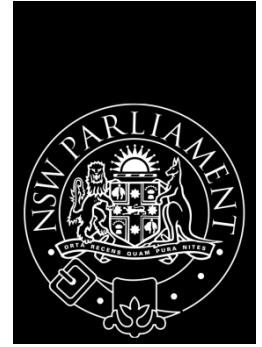


LEGISLATIVE ASSEMBLY



Public Accounts Committee

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Table of Contents

Table of Contents	iii
Membership and staff.....	iv
Terms of Reference	v
Chair’s Foreword	vi
List of Recommendations.....	vii
CHAPTER ONE – INTRODUCTION	1
Overview	1
Conduct of the Inquiry	1
CHAPTER TWO – THE PROBLEM.....	2
Forecasting Budget Result.....	2
Accounting Errors.....	3
Repeated Budget Overruns	3
CHAPTER THREE – THE SOLUTIONS.....	5
Hard Close	5
Agency & Chief Financial Officer Accountability	9
Earlier Reporting	10
Improve Accounting Skills & Qualifications	11
CHAPTER FOUR – CONCLUSIONS	13
Hard Close	13
Agency & Chief Financial Officer Accountability	14
Reporting Timeframe	14
Accounting Skills and Qualifications	15
APPENDIX A – DEPARTMENT OF HEALTH CASE STUDY	16
APPENDIX B – SUBMISSIONS	20
APPENDIX C – WITNESSES	21

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Terms of Reference

The Public Accounts Committee resolved on 19 May 2010

That the Committee examine the quality and timeliness of financial reporting by government departments and agencies with particular regard to:

- (1) The adequacy of current processes in place to identify and correct errors in accounts in a timely manner;
- (2) Identification of best practice procedures for financial reporting;
- (3) Impediments to the implementation of best practice procedures;
- (4) Any related matter.

Chair's Foreword

Timely and accurate financial reporting is vital for the effective delivery of Government services.

When preparing its Budget, the Government needs accurate information about the cost of services in order to make sustainable decisions about what services it can fund. Financial resources are always under pressure. One of the hallmarks of responsible Government management is the ability to make difficult and informed decisions about providing effective programs to ensure optimal results with available public resources.

Fiscal over-commitment increases Government debt while under-resourcing can result in important services being unfunded. Similarly, when agencies are administering programs, they need up to date information on their operating balances to ensure they can provide their services throughout the year, respond quickly to resourcing problems they encounter and plan for improvements. It is also important for the Parliament to receive accurate financial information in a timely manner to ensure adequate accountability.

Recently, financial reporting in New South Wales has fallen short of the standards required to maximise service delivery. This needs prompt correction to improve the Government's capacity to make good decisions and prevent the waste that results from agencies needing to amend and revise accounts.

The Committee was pleased to see that the Treasury and other Government agencies have been responding to shortcomings identified by the Auditor-General and the Committee hopes to see a general improvement in the accuracy and timeliness of reporting in this and future years. However, more action is required.

The Committee has made five recommendations to bring the quality and timeliness of financial reporting to an appropriate level. In particular, the Committee considered that all agencies should be conducting a hard close of their accounts as at 31 March each year and that agencies' accountability for the accuracy and timeliness of their financial reports should be strengthened. An earlier deadline for annual reporting would also improve the discipline of the financial reporting process and result in greater public accountability.

The Committee thanks the Audit Office, the Treasury and other agencies that made submissions, and KPMG for their contributions to the Committee's inquiry. I also extend my thanks to my fellow Committee Members for their continued work and cooperation.



Paul Gibson MP

Chair

List of Recommendations

Recommendation 1

The Committee recommends that the Treasurer require all agencies to conduct a hard close of their accounts at 31 March from 2011.

Recommendation 2

The Committee recommends that the Treasurer propose amendments to the *Public Finance and Audit Act 1983* requiring chief financial officers to certify their financial reporting systems.

Recommendation 3

The Committee recommends that the Premier ensure that accountability for accurate and timely financial reporting is included in all chief executive officers' performance agreements.

Recommendation 4

The Committee recommends that the Treasurer develop and implement a program to bring forward the deadline for the tabling of annual reports in Parliament to three months after the end of the financial year by 2013 at the latest.

Recommendation 5

The Committee recommends that the Treasurer consider proposing amendments to prescribe minimum qualifications of chief financial officers in the *Public Finance and Audit Act 1983*.

Chapter One – Introduction

OVERVIEW

- 1.1 In 2009, 12 of the 24 largest agencies' financial reports submitted for audit contained significant errors. Five agencies had significant and consistent budget overruns over the previous two years. Also, in the previous years, there were significant differences between the estimated previous year's net operating balance included in the Budget in June and the actual balance at the end of the financial year.
- 1.2 The Committee considers that financial reporting needs to be of a higher standard to better inform budget decisions, enable more effective and timely management of public funds by Government agencies, and to improve accountability for public expenditure.
- 1.3 Financial reporting processes can be improved through:
 - agencies conducting a 'hard close' of their accounts before the end of the financial year;
 - improving the accountability of agencies and their chief financial officers for their financial reports;
 - requiring earlier reporting deadlines; and
 - improving the accounting capacity of agencies.
- 1.4 The Committee has made a number of recommendations to achieve this end.

CONDUCT OF THE INQUIRY

- 1.5 In its 2009-10 work plan, the Public Accounts Committee undertook to hold an annual briefing with the Auditor-General and Treasury on the effectiveness of the form of financial reporting to aid the exercise of its functions under section 57(1)(d) & (e) of the *Public Finance and Audit Act 1983*. That briefing was held on 5 May 2010.
- 1.6 In Volume Four of his 2009 Financial Audit, the Auditor-General identified a range of issues regarding the quality of financial reports. These issues were discussed in detail at the Committee's public briefing.
- 1.7 The Committee subsequently resolved on 19 May 2010 to conduct an inquiry into the quality and timeliness of financial reporting and called for public submissions. The Committee advertised the inquiry in *The Sydney Morning Herald* and the *Financial Review* on 2 June 2010 and wrote to a range of stakeholders to invite submissions by 2 July 2010.
- 1.8 The Committee received 10 submissions to the inquiry, as listed at Appendix B.

Chapter Two – The Problem

- 2.1 The Auditor-General has raised concerns regarding the quality and timeliness of financial reporting of Government agencies. Some agencies have submitted accounts after the statutory deadline and many accounts were submitted with significant errors.
- 2.2 The quality and timeliness of accounts impacts on the decision-making of Government. Better decisions can be made with better quality information. The importance of having reliable and up to date accounting information is demonstrated by difficulties faced by the Department of Health in recent years, where it became a matter of public record that some Area Health Services' failure to pay their bills on time impacted on their ability to provide services. While these difficulties had a number of causes, lack of accurate information impacted on the ability of the Department and its entities to understand and respond to the challenges they faced. It is pleasing to note that, through the introduction of an early hard close and other measures, the Department has significantly improved its financial reporting and thereby its ability to address its financial challenges.
- 2.3 Problems with the quality and timeliness of financial reporting have manifested in three particular ways:
- the forecast result of the previous financial year included in the budget has differed significantly from the actual result;
 - accounts submitted by agencies to the Auditor-General have included significant errors; and
 - some agencies have had repeated budget overruns of similar amounts.

FORECASTING BUDGET RESULT

- 2.4 The table below compares the estimated net operating balance for the previous year included in the last two budgets.

NSW net operating balance as estimated in following year's budget (revised) compared with actual

2007-08			2008-09		
Revised \$m	Actual \$m	Difference \$m	Revised \$m	Actual \$m	Difference \$m
700	73	(627)	(1,337)	(897)	440

- 2.5 This table shows that budgets are being prepared on estimates of the previous net operating balance that are out by around half a billion dollars. The 2009-10 Budget was prepared on the assumption of the previous year's net operating balance being \$440 million less than it actually was, and the 2008-09 Budget was prepared on an overestimation of the balance by \$627 million.
- 2.6 The Committee is concerned that the inaccuracies in these estimates would have impacted on the quality of the decisions being made in formulating the budget.

Accurate information on the previous year's expenditure is clearly crucial to predicting outlays and formulating effective budgets.

ACCOUNTING ERRORS

2.7 The Auditor-General reported that 12 of the 24 largest agencies' financial reports submitted for audit contained significant errors in the current year's financial information, while five included significant errors in the prior years'.

Significant errors in accounts submitted for audit in 2009

	Errors \$20 - \$50 million	Errors \$50 - \$100 million	Errors > \$100 million	Total Errors >\$20 million
Largest 24 Agencies	12	4	9	25
Other Agencies	4	2	1	7
Total	13	6	10	32

Financial Audit Volume Four 2009, p 13

2.8 It was noted that many of these errors related to the accounting treatment of matters such as the valuation of assets for which there is no market and that, while large in dollar terms, comprise only a small fraction of the agencies' budgets.

2.9 Nevertheless, such errors cause extra expense and delays in finalising accounts and weaken the quality of financial information the agencies and Government have available.

REPEATED BUDGET OVERRUNS

2.10 The Auditor-General has noted the following significant and consistent overruns of budgeted expenditure:

Significant and consistent overruns of budgeted expenditure in 2009

Agency	2009 Excess over budget \$m	2008 Excess over budget \$m
Department of Health	674	611
Crown Finance Entity	386	252
Roads and Traffic Authority	272	269
Department of Education and Training	178	176
NSW Police	120	133

Financial Audit Volume Four 2009, p 29

The Problem

- 2.11 While occasional overruns are inevitable given the complexity of public administration, consistent overruns may reflect an inability to adequately and promptly account for, and thereby predict and control, expenditure.

Chapter Three – The Solutions

3.1 From discussions with Treasury and the Auditor-General and submissions to the Committee, four mechanisms emerged as a means of improving the quality and timeliness of financial reporting:

- agencies completing early hard closes of their accounts;
- improving the accountability of agencies and their chief financial officers for producing accurate accounts;
- making reporting deadlines earlier; and
- improving the accounting skills of agencies' staff and mandating qualifications of chief financial officers.

HARD CLOSE

3.2 According to the Australian National Audit Office's *Better Practice Guide on the Preparation of Financial Statements by Public Sector Entities*,

A hard close typically involves performing reconciliations; examining transactions for undetected accruals or transactions processed into the wrong period (cut-off); verification of physical balances through stock counts; and an analysis of current period transactions and balances to highlight possible errors arising from mis-classification or mis-posting. Hard closes will also involve independent valuation and estimates for balances that are not able to be determined by other means. For example, the valuation of non-current assets and the actuarial assessments of certain liabilities.

In effect a 'hard close' is regarded as a full 'dress rehearsal' of the end-of-year processes to the extent practicable, recognising that some balances and processes can only realistically be calculated or conducted at or after year-end.¹

3.3 The *Better Practice Guide* further states:

The decision to prepare a hard or soft close process will generally depend on the maturity of an entity's systems and processes and the nature and complexity of its transactions and operations. Better practice entities have found that the need to conduct a hard and/or soft close tends to diminish as entities' systems and processes mature, their ability to provide reliable and timely financial statements improves and accurate full accrual monthly financial statements are produced. Entities that have better practice financial statement arrangements in place are likely to have sufficient confidence in their systems, controls and processes so that they do not require additional assurance from the conduct of a hard or soft close. Put simply, an entity's judgement about the appropriate strategy to adopt will be influenced by:

- the availability of staff and/or contractors with the necessary skills and experience
- the level of confidence the Chief Executive/Board and management have in the entity's existing financial systems, controls and related processes, and
- the level of assurance that the Chief Executive/Board and management require about the entity's ability and capacity to meet its year-end financial statement responsibilities.²

¹ Australian National Audit Office, *Preparation of Financial Statements by Public Sector Entities: Better Practice Guide*, June 2009, p 47.

The Solutions

- 3.4 The New South Wales Auditor-General has recommended that Treasury mandate that agencies perform hard close procedures at 31 December and 31 March each year.³
- 3.5 The Treasurer's submission states that:
The response most likely to address the issue of misstatements is to introduce an early "hard close". This means that:
- Agencies provide the Audit Office with a complete full set of financial statements as at 31 March or 30 April, with all valuations complete and accounting policy issues resolved...
 - The Audit Office reviews these statements and any disagreements or other issues are resolved with the agency prior to 30 June
 - Full financial statements for the Year ended 30 June are provided to the Audit Office after the year end. These statements reflect the resolution of any issues that arose from the Audit Office review of the March or April statements.⁴
- 3.6 Treasury and the Audit Office piloted elements of hard close procedures with 15 large agencies for 2009-10 year end. This pilot drew on the experience of the Department of Health adopting early close procedures in 2009. In addition, Treasury undertook to issue its accounting policy and reporting circulars by 30 March, which is significantly earlier than last year. The relevant agencies, Treasury and the Audit Office have agreed to meet in November 2010 to review the findings of the pilot, with a view to widening the program across the public sector.⁵
- 3.7 Many Australian jurisdictions have some agencies that perform hard closes as a tool to provide greater assurance to management and to assist them meeting their reporting deadlines. No Australian governments mandate hard close procedures.⁶

Issues

- 3.8 The main concern that arose regarding hard closes was the availability and cost of accounting capacity within agencies. Impediments to conducting hard closes identified in submissions to the Committee included:
- Availability of agency finance staff because they may be engaged on State Budget and internal budgeting matters;
 - Availability of Audit Office staff because they may be involved in performing university audits during March and April;
 - Higher audit costs for agencies to perform a hard close;
 - Practical difficulties in scheduling valuation exercises in March or April and valuation exercises that can only be done at year end;
 - Late advice from Treasury in regard to changes to the reporting code;

² Ibid, pp 46-7.

³ Auditor-General's Report, *Financial Audits, Volume Two 2010*, p 12.

⁴ Treasurer's Submission, p 5.

⁵ Ibid, pp 5-6.

⁶ Ibid, p 9.

- Lack of accounting capacity, commitment, or change management procedures within agencies; and
 - Cultural issues within organisations.
- 3.9 Performing a hard close requires agencies performing an additional task, which means increased use of resources.
- 3.10 Conducting a hard close should make the submission of the final accounts easier, as processes will be established and much of the work done for the final reports. More frequent production of reports will also strengthen the reporting skills of agency staff. However, in the short term at the least, early hard closes will increase the accounting work of agencies.
- 3.11 On the issue of the cost of improving financial reporting, Mr Mark Ronsisvalle, Deputy Secretary, Budget and Financial Management told the committee:
- I think we would all agree that we would like to improve the quality of financial reports, but we also bear in mind that there are risks associated with actually doing something else. The Government prefers to put money into front-line services. Sometimes that means that other things have to be not as well done as they should be.⁷
- 3.12 The Treasurer also noted his emphasis on front-line services in his submission, saying:
- I do not wish to incur additional costs and reduce frontline service delivery on accounting processes that have no impact on economic decisions, i.e. have no additional benefits.
- 3.13 In contrast, the Auditor-General drew the Committee's attention to the importance of obtaining improved financial data to get better informed decision-making:
- If we can get a more accurate set of data then I believe there will be a benefit in decision-making. I am not sure you can put a figure on that, but if you get better data you get a better decision. It may cost more in the first year, and there may even be a marginal rearrangement of costs in department and central agencies on an ongoing basis.⁸
- 3.14 Mr Ronsisvalle also noted that performing hard closes should improve the accuracy of estimates of the previous year's results in the Budget:
- I guess the concern of the Audit Office is that often 11 months into the year we are told the budget result will be X for the year, For example in 2008 we were told on 8 June that the budget result would be a billion dollars, and three weeks later, when the result came in, it was only \$386 million—that was within three weeks.
- I can understand why it changes over a year, but in relation to the shorter time I guess that is why the benefit of accrual based hard close would have clarified that first figure. As it turns out in that figure we talk about changes in markets and changes in other things, but there was a large result in that as a result of not taking into account long-service leave or something like that, which caused a significant variance. Arguably that would have been picked up if there had been a hard close earlier on.⁹
- 3.15 It is obviously the case that the Government should spend public funds to maximise the services it can deliver and quality financial reporting is not an end in itself but a means to that end. The crucial question is not whether front line services take priority

⁷ *Record of Proceedings Before Public Accounts Committee, 5 May 2010*, p 2.

⁸ *Ibid*, p 15.

⁹ *Ibid*, pp 4-5.

The Solutions

over financial reporting but what form of financial reporting will best deliver those services.

- 3.16 Some agencies noted that their reports have not had significant errors and questioned whether a move to an early close was justified. For example, the Department of Education and Training's submission stated:

it should be noted that neither the department nor TAFE NSW contributed to the significant errors quoted by Treasury and that the issue of errors within the department's financial reports would not appear to justify a move to an early close...

The department has an excellent working relationship with the NSW Audit Office and through client service plans and joint planning, there is already an early close regimen in many areas to facilitate financial statement and audit verification.¹⁰

Department of Health Case Study¹¹

- 3.17 The Department of Health was late in submitting its financial reports in 2006, 2007 and 2008. The quality of these reports caused further delays in the auditing process. In Volume One of the Auditor-General's 2009 Financial Audit, he recommended that:

both the Department and its controlled entities review and significantly improve year-end reporting processes to enable the consolidated entity to meet its statutory reporting timetable. Improvements should include quality control processes and more timely consideration and resolution of accounting and related issues for dissemination to the controlled entities. The Department needs to take decisive action to remedy the continuing unsatisfactory situation. Appropriate accountabilities should be included in staff performance agreements for Departmental and controlled entities' staff.¹²

- 3.18 The Department considered that the best way to simultaneously address both the issues of timeliness and of quality was to:

- implement an 'early close' process; and
- enhance the governance of its end of financial year milestone reporting.

- 3.19 Details of the measures implemented are at Appendix A. These included:

- the Department and its controlled entities performed an early close as at 31 March 2009;
- establishing detailed milestone targets for financial reporting, which were reported against and reviewed monthly;
- requiring Chief Executives and Chair of the Audit Committee to sign off on milestone reports before submission; and
- implementing a comprehensive communication plan.

- 3.20 These measures enabled the Department to identify any process weaknesses with sufficient time to initiate remedial action, allowed the Audit Office to undertake early substantiation, and increased the focus of accounting and corporate staff on completing end of financial year tasks in a timely manner.

- 3.21 The Auditor-General subsequently reported:

¹⁰ Department of Education and Training Submission.

¹¹ Department of Health Submission, see extract at Appendix A below.

¹² Auditor-General's Report, *Financial Audits, Volume One 2009*, p 23.

There has been a significant improvement this year, and the Department and its agencies are to be commended. I received the financial reports of all [Area Health Services], of the Health Administration Corporation, and the Department within the statutory timeframe. In addition, the majority of AHS provided adequate working papers to support their financial reports.¹³

AGENCY & CHIEF FINANCIAL OFFICER ACCOUNTABILITY

3.22 There is evidence that agencies have not taken sufficient responsibility for their financial reports but have been using the audit process as a means of correcting errors rather than ensuring accountability.

3.23 Mr Ronsisvalle, told the Committee:

[The Auditor-General] and I probably agree that agencies do not see the submission of their accounts to the Auditor-General as an opportunity to go back and check the accounts that they have provided to the Auditor-General. The full checking process needs to occur prior to giving it to the Auditor-General.

It is, in my opinion, not acceptable for significant changes to occur in accounts after they have been given to the Auditor-General. That says something about the process the agencies go through.¹⁴

3.24 Mr Tony Whitfield, the Deputy Auditor-General told the Committee:

In some cases the errors are there because there has been a lack of suitable scrutiny and review of the issues. We have had instances where lines or cells in a spreadsheet have been left out of the total and that has left out \$500 million worth of assets, for example. It is simple things like that, that if there were a high degree of scrutiny and if it had been done earlier, someone would have picked up that they were not adding all the cells in the spreadsheet. It is issues like that that contribute to it, but there are, in addition, issues in relation to valuation where we have had assets included in an agency's accounts that did not belong to that agency, or to which they have applied wrong valuations, or picked up the wrong numbers out of another document and transposed them. Those are things that should be picked up before they come to the Auditor-General.¹⁵

Chief Financial Officer Sign off

3.25 To ensure agencies take greater responsibility for their accounts, Treasury wrote to all agencies in April 2010 indicating that in March each year, as part of their annual Budget returns, chief financial officers must attest that as at 31 March their agency "has effective systems, processes and internal controls to ensure that the monthly and annual financial information provided to Treasury is relevant and reliable." This certification is to start in March 2011 to allow sufficient time for agency Audit and Risk committees to ensure that systems, processes and internal controls are in place to support the required certification.¹⁶

¹³ Auditor-General's Report, *Financial Audits, Volume 11, 2009*, p 11.

¹⁴ *Record of Proceedings Before Public Accounts Committee*, 5 May, p 2.

¹⁵ *Ibid*, p 5.

¹⁶ Treasury Submission, p 6.

The Solutions

- 3.26 CPA Australia said in its submission that the NSW *Public Finance and Audit Act 1983* is deficient in that the role and responsibilities of the chief financial officer of public sector entities is not defined.
- 3.27 Requiring chief financial officers to attest to their agencies' accounting systems is already the practice in Queensland and Western Australia. In Queensland, the *Financial Accountability Act 2009* makes chief financial officers responsible for providing the annual financial statements and a statement about whether the financial internal controls of the department are operating efficiently, effectively and economically.
- 3.28 Treasurer's Instructions under the Western Australian *Financial Management Act 2006* require both the chief financial officer and the accountable authority to certify:
- The accompanying financial statements of the (name of the agency...) have been prepared in compliance with the provisions of the *Financial Management Act 2006* from proper accounts and records to present fairly the financial transactions for the (period as specified) ending (date) and the financial position as at (date). At the date of signing we are not aware of any circumstances which would render the particulars included in the financial statements misleading or inaccurate.¹⁷

Audit and Risk Committees

- 3.29 Another measure Treasury has introduced to improve internal agency accountability is requiring all agencies to have independent audit and risk committees.
- 3.30 Mr Ronsisvalle informed the Committee:
- These audit and risk committee consist of a majority of independent members. They are not departmental committees rubberstamping the actions of the department. Of a committee of five, three of them have to be independents and the chair is an independent. That is going to put considerable pressure on the agencies to improve both the internal audit risk management and, in particular, the quality of the production of their accounts. We are hoping this will improve the quality of the accounts and bring them forward.¹⁸

EARLIER REPORTING

- 3.31 The Treasurer has suggested that earlier reporting deadlines would improve the quality and timeliness of financial reports.
- 3.32 While it may seem perverse that the remedy for agencies submitting reports late is to make the deadline earlier, it is argued that such deadlines would provide incentives for agencies to adopt more effective financial reporting processes, such as a hard close or early substantiation.
- The urgency of achieving a tighter deadline, such as tabling annual reports by say 30 September instead of 30 November for New South Wales, would result in agencies and audit having to streamline and bring forward their year end processes through early substantiation, or a 'hard close'. Such a significant change would be expected to take more than one year for NSW agencies to implement.¹⁹
- 3.33 Departments currently have three statutory reporting deadlines:

¹⁷ Western Australian Treasurer's Instruction 947.

¹⁸ *Record of Proceedings Before Public Accounts Committee, 5 May 2010*, p 8.

¹⁹ Treasury Submission, p 7.

- 11 August – agencies lodge financial report with the Auditor-General;
 - 20 October – sign off financial report;
 - 31 October – submit annual report to Minister (who must then table the annual report in Parliament within one month, which could be up to 30 November).
- 3.34 The Treasurer notes that other large State governments do not generally have three statutory deadlines for agencies, but operate in a more flexible environment to meet a statutory tabling deadline, generally the end of September or October.
- 3.35 The Treasurer also notes that deadlines for NSW government agencies have not been updated for many years, while other States and the private sector have been gradually shortening reporting deadlines.
- 3.36 All other States and Territories require annual reports be tabled in either September or October. The Victorian Parliament is currently considering a bill to move the deadline for tabling annual reports from 31 October forward to 30 September. The deadline in NSW is 30 November.
- 3.37 The Treasurer informed the Committee that the date that audit signed the 2010 Independent Audit Reports for the State Accounts for each jurisdiction is as follows:

Jurisdiction	2010 Sign off Date
New South Wales	22 October
Victoria	29 September
Queensland	20 October
South Australia (Audit Review Letter)	16 December
Tasmania	28 October
Australian Capital Territory	30 October
Northern Territory	14 October

Treasurer's Submission

IMPROVE ACCOUNTING SKILLS & QUALIFICATIONS

- 3.38 The level of accounting skills of staff within government agencies was raised as an impediment to improved quality and timeliness of financial information.

Mr RONISVALLE: [The cost of performing hard closes] is the primary issue that would need to be addressed, bearing in mind the skill level of people in public sector agencies. I do not know whether you are prepared to comment on this more than I, but I suspect that the skill level is probably—the public sector does not pay substantial salaries for accountants. Therefore, if there is a correlation between skill level and pay, there may be an issue in the public sector as to the quality of the people who produce our accounts.

Mr WHITFIELD: If I could add to that, not so much in the State-owned corporations where they tend to have more private sector people on the boards and the quality of the people preparing financial statements are a lot better, but within the departments I would tend to agree with Mark. We did a study a number of years back and came up with a recommendation that people responsible for preparing the financial statements should have professional qualifications either with the Institute of Chartered Accountants or CPA Australia. The Premier of the time issued a memorandum to put that in place and then eight weeks later that got withdrawn because the National

The Solutions

Institute of Accountants [NIA] thought it was a restriction. The requirement now is you have to be a member of an accounting body. That could be anything, quite frankly. So that requirement got watered down. What we are finding is that the State-owned corporations and some of the statutory authorities tend to provide better financial statements than the government departments. It is linked back to the quality of the people and the experience they have in the government departments and the fact that they only do it once a year. Therefore, they go through a relearning curve every time that they do it.²⁰

- 3.39 CPA Australia were concerned that the *Public Finance and Audit Act 1983* does not articulate the attributes required to be successful as a chief financial officer.

The environment in which the Chief Financial Officer operates is dynamic and creates a range of challenges that include the production of quality statutory reporting in a timely manner, management of technical accounting and financial management issues and advice on the financial effects of different strategy options. Further, the role of the Chief Financial Officer is at the core of governance. CPA Australia believes that to be successful as a Chief Financial Officer, the attributes required of the incumbent include a high quality technical education complemented by a thorough understanding of the professional elements of ethics and integrity, within the context of business strategy, decision making and leadership and corporate governance. The status of the CPA designation is consistent with those attributes. CPA Australia strongly suggests that the above attributes be incorporated into the legislation.²¹

- 3.40 The Queensland Financial Accountability Regulation 2009 and the Western Australian Treasurer's Instruction 824 each require that chief financial officers hold qualifications from CPA Australia, the Institute of Chartered Accountants in Australia, the National Institute of Accountants, or an overseas accounting body that is recognised by at least two of the above organisations. The Western Australian Treasurer's Instruction also requires that chief financial officers have direct access to the chief executive officer.

²⁰ *Record of Proceedings Before Public Accounts Committee, 5 May 2010*, p 9.

²¹ CPA Australia Submission, p 1.

Chapter Four – Conclusions

- 4.1 The Committee is very concerned about the problems that have been identified with financial reporting in New South Wales. Accurate and timely financial information is vital for the effective delivery of services. The quality of decisions is affected by the quality of information available to the decision-maker. Earlier notification of budget overruns allows problems to be addressed before they escalate. The errors in financial reporting and recurring budget overruns that have been identified fall below the standards the Committee expects and this needs to be remedied as a matter of priority.
- 4.2 The Committee is pleased to note that action has already been taken to improve financial reporting. Treasury's more timely issuing of instructions, the piloting of early hard closes with 15 large agencies, strengthened accountability of chief financial officers and improved governance through independent audit and risk committees are all significant steps that the Committee expects will increase the quality and timeliness of financial reporting.
- 4.3 The Committee also acknowledges the significant improvements that the Department of Health achieved in its financial reporting through implementing an early hard close, together with strong leadership and improved governance.
- 4.4 However, while the Committee welcomes these improvements, the response has not yet been adequate to address the problem at hand. The Committee therefore recommends a range of further initiatives be pursued.

HARD CLOSE

- 4.5 The Committee notes that while the Government has initiated a pilot of agencies conducting an early hard close, it has not yet committed to mandating such procedures for all agencies, as recommended by the Auditor-General.
- 4.6 The Commonwealth Auditor-General's *Better Practice Guide* says that the decision to prepare a hard or soft close process will generally depend on the maturity of an entity's systems and processes and the nature and complexity of its transactions and operations. A mature financial system is one that produces accurate full accrual monthly financial statements.
- 4.7 While the Committee is aware that many agencies have produced reports on time and without significant errors, it is not aware of any agencies that have achieved the above level of maturity in its reporting systems. Furthermore, the widespread nature of the problems that have been identified with financial reporting in New South Wales also suggest that strong whole-of-Government action is needed to improve standards and the level of expertise.
- 4.8 The Committee considers that requiring all agencies to complete an early hard close will improve the quality of information available to the Government when preparing the Budget, give agencies earlier and more accurate information on their financial condition, and lead to improved accounting systems, and skills and discipline of accounting staff. The resulting improved financial information will better enable agencies individually and the Government as a whole to provide effective services.

Recommendation 1

The Committee recommends that the Treasurer require all agencies to conduct a hard close of their accounts at 31 March from 2011.

AGENCY & CHIEF FINANCIAL OFFICER ACCOUNTABILITY

- 4.9 The Committee considers that it is vital that chief executive officers and chief financial officers take responsibility for the quality and timeliness of their agency's financial reports. Submission of incomplete financial reports or 'misstatements' to the Auditor-General should not be tolerated.
- 4.10 As noted above, the Committee welcomes the requirement that chief financial officers certify their agency's financial reporting systems, processes and internal controls, and the introduction of independent audit and risk committees. These measures will significantly improve accountability for financial reporting.
- 4.11 A number of jurisdictions have elevated accountability for financial reporting systems to a statutory basis. The Committee considers that Parliament enacting such accountability requirements gives an appropriate message about the importance of accurate financial reporting.
- 4.12 The Committee also considers that chief executive officers share responsibility for accurate and timely financial reporting and provisions relating to financial reporting should be included in chief executive officers' performance agreements.

Recommendation 2

The Committee recommends that the Treasurer propose amendments to the *Public Finance and Audit Act 1983* requiring chief financial officers to certify their financial reporting systems.

Recommendation 3

The Committee recommends that the Premier ensure that accountability for accurate and timely financial reporting is included in all chief executive officers' performance agreements.

REPORTING TIMEFRAME

- 4.13 The Committee concurs with the Treasurer's suggestion that statutory reporting deadlines should be brought forward.
- 4.14 The Committee considers that financial and annual reports should be tabled in Parliament as soon as is practicable to maximise public accountability. It is clear from experience in other jurisdictions that New South Wales has not adopted the better practices of some other jurisdictions.
- 4.15 The Committee also finds compelling the Treasurer's argument that tighter deadlines will provide incentives for agencies to implement improved financial reporting practices. The Committee also notes the Treasurer's advice that earlier reporting deadlines will take more than one year to implement.

Recommendation 4

The Committee recommends that the Treasurer develop and implement a program to bring forward the deadline for the tabling of annual reports in Parliament to three months after the end of the financial year by 2013 at the latest.

ACCOUNTING SKILLS AND QUALIFICATIONS

- 4.16 The Committee noted the questions that were raised about whether agencies had the necessary capacity to produce quality and timely financial reports, and the requirement of particular qualifications of chief financial officers in some jurisdictions.
- 4.17 The measures already taken to improve the accountability for, and discipline of, financial reporting, together with the measures recommended above, should themselves lead to improved accounting capacity within agencies.
- 4.18 While these strengthened accountability requirements may provide sufficient impetus for agencies to have the necessary accounting skills, the merits of setting minimum qualification requirements warrant further investigation in any review of the *Public Finance and Audit Act 1983*.

Recommendation 5

The Committee recommends that the Treasurer consider proposing amendments to prescribe minimum qualifications of chief financial officers in the *Public Finance and Audit Act 1983*.

- 4.19 The Committee notes that it will continue to monitor and review the quality and timeliness of financial reporting to fulfil its functions under section 57(1) (d) and (e) of the *Public Finance and Audit Act 1983*.

Appendix A – Department of Health Case Study²²

ISSUE

The 2009 Auditor-General's report on the 2007/08 NSW Health Financial Audit highlighted deficiencies in the quality and timeliness of the financial statements lodged by NSW Health in both 2006/07 and 2007/08. These deficiencies led to the following recommendation from the Auditor-General:

"We recommend both the Department and its controlled entities review and significantly improve year-end reporting processes to enable the consolidated entity to meet its statutory reporting timetable. Improvements should include quality control processes and more timely consideration and resolution of accounting and related issues for dissemination to the controlled entities. The Department needs to take decisive action to remedy the continuing unsatisfactory situation. Appropriate accountabilities should be included in staff performance agreements for Departmental and controlled entities' staff."

(Source: Auditor General's Report, Health Overview, Vol. 1, 2009)

Therefore, there were two substantive issues to be addressed by NSW Health namely, timeliness and quality.

CONTRIBUTING FACTORS

The ability of NSW Health to meet its statutory reporting requirements in both 2006/07 and 2007/08 was impaired by a number of factors including:

- In 2005/06 there was a major restructure of NSW Health:
 - Reduction from 17 Area Health Services to 8
 - Reduction in corporate support staff of over 1,000 FTE

The restructure required NSW Health to rebuild its accounting processes to accommodate the revised structure, but with significantly less staff. The revised processes would require time to "mature".

- The transition to a shared corporate services model for accounting transaction processing
- The introduction of a new Standard Chart of Accounts across all of NSW Health
- Late advice on revaluations, actuarial assessments of leave from external advisors
- Late advice from Treasury in regard to changes to the reporting code
- Late advice issuing from the Department to the Health Services

²² Department of Health's Submission, Attachment 2.

SOLUTIONS

The Department considered the best way to simultaneously address both the issue of timeliness and the issue of quality was to:

- (1) Implement an "early close" process, where the early close is a simulation of the end of financial year processes and is conducted prior to 30 June; and
- (2) Enhance the governance of its end of financial year milestone reporting.

Early Close

- The Department chose to undertake its early close as at 31 March 2009.
- All NSW Health's controlled entities (and parent) were required to "close" financial systems and prepare pro-forma end of year financial statements as at 31 March 2009.
- Full working papers were prepared by NSW Health's controlled entities (and parent), noting there were some limitations on available information, such as revaluations, actuarial adjustments (which are not always available until late in the financial year).
- The pro-forma financial statements were required to be submitted by the controlled entities to both the Department and also to the entity's auditors by the end of April, 2009.

Milestone Reporting

- A detailed list of milestone targets has been established for each of the controlled entities and the parent.

The setting of milestone targets involves the collation of end of financial year tasks into sequential order, assigning responsibility for achievement of tasks to an individual, and then assigning dates for completion of the tasks so as to coincide with the statutory reporting deadlines.

- Controlled entities (and the parent) are required on a monthly basis (from April to July) to report on progress in meeting the milestone targets.
- Milestone reports include a requirement for the controlled entity to advise which milestones were being achieved and where milestones were not achieved, to advise the remedial action initiated.
- On a monthly basis the Department reviews the progress of the controlled entities (and the parent) in meeting their milestones and works cooperatively with entities that were required to implement remedial actions to address non-achievement of milestones.
- Milestone targets and reporting has been a long standing feature of the NSW Health end of financial year process. However, in 2009 the governance surrounding the milestone reporting process was significantly enhanced whereby the milestone report was, for the first time, required to be co-signed by the Chief Executive and the Chair of the Audit Committee before submission to the Department.

Communication

To support the milestone reporting and the introduction of the early close, the Department initiated a comprehensive communication plan, including:

- In January 2009 correspondence issued from the Deputy Director-General Health System Support to Chief Executives regarding the need to improve the timeliness and quality of end of year financial reporting;
- In early March 2009 a meeting was convened (including video conferencing facilities) with all Senior Finance Staff in NSW Health in attendance;
- Formal correspondence issued from the Chief Financial Officer, DOH regarding the need to improve the timeliness and quality of end of year financial reporting including outlining the roles, responsibilities and obligations of the controlled entities (and the parent) in supporting the early close and milestone reporting processes;
- Monthly feedback, where appropriate, on progress in achieving milestone targets; and
- Ad hoc, informal liaison with Health Services and controlled entities.
- The involvement of Treasury in consideration of the more complex emerging issues.

Benefits

- The March 2009 early close allowed DOH to test its end of financial year processes some 3 months in advance of the end of financial year. This allowed NSW Health to identify any process weaknesses with sufficient time to initiate remedial action
- The Audit Office was provided the opportunity to undertake early substantiation of financial transactions processed between July 2008 and March 2009
- The early close, when combined with the milestone reporting, increases the focus of accounting and corporate staff to ensure progress in completing end of financial year tasks in sufficient time to meet the statutory deadlines without compromising the quality of supporting paperwork

OUTCOME

In the space of less than six months, the Department moved from a position of being criticised for the timeliness and quality of its financial reporting, to being commended. The 2008/09 Auditor General's report included a commendation for NSW Health:

"There has been a significant improvement this year, and the Department and its agencies are to be commended. I received the financial reports of all Area Health Services (AHSs), and of the Health Administration Corporation and the Department within the statutory timeframe. In addition, the majority of AHSs provided adequate working papers to support their financial reports."

(Source: Auditor General's Report, Health Overview, Vol. 11, 2009)

CRITICAL SUCCESS FACTORS

When considering this significant achievement, NSW Health Finance Branch consider the critical success factors to be:

- Strong leadership and improved governance
- Support from:
 - Deputy Director-General, Health System Support
 - Chief Executives
 - Auditors
 - Audit & Risk Committees
 - Treasury
 - Health Services' Directors of Financial Operations & Directors of Finance
- Communication
- The cooperative approach of all parties involved to achieving a shared vision

CONSOLIDATING THE CHANGE

Whilst significant, the achievements of 2008/09 need to be consolidated into the culture of NSW Health to ensure sustained quality and long term compliance with statutory reporting deadlines.

In 2009/10 NSW Health will again implement an early close with milestone reporting. Actions implemented to date include:

- Communication has commenced
- A "Lessons learned" workshop for Health Services and controlled entities was held in March 2010
- 2009/10 early close conducted in March 2010
- Audit & Risk Committee Chairs met in mid April 2010 at which time a workshop was also conducted to acquaint key finance/accounting personnel with their 2009/10 reporting responsibilities
- Monthly milestone reporting has commenced

Appendix B – Submissions

1. Audit Office of NSW
2. The Department of Education and Training
3. Industry & Investment NSW
4. Treasurer
5. Attorney General of NSW
6. Department of Health
7. Minister for Transport
8. CPA Australia
9. Minister for Juvenile Justice
10. KPMG

Appendix C – Witnesses

Prior to the formal commencement of the inquiry, the Committee held a public briefing on financial reporting on 5 May 2010 with the following witnesses:

- Mr Peter Achterstraat, Auditor-General
- Mr Tony Whitfield, Deputy Auditor-General
- Mr Mark Ronsisvalle, Deputy Secretary, Budget and Financial Management, New South Wales Treasury
- Mr Mark Pellowe, Senior Director, Budget and Infrastructure Management and Reporting Branch, New South Wales Treasury