial risks, as this would assist them to become less risk averse, and thereby enable them to more fully embrace the performance aspects of their conformance and performance objectives.

The ultimate responsibility for an organisation's risk management sits with the head of that organisation. But all managers and staff have a responsibility to manage risk. Effective risk management requires a risk assessment culture, which supports a holistic approach to the identification and management of risk throughout an organisation. This means that risk management should be seamlessly integrated into the day-to-day business of an organisation as well as being part of its higher-level strategy and planning processes.

This concept of risk management is particularly important as the nature and significance of risks change in the public sector as the role of the public sector itself changes. The lack of suitable risk management practices generally features in examples of poor administration that are highlighted in our audit reports from time to time. An example of such changes is the greater involvement of the private sector in delivering public sector services and notions of risk sharing, as noted earlier.

Importantly, an integrated risk management system develops the control environment and control activities, which provide reasonable assurance that the organisation will achieve its objectives with an acceptable degree of residual risk. Taking this approach to risk management can ultimately mean that all major decisions are considered in terms of sound risk management principles. For public officials, there is also a need to understand, and deal effectively with, the notion of insurable risk.

It is difficult to over-emphasise the importance of integrating an organisation's approach to control with its overall risk management strategy in order to determine and prioritise the agency functions and activities that need to be controlled. Both require similar disciplines and an emphasis on a systematic approach involving identification, analysis, assessment, treatment and monitoring of risks. Control activities to mitigate risk need to be well designed and implemented and relevant information regularly collected and communicated throughout the organisation.

Management also needs to establish ongoing monitoring of performance to ensure that objectives are being achieved and that control activities are operating effectively. The results should be regularly reported to the Board/CEO for information and any guidance or direction, including considering whether controls are effective and if not, how they should be adjusted. An audit committee should have particular interests in these issues which should also regularly feature on their meeting agendas.

The key to developing an effective control framework lies in achieving the right balance so that the control environment is not unnecessarily restrictive nor unduly encouraging to risk adverse behaviour and, indeed, aims to promote sound risk management.

The control structure must provide a linkage between the agency's strategic objectives and the functions and tasks undertaken to achieve those objectives. A good governance model will include a control and reporting regime which is geared to the

achievement of the organisation's objectives and which adds value by focusing control efforts largely on the 'big picture' and not simply on particular processes.

Finally, it must be kept in mind that control is basically a process, a means to an end, and not an end in itself. It impacts on the whole agency; it is the responsibility of everyone in the agency; and is effected by staff at all levels, not just by management. Effective control is neither accidental nor incidental. It is fundamental to accountability and performance. Indeed, it has been suggested that boards should formally accept their responsibility for reviewing the effectiveness of internal control.¹⁰⁵

From Accountability to Public Sector Governance

As I have worked through the public governance issues, it is clear that there are a number of key elements in developing a sound governance framework. As I see it, financial management and accrual information is an *enabler* for improved governance arrangements and returning to my 'golden thread' theme, it is a key driver in providing quality information which leads to effective decision-making and a more informed debate on key decisions.

Reliable and complete information must be routinely available on performance and consumption of resources used in delivering government services. This should cover not only cash expenditure but also how the investment in assets and work in progress is used to provide assurance that the resources are deployed efficiently and effectively. Such information and analysis provide agencies with the means to make better use of their existing resources and also to identify and manage important risks. In turn, this imposes a discipline on public sector managers to ensure assets are put to good use and liabilities are identified and managed.

The new corporate governance challenge for CEOs and CFOs is that they are increasingly being held accountable for external financial reporting and corporate governance. Clearly, this requires a heightened awareness of, and involvement in, these areas. The Australian Stock Exchange Corporate Governance Principles (4 and 7) and CLERP 9 include requirements that put the onus on CEOs and CFOs to ensure that they have adequate systems in place to enable them to sign off with confidence.¹⁰⁶ If this requirement were to flow onto public sector agency heads and their chief finance officers, accrual information would be an even greater imperative, as it is in the private sector, in providing that certification in respect of the financial statements and governance arrangements. As Jeffrey Lucy, acting Chair of the Australian Securities & Investments Commission, observed recently:

*'One of the foundations of good governance is the provision of adequate, timely and reliable information about corporate performance'*¹⁰⁷

Increasingly, it is the financial management framework, with its emphasis on accrual accounting and budgeting, that will be required to provide that information. The emphasis will not only be on knowing and understanding the costs of what we do, but also on how well we manage our financial responsibilities reflected in our financial reporting, such as the efficient management of our assets and liabilities on an accrual basis. Cash management will also continue to be of importance but will be only one

aspect for which we will be held accountable as part of our overall governance responsibilities.

V Concluding Remarks

The evolution of the public sector, under successive internal reforms and external pressures, is presenting significant challenges to agencies and has profoundly affected the way in which they operate today. New challenges are ever present, notably those that relate to the adoption of new technology, the growing convergence of the public and private sectors, the 'whole of government' approach, and the effects of globalisation. Thus, in today's rapidly changing public and private sector environments, the rising demands for corporate accountability, including transparency; dealing pro-actively with new risks associated with globalisation; and implementing e-commerce and evolving information technologies as important elements of managing and conducting business; have propelled corporate governance into the 'mainstream' of public, political and business awareness. Organisations now face intense public scrutiny of their business workings to a degree not seen before, for example, investors and citizens expect more than just compliance with the new 'rules'. They simply want better governance overall.

There is no doubt that changes in the areas of accounting, budgeting and governance, have had a far-reaching influence on the day-to-day operations of Australian Government entities. Indeed, there is still work ahead for the APS to fulfil the accounting and budgetary requirements and goals that have been set by the Government, Parliament and the professional accounting, auditing and standards bodies—both national and international. It is my observation that these will increasingly occur in tandem with the private sector, reflecting real notions of partnering using common accounting, budgeting and auditing concepts, practices and procedures. In addition, there is a greater emphasis on the structural elements of the varying governance frameworks ranging from core government departments to non-core government corporations, with publicly listed shares, in full commercial competition. In particular, there are issues of accountability relationships that have to be resolved.

Undoubtedly one of the most significant changes to the overall financial reform program in the APS was the implementation of accrual-based accounting and the associated outputs and outcomes budgetary framework. While I have included some comments on the challenges and difficulties with the implementation of accrual accounting, I want to put on the record my acknowledgment of the major achievement represented by the implementation of this accrual model, both by Department of Finance and Administration, as the driver of the change, and by public sector agencies, as its implementers. It is also important to acknowledge the support provided by the Joint Committee of Public Accounts and Audit and the Senate References Committee on Finance and Public Administration to the adoption of the accrual budgeting framework.

The accrual budgeting framework has required a significant investment from public sector agencies and has achieved some notable results—it has changed the focus of public sector financial management from being narrowly focussed on inputs to one more based on the outputs and outcomes managed by agencies. In short, there has

been a real emphasis on results. Nevertheless, as with the private sector following a number of well publicised corporate collapses, the public has had to pay increasing attention to its control environment and the need for public assurance in this respect.

Accrual based information has enhanced transparency and accountability in the public sector. I referred earlier in to Robert Behn's 'accountability dilemma' reflecting the need to achieve the 'right balance' between conformance and performance. I contend that this dilemma is further complicated by the Parliament's and Government's insistence on holding agencies accountable for performance where the services are primarily, or wholly, being delivered by the private sector. That, in itself, complicates the governance relationships and approaches taken by both sectors even where there is an increasing sharing of, and commitment to, sound corporate governance concepts, principles and practices.

A wider issue is how we address questions such as the government's impact on the environment, the quality of assets provided to the community by the government, and the intellectual capital available to the community from within government. The growing global trend towards corporate social responsibility and sustainability signals a new approach to business and its method of reporting. Recently, CPA Australia's Audit and Assurance Centre of Excellence published a database on their web site of over 160 companies worldwide that prepare Triple Bottom Line (TBL) reports accompanying their financial reports. This database provides information about these reports, including a listing of those providing TBL audit services. This commitment to TBL by CPA Australia, and indeed, also by the Institute of Chartered Accountants in Australia, shows the increasing importance of this type of reporting as a means for Chief Executives to discharge their accountability.

There are many definitions and explanations of what TBL is and what it stands for. Mark Sullivan, the Secretary of the Department of Family and Community Services (FaCS), defines TBL and its uses as follows¹⁰⁸:

TBL focuses on reporting and making decisions explicitly taking into consideration information on economic, environmental and social performance. As such TBL can be seen as both an internal management tool as well as an external reporting framework.

While TBL reporting is not new to the private sector, it is a new concept for the public sector. In 2003, FaCS prepared the first-ever verified TBL in the Australian Government sector. This year, FaCS will again prepare a TBL for verification by the ANAO. As well, the Department of Environment and Heritage will prepare its first TBL report for 2003-2004.

Emerging developments such as triple bottom line reporting, and the reporting of intellectual capital, take us a good deal further than where we are today. Governments and their accountants can ignore these latter developments in favour of the more limited picture provided by traditional financial reporting models, or they can take a leading role in their implementation. Despite governments' late start in the accrual environment, it might be time to take a more complementary role in making financial statement reporting more meaningful and useful in these wider respects. It would obviously be better to anticipate, rather than react to, user demands in the interests of greater accountability for performance as required of a

more responsive public sector. The imperative is to be clear as to what purposes consolidated government financial statements are meant to serve. There is no doubt we can, and should, improve their usefulness in coverage, consistency and simplicity. This is as much a challenge for the profession as it is for account preparers and auditors. The general public should expect no less.

Finally, I have endeavoured to highlight that the various federal public service reforms over the past twenty years have narrowed the differences in governing and managing both the public and private sectors. However, we will do well to bear in mind the importance of 'politics' in the public sector environment, with all its complexity and uncertainty. Nevertheless, that is what makes public administration so interesting and demanding. I will leave you with this observation from Senator Abetz (Special Minister of State):

Whether you are working in the public or the private sector, good corporate governance is paramount to the sustainability, credibility, and success of your organization. Travelling the road of good corporate governance won't guarantee success, but not travelling upon it, will almost certainly guarantee failure.¹⁰⁹

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- 29 System of National Accounts SNA93
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"Timing differences relate to those items that affect the GFS and GAAP operating results
in different periods. For example, defence weapons platforms are treated as expenses in
the year of acquisition under GFS but are not recognised as expenses until later years
(through depreciation or impairment) under GAAP. Permanent differences relate to those
items that affect only one of the GFS or GAAP operating results. For example, dividends
paid are treated as an expense under GFS but are treated as a distribution to owners
under GAAP (and therefore will not affect the GAAP operating result in the current or
future years)."
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