

Public Accounts Committee
Parliament of New South Wales

**Report of Proceedings of the Accrual
Accounting Seminar 5 February 1988**

1988

Parliament of New South Wales

**Public Accounts Committee of the
Forty-ninth Parliament**

Thirty-eighth Report

Report of Proceedings of the Accrual Accounting Seminar--Sydney, 5 February, 1988.

May 1988

MEMBERS OF THE PUBLIC ACCOUNTS COMMITTEE

The members of the Public Accounts Committee are:

Mr Phillip Smiles, LL.B., B.Ec., M.B.A., Dip. Ed.M.P. Chairman

Mr Phillip Smiles was elected Member for Mosman in March, 1984. A management and marketing consultant since 1974, Phillip Smiles has been involved with entrepreneurial business activities since his teens. Since entering Parliament he has been actively interested in the areas of small business, emergency services, welfare and financial analysis. He was appointed a Member of the Public Accounts Committee in 1984 and was elected Chairman in 1988.

Miss Wendy Machin, B.A., M.P.

Wendy Machin was elected Member for Gloucester in 1985. Following completion of a Bachelor of Arts (Communication) Degree she worked in public relations for the National Party and a Sydney consultancy. Later Wendy established her own public relations consultancy business specialising in the rural sector. She also served as an independent alderman on North Sydney Council prior to becoming a Member of Parliament. In 1988, following a redistribution, became Member for Manning.

Mr John Murray, B.A., M.P.

John Murray, formerly a teacher, was elected Member for Drummoyne in April, 1982. An alderman on Drummoyne Council for three terms, John Murray was Mayor of the Council for five years and served four years as Councillor on Sydney County Council. He has served as a member of the Prostitution Committee, and the House Committee and is a former Chairman of the Public Accounts Committee.

Mr Allan Walsh, B.A. (Hons.), Dip. Ed., M.P.

Allan Walsh was elected Member for Maitland in September, 1981. Following eight years as a Mirage fighter pilot with the RAAF, he was involved in business management Allan Walsh has also taught industrial relations, management and history at technical colleges.

Mr Terence Allan Griffiths, M.P.

Terry Griffiths was elected Member for Georges River in 1988. Prior to being elected to Parliament he was [the Chief Executive of the Scout Association of Australia. Before this he was an Army Officer. He is a graduate of the Officer Cadet School Portsea, a graduate of the School of Military Engineering and a Fellow of the Australian Institute of Management. He has been actively involved in Lions, Rotary and other community organisations.



Committee Members. From left: Wendy Machin, Allan Walsh, Phillip Smiles (Chairman), Terry Griffiths, John Murray

Secretariat

John Horder, LL.B., AASA, CPA, Clerk to the Committee

Bronwyn Richardson, B.A.(Hons.), Dip. Ed., M.Comm.(Hons.), Senior Project Officer

Grahame Gibbs, B.Bus., Adviser on secondment from the Treasury, N.S.W.

Tony Boulton, B.Ec. (Syd), AASA, Adviser on secondment for the Auditor-General's Office

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CHAIRMAN'S FOREWORD

The credit for the success of the Accrual Accounting Seminar organised and hosted by the New South Wales Public Accounts Committee is attributable to my predecessor, John Murray, B.A., M.P., and other Members of the prior Committee, Dr Andrew Refshaug, Member for Marrickville, Mr Colin Fisher, former Member for Upper Hunter, now retired and Mr Alan Walsh, Member for Maitland.

On behalf of the present and former Members of the Committee I would like to record our appreciation of the very valuable contribution made to the work of the Committee by Colin Fisher. His vast practical experience and pragmatic approach greatly assisted the Committee in arriving at positive recommendations. We wish him well in his retirement although all will miss his happy disposition.

As the new Chairman of the Committee, I am pleased to present this Report on the Proceedings of the Seminar. I would like to thank those persons who contributed to its success especially the guest speakers and commentators, Mr Ken Robson, Auditor-General of New South Wales, Professor Bob Walker, University of New South Wales, Mr Percy Allan, Secretary, New South Wales Treasury, Mr David Shand, First Assistant Secretary, Australian Department of Finance, Mr Michael McGinniss, Price Waterhouse, Mr Ian Plater, Arthur Andersen and Mr Paddy McGuinness, Australian Financial Review.

The interest in the Seminar was widespread. The fact it was a complete sell-out reflected the timeliness of the Seminar. There were attendees from *interstate* Public Accounts Committees, Government Departments, *Statutory* Authorities, Universities, and Colleges of Advanced Education.

Following the Seminar there has been substantial positive feed-back and expressions of interest in the proceedings. There has also been considerable media interest.

As the incoming Chairman of the Committee I look forward to continuing the Committee's work of enhancing and promoting accountability, efficiency and effectiveness in the public sector.

Finally, on behalf of the Committee, I would like to thank John Horder, Clerk to the Committee, and the Staff of the Secretariat for their first class effort in organising the Seminar.

PHILLIP SMILES LL.B., B.EC., M.B.A., DIP. ED., M.P.,
CHAIRMAN

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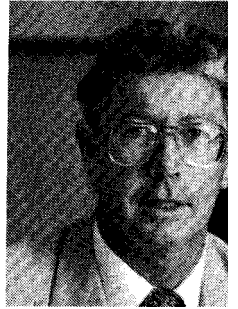
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OPENING ADDRESS

JOHN NURRAY, B.A., N.P.,

PUBLIC ACCOUNTS COMMITTEE

ACCRUAL ACCOUNTING SEMINAR



5 FEBRUARY 1988

Welcome:

Ladies and gentlemen on behalf of the N.S.W. Public Accounts Committee it is my pleasant duty this morning to welcome you to today's Seminar.

In particular I acknowledge the presence of Members of Interstate Delegations from Queensland, Western Australia, Northern Territory, Tasmania, Victoria and Canberra.

I might say *that* the Seminar has been a sell out with 200 participants and a reserve list of over 50.

Unfortunately I have an apology from those two well known exponents of accountancy, Mick Young and Stephen Loosley.

Please allow me to introduce my Parliamentary Colleagues and Members of the Public Accounts Committee.

- Deputy Chairman and Member for Marrickville,
Dr Andrew Refshauge
- Mr Allan Walsh, Member for Maitland;
- Mr Colin Fisher, Member for Upper Hunter
- Mr Phillip Smiles, Member for Mosman

Ladies and gentlemen the words "accrual versus cash accounting" conjures up a variety of reactions.

In years gone by, the average Government accountant could have been excused for thinking accrual accounting was something the sadists did to delight the masochists!

As chairman of the NSW Parliament's PAC I believe an accounting system as a source of information, needs not only to account for the spending of the public dollar at year's end, but also, it should bring to account, in dollar terms, future obligations.

This seminar arose directly out of the Biennial Conference of Public Accounts Committees hosted by the NSW PAC in May last year. It became clear during that Conference and indeed from other PAC work in the public accounts area, that there was a need to air the various points of view being espoused in relation to accrual accounting. Also to dispel the myths that surround the topic and to hone in on exactly what it is, that distinguishes one system from another and finally to settle on criteria for the evaluation of the various accounting systems.

Hopefully today's forum will do just *that*.

For the information of our Interstate guests I should explain *that* the NSW Government already requires Statutory Authorities and some Government Departments to adopt accrual accounting. Whilst accrual accounting is widely accepted as an appropriate system for commercially oriented Government undertakings, the same may not necessarily be the case for the large volume of non commercially oriented activities.

Ladies and gentlemen the NSW Government has been a leader in introducing financial reforms within the public sector, in Australia:

- our annual reporting requirements are second to none;

- the accounting profession's public sector standards have been adopted;

- program budgeting has been introduced;

- the Public Finance and Audit Act has been updated which included a significant widening of the powers of the Public Accounts Committee;

You would be aware that the NSW Treasurer Ken Booth announced in December last year that the State Government had established a task force to examine the methodology required to implement full accrual accounting in Government. It is the explicit aim of today's Seminar to provide a positive contribution to this current debate.

Today, we are privileged to have with us three Speakers who are in the forefront of public sector decision-making; Mr Ken Robson, NSW Auditor-General, Mr Percy Allan, Secretary, the NSW Treasury and Mr David Shand who brings a wide range of experience from the Australian Department of Finance.

We are also fortunate to have the independent academic views of Professor Bob Walker from the University of New South Wales.

From the private sector we have two eminent practitioners, Mr Ian Plater from Arthur Andersen and Mr Michael McGinniss of Price Waterhouse whom I believe will provide perfect "foils" to both Ken and Percy.

Unfortunately Ian MacKintosh who was listed on today's programme will not be with us due to a family bereavement. However we have been fortunate that Grahame Carpenter, the Comptroller-General in Victoria has at the last minute been able to provide us with a video tape of his Speech delivered at a recent Seminar in Victoria.

Last but by no means least that financial "Guru" Mr Paddy McGuinness will dissect those propositions presented today and in his inimitable style - tear them apart.

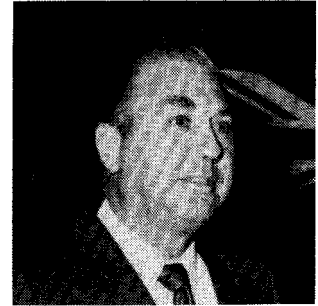
I might say to those of you who have not taken to reading the backpage of the Australian Financial review that Paddy has been in good form of late.

Finally I would like to thank all Speakers for taking time to be with us and allowing their ideas to be exposed to public scrutiny.

I now call on the Committee's Deputy Chairman,
to introduce our first Speaker.

Andrew Refshauge,

Thank you.



ACCRUAL ACCOUNTING SEMINAR

"VIEWS ON ACCRUAL ACCOUNTING"

BY

MR KEN ROBSON, FASA, CPA (AUDITING) AUDITOR-GENERAL OF NEW SOUTH WALES

Paper presented at New South Wales Public Accounts Committee's Accrual Accounting Seminar
Parliament House, Sydney
5th February, 1988.

VIEWS ON ACCRUAL ACCOUNTING

Today I wish to address issues surrounding accrual accounting in the public sector. I will be looking at the present position and what directions it can or should take in the future. From material I have read and information obtained at a recent Accounting Seminar on the topic it is obvious to me that overseas governments are seeking ways of improving accountability and reporting performance in the public sector. The question for today is whether or not cash based accounting alone is able to meet this challenge in New South Wales. I am sure you will agree that there is a need for something more than cash based accounting, and I will put to you some of the issues that I consider appropriate for the implementation of accrual accounting.

Most of my remarks and references today are in relation to the position in New South Wales. Nonetheless] I am sure the problems we are experiencing are being noted elsewhere.

I must acknowledge that in this State a great deal has 'been achieved in financial accountability over the last few years, and I emphasise the word great. Still; much more needs to be done. There is a need to ensure that the true costs and revenues of a year are brought to account for those items which are currently reported. Also; other costs for items which are not currently reported must be recognised.

No individual, and certainly no business person% should try to manage an organisation without some understanding of all the costs involved. Without knowing all cost information% an organisation in the private sector would, almost certainly, be doomed.

Decision makers, including Members of Parliament, need to know not only the immediate, but also the long *term* cost of programs being initiated. Operational managers need to know the true cost of their operations

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Recent Legislation

Until the early 1980s, the public sector was not required to have recourse to accounting standards. In fact, they were virtually unheard of even in statutory corporations. The result was that organisations produced financial statements when they liked and included in them virtually whatever they liked. Compared to present day statements they were nothing short of a sham.

A series of statutes and regulations now requires statutory bodies to produce accounts on an accrual basis. There is scope for exemption from *that* requirement, although there needs to be cogent reasons why a request for exemption should be agreed to. The legislation which required departments to prepare individual statements from 1985-86, however, has not set out any similar requirement for either accrual accounting or for adherence to the spirit of Australian accounting standards. Thus, while statutory bodies produce far better financial statements than they used to, the departments, although now supplying a lot more information, to my mind, still produce financial statements which need many changes to make them meaningful.

Implicit in recent amendments to legislation, is the formal recognition *that* government activity is ongoing; and that, I believe, is a key to the difference targeted by accrual accounting compared to cash based concepts.

Although there are still a number of statutory bodies which have not fully adopted accrual accounting - legislation nonetheless provides for it. Therefore, today% my paper will concentrate on the appropriateness of accrual accounting in budget sector departments.

Accountability

First, I will speak to you about general considerations in regard to accountability because this is what the calls for accrual accounting are all about.

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The ultimate objectives of financial management are to disclose the effectiveness of government operations at the various levels. The establishment of bodies such as the Public Sector Accounting Standards Board will lead to standards for non-business accounting and the increasing levels of consultation between the parliamentary reviewing committees and the Auditor-General also mechanisms which will help to achieve these objectives. Also these measures should provide users of public sector financial statements with additional useful information. The co-operative efforts of these parties; and let's not forget the efforts of the Parliamentary Public Accounts Committee and the State Treasurer and his officers, will I hope lead to uniformity and improved accountability, and, I hope in a much shorter time than might otherwise be possible.

In 1985 the New South Wales Public Accounts Committee, in its 15th Report, indicated that accountability requires the transmission of meaningful information and a system of internal review designed to report on how the organisation meets its objectives in an efficient and effective manner. I agree with that finding.

In past years, in New South Wales, the process of accounting by Departments for transactions outside the budget by the use of large numbers of special deposit or trust accounts had obscured accountability. For *that* reason, the NSW Treasury has been strenuously working to remove any ambiguities and reduce the number of places which had to be searched to understand fully what was going on.

The requirement for annual reports to show all transactions affecting the respective organisation is another step in the process, as is including Commonwealth grants within the State Budget.

Accountability, in its simplest terms, presumes that there is one party to allocate responsibility and another which accepts that responsibility and undertakes to report the results. Traditionally, financial statements by which governments report

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operations have been budget based and have reflected Parliamentary appropriations and demonstrated stewardship. This had led to limitations on the scope and value of the Public Accounts. The need to report in that way is of course important. It can be said that the fact that government does not have profit as a goal is a good reason to suggest that there should still be a focus on stewardship, but there is a need for wider accountability than in terms of annual cash flows. However; we should never lose sight of the concept that the appropriation of cash by Parliament is how the public purse is controlled.

On the other hand; the fact *that* government is not profit oriented does not mean *that* a view of the current departmental type stewardship is the only way by which the government's activities should be examined. That, - by itself, is no argument at all - it lacks substance. It ignores the obvious necessity for the government to live within its capacity, to pay its way. There is a need to ensure accountability for all resources under Government control.

When you look at financial *statements*, particularly in the area of departmental commercial operations - where there are often working accounts involved, there are variations in the quality of disclosure. In most cases; organisations are only too happy to demonstrate their ability to function effectively and economically. In others% the primary aim seems to be to conceal as much as possible. Despite meeting the minimum requirements set out in Reports legislation% and I regard them as minimum requirements% these organisations are not able to demonstrate satisfactory performance and therefore engage in innovative accounting practices to conceal the true picture. I cannot of course mention the audits involved, but it is not difficult to imagine that the level of provisions each year fluctuates at nearly the right amount to produce the desired bottom line. Of course% there is always some expert's report to justify the amount of the provision. One of the consequences ~~is~~ pricing

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policies may be completely distorted; another is that there might be pressure placed on the ability of the government to raise revenue.

It is precisely because of the nature of government activity that program budgeting and reporting was *instituted*. While there is some way to go it cannot be rationally argued that the experience has not contributed much to accountability. Although program objectives may be difficult to define precisely; it may be implied rather than stated; and; there may be conflict in the objectives between programs - it is nonetheless critical *that* the momentum be maintained.

Program Budgeting

One of the steps to take to transmit meaningful information is by introducing program budgeting ~~and~~ transactions and operations can be analysed outside of the traditional financial framework of simple receipts and payments on a line item basis. It is important for the Government to decide what programs and activities are to be undertaken; how to allocate resources ~~those~~ programs; and to account for those resources and assess their results.

Program budgeting was fully implemented in the New South Wales budget sector in 1986-87. Estimates of all departments and authorities coming within the Budget are now presented in a program format. Thus both recurrent services and capital works and services are appropriated separately but detailed together; and% special deposits transactions 'are also included in the program.

To my mind a key word in the budget sector is "program" - it is a word which denotes continuity in activity. It is because of this continuity that receipts and payments information alone is inadequate. Since costs of programs are usually determined at a common point in time, traditionally the *thirtieth* of June% *then* some form of accrual accounting is the only equitable comparison

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value between alternative programs. How else can you properly compare the efficiency, effectiveness and appropriateness of programs unless the "matching" concept used generally by accountants is applied? It is too easy to manipulate reported results without accrual accounting - for example, by delaying payment on material invoices on hand, or drawing cheques and keeping them in the safe as was so popular not so long ago. Also, there is new a tendency for the Treasury to transfer large sums of money to what can be called "Reserves and Provisions" as at the balance date. All of these innovative accounting techniques can be overcome by accrual accounting.

A further point of note is that at this stage figures in departmental financial statements are incomplete in that they do not include certain service-wide payments made from the programs of other organisations, that is, payments met by central agencies. As can be imagined, some of these costs are substantial. To show full costs of a program you need to know those payments incurred by other departments on your behalf and not recovered by them. By the same token how can we be sure *that* pricing strategies are legitimate if all the costs are not brought home to the program? It is pleasing to see *that* the NSW government recently established an interdepartmental committee to determine whether or not full cost recoveries should be made or whether notional amounts should be highlighted against programs. I understand that the Committee reported recently to the Treasurer and I am pleased to see further progress is being made toward improving program budgeting concepts.

But as I have just said, program budgeting still only looks to half the picture and therein lies both the relationship with and the need for accrual accounting. Program budgeting% when all is said and done, can only go so far in measuring expenditure against changes in policy objectives, but it is still caught up in an annual time frame. Budgets only show what you spent in the year but not what you incurred in terms of liabilities. These cash flows are important but they are not enough. Because annual budgets of cash flows tend to be locked into one year brackets,

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there is no accurate measure given of how progressive policy changes impact costs. This is where accrual accounting is said to supplement cash accounting. In fact; I would go even further to say that cash accounting should be seen as supplementing accrual accounting% not vice versa. Cash forecasting is a very necessary part of management. Program costs may vary but when assessed on a cash basis they do not reflect the future unreported costs - like long service leave and deferred superannuation - which legitimately should be part of the program's costs in the year. Knowledge of their true costs and commitments is also important and will be provided if departments go all the way to balance sheet presentations.

I am led to believe that A.S.A. Acting President Elizabeth Alexander said that it is impossible to determine the true state of national debt or finances because the value of assets held by the government is an unknown factor; and further; that future commitments are not recorded. That statement included a call for government to adopt accrual accounting methods as part of the annual Budget process. I can only add that I see this will be a worthwhile development in extending the cash flow trends because it adds to the information available to the decision makers. It would be advantageous to be able to gauge the total cost of a program over its life or at least for a reasonable period into the future and this suggested method is one way to go about it. This would allow us all to distinguish those programs with a limited life from those intended to continue for several years; and properly study trends and cost movements.

There will be costs in implementing and enhancing these systems and there will be a need to educate both managers and other users; but I am sure there will be a favourable cost-benefit.

Related to budgeting is the fact that budgets and what goes into them are influenced by the proximity of elections. Accrual accounting% in catering to accurate long term trends% discounts *that* influence and draws 'us back to proper accountability and

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asset maintenance. For example, decisions to lease rather than buy in an election year can be highlighted in balance sheets to reflect commitments made at the expense of future taxpayers.

In my opinion, public sector activities should be reported to Parliament as far as possible in the same way as a private sector organisation is accountable to its shareholders. As I have intimated, financial statements prepared on a receipts and payments basis do not always reveal the full cost of all the resources utilised by the organisation in the accounting period. Thus, when users attempt to interpret the financial statements they are of less value and it might be difficult to assess performance accurately.

The next step should therefore be to go to accrual accounting so as to overcome some of these problems.

Accrual Accounting

For the moment I will limit my arguments on accrual accounting purely to the situation of bringing to account all the costs of operating in that year.

As I see it, there are a number of questions to be asked if accrual accounting is to be considered as a viable alternative to cash based accounting in the public sector. They include:

1. Is it appropriate to introduce the concept of matching revenues and expenses in government, considering the historical and constitutional links with cash based stewardship? I think, yes.
2. Will accrual accounting give a better indication of the financial well-being of the government? Again, I think, yes. Is it more sensible to look to the ability to meet short term cash requirements; or, should there be some indicator of the manageability of long term liabilities?
I am sure you will agree that both are important.

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3. What performance indicators can be designed, recognising the uniqueness of government activities in providing services at the lowest cost rather than in producing profit? This will, I think, depend on the circumstances.

4. How do you account for cross-subsidisation between programs in looking to the decision to continue a program or not - do you need a form of social accounting to make any necessary adjustments? Again, this will depend on the circumstances.

I consider the specific issues are that pure cash based accounting and, to some extent, modified accrual accounting results in the reporting of incomplete information and can:

- * lead to misallocation of resources;
- * not adequately disclose the size of assets and liabilities;
- * cloud the full cost of programs and cost fluctuations in program costs from year to year;
- * impose burdens on future taxpayers by deferring the bringing to account of liabilities such as long service leave and employers' deferred superannuation contributions and
- * impose burdens on current taxpayers; by charging in full each year, the cost of assets purchased rather than capitalising such expenditure and spreading costs over their useful life to bring to account each year the cost of using the assets employed.

On the other hand, accrual accounting produces:

- * the true annual costs of services and an accurate picture of the size of an organisation or government if a consolidated financial statement is prepared;

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- * an annual surplus/deficit that reflects the result of bringing to account all items as they either are earned or consumed;
- * the full extent of financial position; assets and liabilities and
- * meaningful figures for analysis of trends.

I think most of what I have just listed speaks for itself. However; there are some other issues which need to be kept in mind.

The basic problem with cash based accounting is that it links receipts and payments but ignores the timing of the economic events which surround them. It does not take much imagination to see that decisions may impact not only on the current year but for several years.

I have stated on other occasions that the usefulness of departmental financial accounts - which are not prepared on an accrual basis - is doubtful. As long as departments are insulated from full disclosure by the cash based budget I do not see real value in the financial reports they produce.

However; I am pleased to see that on this subject recent speakers from the USA and myself are not alone in calling for accrual accounting to be introduced in the public sector. I mention ; for example; the third meeting of the IFAC Public Sector Committee held in Hong Kong late last year which considered a submission from the AARF, and agreed to adopt accrual accounting as the most appropriate basis of accounting in the public sector. Although the French and Dutch representatives had minor reservations about whether some public bodies are sufficiently free of social service delivery to be treated as business entities% I would argue that the concept of accrual accounting can be applied irrespective of the type of organisation. I firmly believe that it does not matter whether we are talking about the public or private sector;

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or, whether it is a profit or non-profit organisation. To me these are labels which only help to identify the objectives of performance; but cannot of themselves explain performance.

Also, the National Council on Governmental Accounting in the USA several years ago noted *that* "the accrual basis is the superior method 'of accounting for the economic resources of any organisation". It results in accounting measurements based on the substance of transactions and events rather than merely when cash is received and disbursed and thus enhances their relevance% neutrality; timeliness; completeness and comparability. It went on further to recommend the accrual basis to be used to the fullest extent practicable in the Government environment.

In departments I could argue that unless accrual accounting is introduced then performance indicators based on financial data will result in inaccurate decisions. If performance indicators aim toward the concerns of efficiency; effectiveness and appropriateness then how can you compare results if vital information does not form part of the calculation? For example; those departments which are basically a spending department tended to measure performance only in terms of keeping within budget. What you end up with could be quite meaningless for informed decision making. Or; to put it another way; the objectives of controls concentrate on budget compliance rather than the reason for the organisation's existence. Adjustments otherwise need to be made to give any validity to the performance indicators and accrual accounting is part of that adjustment.

As mentioned earlier; in recent years there has been a lot of progress in financial accountability but departmental accounting still lags behind, although salaries and wages have been accrued for many decades and last year certain accruals were made for goods and services. Further% since 1985-86% departments are required to disclose by way of note details of unpaid accounts and outstanding revenue as well as details of charges which are met on their behalf by other departments. These include such items as payroll tax and accommodation charges. As these items are a basis

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of accrual accounting, one can hope that it will not be that much longer before this information is adopted in the financial statements themselves. Probably the only things missing then will be the cost of asset utilisation, department's share of employer's superannuation liability, and fuller disclosure of costs and commitments like annual leave and long service leave. I don't think that these steps should be postponed much longer, despite the pain of change and the risk of error until accounting systems are able to cope with the expectations of them.

As indicated earlier, adoption of accrual accounting would result in the disclosure of the full extent of assets and liabilities. Admittedly the Treasurer's Public accounts provide, by way of note; information on some assets and liabilities not reflected in departmental financial statements, such as advances repayable to the State and loan liabilities. However, the value of many, such as land, long service leave and unfunded employer's superannuation liability, are now shown in the Public Accounts. They do not appear in departmental statements either.

It should not be overly difficult to assess the value of the liabilities for long service leave and superannuation, nor to assess their true costs for the year. I have already undertaken this exercise for my Office. Departmental financial *statements* currently only reflect actual payments made for long service leave and do not detail the *total* liability for employee benefits incurred in the current year. Further% the costs are reflected in the financial statements of the end user of the employee, whereas the bulk of the liability may have been incurred as an employee of another department. Thus there may not be any link between who gets the benefit of service and who gets to pay for long service leave and whose program reflects this event.

Further, a review was made by my Office in the tertiary education area to see if accrual accounting would be useful, and I am pleased to say that the exercise was worth the effort. I have

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made several recommendations to the Treasurer and Minister for Education following that study. The next proposed review will be in the cultural area of government.

There are some peculiarities of government which need to be addressed.

One important difference is in the way capital projects are funded in government compared to their private sector counterpart. There is argument *that* these should not form part of the operating revenues of the departments, but, on the other hand, it may be catered for by the simple expedient of a note to the accounts which explains what is happening. What is important though in such an exercise is to recognise the assets which have been acquired and to bring to account some form of charge for the use of them to the program. There is nothing unusual in that. However, when we speak of capital projects funded out of loan moneys, then there should be a recognition for the cost of servicing the loan. The problem is - what if the term of the loan is vastly different from the life of the asset? And, how do you treat the proceeds, if any, from the disposal of the assets at the end of their useful life, or, if they are sold off early because there are better opportunities elsewhere? At the moment Consolidated Fund ignores the difference in loan and asset lives, and scoops up the proceeds from disposals. Does *that* encourage the managers of those departments to take better care of the assets? It is just something else which has to be sorted out in dealing with non-profit organisations.

A big problem of not having to report the value of all liabilities is that they can be ignored and deferred. No wonder cash accounting is sometimes called deferral accounting. Likewise with assets, a department having valuable under-utilised holdings has no real budgetary incentive to either use them or dispose of them. One highlight of accrual accounting is *that it* emphasizes the costs met by different generations of taxpayers. It reveals the assets paid for by past taxpayers and currently being used, just as it points to assets acquired today but which have little current

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benefit or greater benefits for future taxpayers' The public reporting of these figures will be a major task but requirements of the Annual Reports (Departments) Act and RegUlation have set in place some of the machinery which will be needed to obtain the asset figures.

As far as disclosing the value of assets is concerned there would have 'to be a policy decision On how to go about valuing certain public sector assets such as national parks and historic buildings. Further-, there is a need to examine if these should be depreciated and if so; at what rates this should occur or should they be treated the same as "goodwill" is in the private sector? I know *that* there are those who don't think depreciation is appropriate in the public sector; and there are some who say *that* the debt charge should be used as depreciation; but I do not wish to go into that argument here. Suffice it to say *that* assets represent a significant resource base and probably should not be excluded% but they also present significant recording difficulties. One thing is reasonably certain and that is that if the assets are not recorded% together with their maintenance costs% then we will never really know if we should be holding the assets at all. At present% no-one is effectively accountable for the continued use of assets.

A large hurdle for departments to overcome relates to capital expenditures and is worthy of further comment. Related to that of course is how to account for the utilisation of assets; such as looking at depreciation on plant and equipment and the opportunity costs involved. So long as the costs of the assets are met by pricing strategies which recover the costs of their use then one problem is overcome. However; I am sure you will agree *that* the chances of this occurring should not be considered as a valid argument for solely continuing with a cash based system. There is a need; .if accountability is to follow% for the reporting of assets held., whether they are being utilised for operations or not; and whether they are being used to the greatest advantage.

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It has been said that accrual accounting and identification and measurement of assets are linked and would provide the necessary discipline in the area of asset recording and certainty of reporting. Also% it has been said financial control by the use of accrual accounting means *that* assets owned by the Government should be properly recorded and ~~ap~~protected.

There may be opportunities as well to pass dormant assets to another department which can use them and while there' may be a book entry there are no demands placed on taxpayers for this action. Even if interdepartmental transfers are at a moderate value for *the* purposes of this exercise, both departments would benefit. It is a question by and large of optimising opportunities. Certain statutory bodies are already required to pay a dividend to Treasury based on assets held. (This concept is caught up in Section 59B of the Public Finance and Audit Act.) One hopes it will also motivate *statutory* bodies to divest themselves of unwanted assets and consider opportunity costs as well. Perhaps departments' budgets will be adjusted for portion of the value of assets which had been disposed of. Maybe one day consideration will also be given to penalising 'them in some way for holding them if they are not used. While it is an aside when considering accrual accounting% it is part of the process for improvement.

In my view the current strong movement towards the user principle also supports the wider application of accrual accounting.

Unfortunately; I do not think that many in the general population will be able to comprehend accrual accounting and translate the effect easily into the processes of raising taxes; levies; and other government service charges. Therefore I would argue *that* both systems of reporting will be necessary to satisfy the needs of all users.

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Funding

One final item which I will refer to is the Funding of items which

have been accrued.

There seems to be an element of

misunderstanding in relation to accrual accounting for the budget sector and the need to fund amounts

or items which have been accrued. There should not be any confusion on the situation. As with any

normal accounting transaction, the funding or cash outflow only occurs when payment is actually

made. There is no need to find large amounts of cash to fund the bringing to account in the books the

costs in respect of these items. Certainly there remains a need to monitor cash flows. but this is already

a normal Treasury function.

Conclusion

There has been a mounting level of interest, both in Australia and overseas, in the concept of accrual accounting for the public sector. It is recognised that major contributions have been made by the

Treasurer of New South Wales and his Officers in achieving a greater degree of disclosure in financial statements and accountability generally. Action has also been taken which will facilitate a change to

accrual accounting. I support the moves for the transition to adopting accrual accounting concepts in

the

public sector.

I believe such moves to be an important goal

towards accountability for the future.

At XII INTOSAI held in Sydney in April 1986, it was observed that only accrual accounting provides accurate measurement of the full cost of government activity. I commend to you the strengths of the assembled voices of the Auditors-General from around the world

in pointing to the well recognised need for the step
accrual accounting. It is not much more information
readily available in a cash accounting system - all that

to full
than is
is being

suggested is that the true costs and values of assets and liabilities be disclosed.

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As I see it, anything less than accrual accounting will not provide the decision makers with all the information they need. You cannot make proper decisions on cash based information alone -you must have before you all the relevant information to do this. But, the argument that preparation of accrual statements would be expensive to produce, can be overcome, by and large, by reference to concepts of materiality. Accrual accounting will at least give decision makers more options to choose from, especially when considering long term policy. I could say that the cost of

ignorance is higher. You only have to think about the number of programs which have been introduced and see the cost blowouts in later years to realise that cash based accounting is inadequate.

Government is big business and as such there is a demand by the shareholders and rightly so, for a high standard of accountability. Although much has been done there is still a fair way to go not looking to compare public with private,

although it could be possible for commercial activities. What I am looking for is greater accountability.

So what does all that has happened in the past tell us about the need for accrual accounting in the future?

We know that times are tough and money is short; and that although in the past accountability was not insisted upon in all quarters, indeed was probably not as critical, it is very much the case now.

We know accounting standards were virtually unheard of in the public sector. Some organisations produced whatever financial statements they thought fit. That has changed with the finance and audit and annual reporting legislation. It is essential that change continues to occur.

We know too that program budgeting is necessary if the full import of government activity is to lead to informed decision making by managers, the Parliament, and even the public.

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The timeliness of financial statements and reports is essential;

as is *that* all government activities should come under the scrutiny of the Auditor-General and Parliament. But% I cannot emphasise strongly enough *that* the single most important development for the future is accrual accounting. I recognise *that* there are and may be problems% but the end result will be improved accountability. I believe there are more advantages than disadvantages in knowing the true financial position.

Governments will continue to need details of its cash budget receipts and payments% *just* like all businesses need cash flow information. However; if there is to be unrestricted decision making by Government and proper review by Parliament; there is a need to know the full costs of operations and the value of assets and liabilities. I recognise that there are problems% but these can be kept to a minimum if due regard is had *to materiality* and not simply applying the corporate model to the public sector. There is a need for public sector reporting of both cash and accrual accounting financial *statements* to satisfy the needs of users at different levels; vis-a-vis; the government, the managers% and the taxpayers. Each has different reasons for wanting one; or both,, of the statement formats. Why not produce both *statements*?

I accept also that there are political issues to consider if accrual accounting is to be adopted in the public sector. There is of course a fear that once adopted there can be no turning back should embarrassing reports be generated. However,, that view ignores the greater number of opportunities presented to decision makers with an improved knowledge base. We cannot make simple cash based decisions - we must know what resources we have or need to acquire; and we must know what our costs have been and future commitments will be.

Might I suggest as any initial step that as both cash and accrual accounting are; in my opinion necessary for the public sector., consideration be given to the budget being presented to parliament; as with the Treasurer's Public Accounts, on a cash

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basis. This would allow departmental accounts (which at present are in a different format to the Public Accounts); to be presented using the accrual system.

Initially it may be necessary to be selective as to which departments are the first to go on accrual accounting and then build up so as to cover all departments,. After some time; and when users have become familiar with such *statements*; a financial *statement* could be produced from individual departmental statements which would reflect the total picture of government finances.

When all is said and done there really is no difference between the private and public sectors. When you think about it; both groups are involved in business of some kind or another; and the absence of profit motive is not sufficient to call for different accounting *treatments*. There are methods in place *that*% if properly redefined and applied; could provide necessary support for positive management initiatives. So the question is not whether there should be accrual accounting in the public sector% but when.

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PROF. R. G WALKER

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ACCOUNTING: NECESSARY; BUT NOT SUFFICIENT**

Debates about the merits of "cash" versus "accrual" accounting have been getting some attention recently. The debates might seem to be about boring bookkeeping techniques. But the use of one or other method can have a big impact upon the way governments go about their business; upon the way resources are allocated between competing uses; upon the behaviour of public sector managers - and upon the accountability of governments to the community.

Yet it's an old debate much shrouded in rhetoric. I'm sure you'll hear a lot of rhetoric today: it's hard to avoid it. Especially among accountants; who tend to be very passionate people.

Some of that rhetoric may involve references to the "true cost" of providing services to the community; and perhaps; of the need to ensure greater "accountability" to parliament; taxpayers; even voters. Who could argue against disclosing the "true cost" of services? And who would argue against "greater accountability"?

My problem is that I'm not sure what is meant by a "truth" in financial reporting. Perhaps I've been in the accounting business too long. And it's not clear to me that adopting accrual accounting will necessarily enhance accountability. There are many notions of "accountability" - ranging from arrangements whereby reviews are undertaken of the probity of transactions, to arrangements whereby the efficiency and effectiveness of managers is subject to independent review. In the context of discussing financial reporting; I assume we're talking about "accountability" in the sense of an expectation that government departments and authorities will provide information about their activities and affairs in external reports% and that ministers or public service managers will be answerable to parliament or other interested parties about those matters.

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What is meant by "accrual accounting"?

The term "accrual accounting" isn't found very often in the *text* books. It's mainly used in discussions of public sector accounting, where it's contrasted with "cash accounting". The customary way of accounting for the activities of government departments and many public sector agencies has been to record cash receipts and payments. A variant of *that* has been to also record "commitments" in the form of outstanding orders and payables. Both have been loosely described as "cash accounting". The basic financial reports are *statements* of receipts and payments, supplemented by *statements* of "fund" or "financial asset balances".

In contrast, the term "accrual accounting" is used to describe a form of accounting close *to that* used by commercial enterprises in the private sector. This involves the production of income *statements* which record "revenues and expenses" rather than "receipts and payments" - the difference being that accrual techniques supposedly record the amount of unpaid bills and receivables at the end of the year, and treating some receipts or payments as attributable to several accounting periods. Accrual accounting also generates balance sheets, which set out the things regarded as "assets" and "liabilities" of the enterprise.

A simple way of describing the difference between cash accounting and accrual accounting is to use an analogy: for an individual, cash accounting would simply summarise cash transactions during a period. Accrual accounting would also take in the unpaid bills: hence total expenses for the year would include *the* Christmas shopping which was charged up to Bankcard (and still hasn't been paid).

That's an oversimplification and I'll try to make it sound more complicated later on. Meantime, it would be easy to go on to say *that* without the use of accrual accounting, governments, public sector managers and the community at large can be fooled about the level of government expenditure; *that* without accrual accounting,

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there can't be adequate accountability to parliament or the public - and so forth. Advocates of change might find those kinds of arguments every effective. But to my mind; there are risks associated with oversimplifying arguments. The arguments might be believed - and that could lead to-disappointment.

What version of "accrual accounting"?

There are many ways of preparing balance sheets or calculating income and expenditure'. Without agreement about underlying accounting concepts; and without a set of well-drafted rules governing accounting practice% the wider adoption of accrual accounting in the public sector could extend opportunities for permissive financial reporting - so *that* financial reports may be unreliable% and not comparable between reporting entities; or from year to year.

Most will have encountered references to "creative accounting" in the corporate sector: during the bull market some companies were even advertising for "entrepreneurial accountants"; apparently because they reasoned it was harder to conduct a successful business than to choose the right accountant.

It's just as easy to fiddle the books in the public sector. Remember that some form of "accrual accounting" is already used to record the affairs of many *statutory* authorities. Public-sector accounting managers seem *to* be just as professional as their private sector colleagues when it comes to displaying inventiveness or creativity. (For example; in NSW we've got something called "modified accrual accounting").

In other words, "accrual accounting" can produce widely different financial results; depending upon how the accountant chooses (or is directed) to interpret a given set of facts.

So when there's a call for the adoption of "accrual accounting" in the public sector; interested observers might well wonder what form of accrual accounting is being advocated. The adoption of

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different concepts of "asset." or "liability" will lead to different balance sheet figures and different income statement numbers. Is it intended that key accounting concepts be defined for public sector purposes? Will there be a tight set of rules governing the application of accrual accounting - or will those rules be worked out later? If there are to be rules; who will make them? Parliament or central agencies? Will individual ministers be permitted to decide how their departments keep score? Or will the reports be knocked together by public servants as they see fit - with due reliance on their "professionalism"?

It's nice to be told *that* accrual accounting will show the "true cost" of certain activities - *but* the fact is *that* without clarification of fundamental accounting concepts (such as "asset" and "liability"; "revenue" and "expense") or% alternatively% without a comprehensive set of accounting rules relevant to the circumstances of the public sector; it's unlikely *that* many of the figures will be adjusted to suit *the* circumstances.

Many statutory authorities are already using "accrual accounting". Yet they are choosing different accounting techniques; which have a major effect on their financial reports.

Let me illustrate by referring to two fairly contentious issues: the accounting treatment of superannuation commitments% and of borrowings in foreign currencies.

Superannuation: for the last few years NSW statutory authorities have been disclosing the amount of the unfunded liability for superannuation commitments. But some authorities have been formally treating it as a liability on their balance sheet.. Many authorities have only been showing the amount of the liability as a parenthetical note. While most have been recording the expense accruing for each additional year's service from their employees; the varying treatment for the accumulated "liability" has effected the level of

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expenses recorded by the authorities for the year - and also affected the reported surplus or deficiency of those authorities.

Yet the NSW approach to accounting for superannuation is more informative than that undertaken by the Commonwealth or other States. At least relevant information is reported in footnotes.

- * Foreign currency translation unfavourable movements on foreign exchange rates affect the Australian dollar equivalents of the liabilities incurred by authorities which have borrowed overseas (either directly, or through central agencies). But the accounting treatment of those liabilities varies: some show recent "losses" as expenses in the year; others (like the Electricity Commission of NSW) allocate them over the remaining period of the loans; others (like the NSW State Rail Authority) have resolved to value the loans at the conversion rate applicable when the money was borrowed, and will only record exchange rate gains or losses when the loans are repaid.

There are other topics in which the application of accrual accounting techniques can put major borrowings "off balance sheet"; sale-and-leaseback transactions, debt defeasance, and "take or pay" contracts. Some of these techniques have already been used in the public sector.

It's obvious that a wide range of accounting techniques is available to record the transactions of a simple organisation. But the opportunities for permissiveness in the application of accrual accounting are multiplied when the public sector embraces complex organisational structures. Indeed, the Victorian Auditor General has recently expressed some concern about the manner in which statutory authorities have been forming subsidiary companies or trusts. The application of consolidation accounting (which combines the financial statements of parent and subsidiary

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organisations) may flush out information about the affairs of those entities. But the major point to be made is that the term "accrual accounting" connotes a wide range of techniques; a decision to introduce "accrual accounting" to some or all public-sector bodies doesn't in itself ensure disciplined, reliable financial reporting - or guarantee that individuals can be placed in a position where they can be held accountable for the performance of public sector organisations. If accountability is interpreted to mean a relationship whereby someone is "answerable" to others, the key is to ensure that those others are able to ask intelligent questions.

Establishing the rules of the game

Technical discussions about the adoption of "accrual accounting" are fairly empty unless there is some reference to the underlying concepts and rules which are to guide the practice of accrual accounting.

In the private sector; recognition of the permissiveness of accrual accounting led the accounting professional bodies to produce recommendations which are currently labelled "accounting standards". These "standards" are still far from comprehensive and are drafted in such a fashion that they can be interpreted fairly liberally.

Recently the two major professional accounting bodies in Australia decided to produce "public sector accounting standards". These are backed by the threat of sanctions on members who don't observe those standards when they are preparing or auditing financial statements. Seven standards have been specifically endorsed for general application in the public sector so far - while there is general endorsement of all of the profession's standards for commercial undertakings. Already it seems that they're not always followed by all public sector commercial undertakings. I don't know whether some of our leading public servants who are also members of the major professional bodies have lost much sleep over that. But I mention it to suggest that so-called public sector

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"standards" are hardly "rules": they're merely "guidelines"; and have persuasive authority only. The profession does not monitor compliance with its standards by public sector organisations.

In the Commonwealth arena the Joint Committee of Public Accounts has expressed the *view* it should be a responsibility of parliament to adopt accounting rules which are appropriate for the public sector (see Report 199; 1982). It viewed the adoption of private-sector accounting standards as only a "short term solution". Senior officers of the Commonwealth Audit Office have expressed similar views (though recently the Commonwealth Auditor-General seems to have reversed this position; indicating that the Audit Office now agrees with the application of the profession's standards; at least "in principle"). The Department of Finance issued "guidelines" concerning financial reporting by Commonwealth undertakings (1982; amended 1985); and these were drafted in the light of recommendations from parliamentary committees.

To my mind some attention needs to be given to the processes to be used to develop *accounting* rules for wider application in the public sector. It would be desirable for common rules to be adopted by both the Commonwealth and the States - and that suggests the need for some joint *Commonwealth-State* activities.

The involvement of the Institute of Chartered Accountants and the Australian Society of Accountants in debates about accounting and financial reporting issues is certainly welcome as an indication *that* those bodies now accept some responsibility to contribute to debate about the financial reporting practices of government bodies. Perhaps many of those involved in the process have also developed an interest in the potential of the public sector as a source of fee income. Whatever the motivation; the recent involvement by the profession was long overdue.

Having said that; I'm critical of some features of the current attitude of the profession towards public sector financial reporting.

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The profession's Australian Accountancy Research Foundation resolved to try to develop common accounting standards for both the private and public sectors. While in the short run; this may lift the standard of reporting by those statutory authorities which already use accrual accounting; it seems likely to slow down the rule-development process. Indeed; it appears that efforts to produce common standards have already caused delays.

But more fundamental concerns relate to the scope of those standards, and about whether the idea of producing common guidelines is well-founded or misconceived.

First: the scope of the standards. Most of the profession's standards were developed with an eye towards the requirements of companies legislation and stock exchange listing requirements: they were to be read in conjunction with those other packages of regulations. Hence there aren't detailed or up-to-date standards on such fundamental issues as the amount of detail which should be disclosed in a balance sheet or income *statement*. The standards which touch on such matters (e.g. AAS 12 concerning funds statements and AAS 15 on disclosure of operating revenues) were produced after such reports were required by the stock exchanges.

In other words; translating private sector standards into the public sector would only be translating less than half of the overall package of regulations currently in force for companies. For accrual accounting to be effective in securing accountability% it can readily be argued that there is some way to go before the accounting profession develops adequate guidelines about the form and content of financial reports in the public sector.

While *text* book writers continue to assert that there are two fundamental accounting reports (the balance sheet and income *statement*) in reality readers of corporate financial statements have come to rely on other material (such as funds statements; and equity supplementary reports, as well as a myriad of notes). Currently companies have to provide considerable detail about those of their future commitments which aren't treated as

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"liabilities" on the balance sheet (e.g. commitments to construct capital works). There appears to be a community demand for similar information from the public sector: such commitments do affect the capacity of governments to allocate resources to new programmes. Unfortunately, the profession's accounting standards haven't addressed such issues; and seem unlikely to do so in the near or medium term future. There seems to be strong case for disclosure of such commitments by public sector organisations. Second: it's not clear that the case for producing common public and private sector accounting rules has ever been seriously examined by the profession. I'm not aware of any attempt to follow a similar programme overseas (indeed, the chairman of the International Accounting Standards Committee dealing with public sector standards has gone out of his way to say that there is no intention of trying to impose private sector standards on the public sector). It seems there are some major differences between the environments within which public-sector and private sector organisations operate - which to my mind warrant the choice of some different accounting concepts and rules in the public sector.

To illustrate:

In the private sector, virtually all real estate is treated as an asset; that's because it's subject to some legal claims, and is expected to produce some benefit either in use or on sale. But should we adopt the same approach for our national parks, schools, court houses, airports, roads and railroad track? To my mind, these properties perform a different function in an organisation which exists to provide services using those resources: in principle, the organisation can't adapt by selling those items of property. (In practice, departments or statutory authorities may be able to dispose of some items without disrupting their activities and even enhance their activities ~~with~~ *substitutes*).

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It follows different kinds of information about "properties" might be relevant when evaluating the performance of those organisations may differ between private and public sectors. There mightn't be any point in treating those things as balance sheet items for the purpose of routine annual reporting.

- * In the private sector, the fear of disclosing secrets to competitors and consequential demands for "business privacy" have led Australian accounting regulations to require far less information about the sources of a company's revenues and expenses than was required by the Securities and Exchange Commission in the USA back in the 1930's. It may seem inappropriate that such approaches to disclosure should be regarded as a model for the public sector.

Accrual versus cash accounting? Or both?

As already noted, discussions about accrual accounting usually contrast those techniques with cash accounting. It's argued that accrual accounting should replace cash accounting - yet in the private sector many have come around to the view that reports based on accrual accounting need to be supplemented by cash flow data.

The USA's Financial Accounting Standards Board recently introduced requirements for cash flow statements; I gather that the New Zealand accounting profession has followed suit; and there's some demand for similar requirements in Australia.

In the private sector, the disclosure of cash flow data is said to enable readers to assess the "quality" of earnings figures' information about cash flows is an antidote to creative accounting.

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In any event, governments will always have to distribute money to departments and statutory authorities (few are self-sustaining) so

there will always be a need to maintain some record of those budgetary allocations. Hence there are good grounds for reporting on both a "cash" and an "accrual" basis. Moreover, as noted before, there are also strong arguments for reporting those commitments which may not be treated as "liabilities" on the balance sheet.

Reporting on programs?

Mention has been made of the fact that the adoption of "accrual accounting", even if undertaken on the basis of agreed accounting concepts and rules, may not in itself ensure that financial reports communicate relevant information to interested parties. Accrual accounting must be linked with detailed rules governing the detail to be provided in published reports if financial reports are to be meaningful.

There are different ways to report on the performance and financial position of an organisation. In the private sector it's now accepted that companies report on a variety of bases: they provide consolidated information covering a holding company and subsidiaries, and also provide reports on the results of different activities.

Recently there's been some advocacy of the managerial technique of "program budgeting" and forms of financial reporting which disclose expenditure on those programs, calculated using "accrual accounting".

That's an interesting proposal. I have had some brief experience as a member of a government body whose major items of expenditure seemed to be travel and accommodation, a well-stocked fridge, and some very good lunches. Naturally, I was filled with admiration for the accountant who managed to attribute those outlays to such

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activities as "public consultation". Nevertheless I nurture the suspicion that interested readers may have got a better idea of our activities from the line-items.

Apart from the subjectivity in- describing programs,, another difficulty with the implementation of program reporting concerns the allocation of costs between programmes (a necessarily arbitrary process), and the establishment of transfer prices between governmental organisations (which unless based on the price of arms-length transactions in the marketplace% would also be arbitrary).

But a more significant difficulty with program or activity reporting ~~that~~ such disclosures are confined to a given department or authority - whereas "programs" may cut across departmental boundaries. A good illustration of this may be gleaned from the recent Joint Committee on Public Accounts Report 272, "Administration of the Commonwealth's property functions". The report noted major increases in outlays for the rental office of accommodation (from \$78.4 million in 1981-2 to an estimated 1987 figure of \$300 million) and attributed much of this to demand for high-priced shop-front offices for the Departments of Social Security and Community Services, an Employment and Industrial Relations.

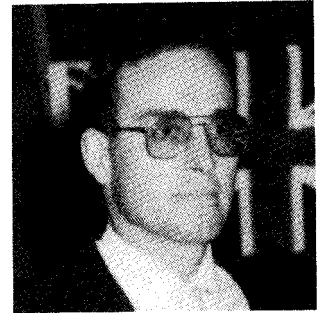
No doubt those outlays were recorded as part of the costs of the then Department of Local Government and Administrative Services -not as part of expenditure on social security programs. It might be politically effective to "bury" expenditure in that way but many would argue ~~that~~ the resultant reports are not conducive to full accountability. In other words, reporting on "programs" will not in itself ensure that the modes of financial reporting adopted in the public sector will ever satisfy every interested party.

In short-, neither accrual accounting nor reporting on the basis of identified "programs" necessarily produce figures which can be regarded as the "true costs" of activities.

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Final comments

The overall thrust of my remarks is that in principle , the adoption of some form of accrual accounting seems necessary to ensure *that* the interested parties are better informed about the activities of public sector departments or authorities. But the adoption of these accounting techniques will not be sufficient to ensure *that* financial reporting conveys relevant information, *that* governments or public service managers are made aware of the financial consequences of the decisions, or *that* those same parties may be held accountable to parliament or the community at large.



ACCRUAL ACCOUNTING SEMINAR

"ACCRUAL ACCOUNTING - TO BE OR NOT TO BE?"

BY

MR PERCY ALLAN, B.Ec., M.Ec. SECRETARY, NEW SOUTH WALES TREASURY

Paper presented at New South Wales Public Accounts Committee's Accrual Accounting Seminar

Parliament House, Sydney

5th February, 1988.

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firmly entrenched in the State public sector. If accrual accounting was added to the menu in the immediate future I have strong doubts that it could be effectively digested. Indeed we would risk accounting constipation.

The Use that would be made of the Information Provided

There is no doubt that accrual accounting would provide much information which would be very useful in the decision making process. What really needs to be determined is what information is required and how we can best achieve that information.

The Timing Problem

Under existing legislation the Departmental Accounts and the Public Accounts are required to be presented to the Auditor-General within six weeks of the end of the financial year. As you know the Public Accounts are in many respects a consolidation of Departmental Accounts. I can assure you that the consolidation is a major task. It will be very important to determine whether accounting information on an accrual basis can be prepared by Departments and consolidated by Treasury within *that* six week period.

I would remind you that unlike other States of the Commonwealth; New South Wales operates for accounting purposes in a totally decentralised fashion, with many payments being made by regional or local offices of Departments.

Interpretation by Journalists

The New South Wales Treasury has a good media profile; so I do not want to be critical of the Press. But there have been instances where incorrect *interpretation* of the States' Accounts by Journalists have led to considerable confusion and considerable work in explaining misunderstandings.

PERCY ALLAN; SECRETARY; NEW SOUTH WALES TREASURY

ACCRUAL ACCOUNTING to BE OR NOT TO BE?

I hope you will forgive the Shakespearean allusion in the title of my paper; but the 'adoption of accrual accounting in Government Departments is certainly not a clear cut issue. It is an issue which Treasury is taking very seriously and one to which we will be devoting considerable *attention* in the ensuing months.

The Treasurer has approved of the appointment of a Treasury Task Force consisting initially of the Deputy Secretary and the Chief Accountant to report to him on the implications if full accrual accounting were to be introduced for Government Departments. As part of their study the Task Force has received the Premier's approval to visit the United States in February to examine the application of accrual accounting in a number of American States.

The Treasurer and the Treasury recognise what a complex issue this is and *that it* is not something *that* can be introduced over night. At the same time we recognise *that* there is a persuasive case for extending accrual accounting to all forms of government operations whether commercial or social. For instance I think we would all agree *that it* is vital to be aware of the extent of and timing of commitments for asset replacement and for salary related payments such as superannuation and long service leave. I should of course mention NSW% unlike most other States and the Commonwealth; does fund part of the accrued liabilities in respect of *superannuation*. We do not have a purely pay as you go scheme.

While recognising pluses; there are several difficulties associated with introducing accrual accounting. This morning I would like to talk for a little while about some of the policy issues which need to be considered.

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Perhaps I should start by referring you to Murphy's first and second laws. Murphy's first law says "nothing is as easy as it looks" while the second is "everything takes longer than you think".

For some time there has been a growing body of opinion favouring the introduction of accrual accounting for Government Departments. Our own Auditor-General has stated his support for the concept and is pressing for it to be introduced at least initially in Colleges of Advanced Education. I would like to say at the outset that this Government has been in the forefront of the introduction of financial and administrative reforms. I am sure that this audience hardly needs to be reminded of such initiatives as:-

- Publication of a Monthly Financial Statement
- Revamped Budget Papers and Public Accounts
- Annual Reports Legislation
- New Public Finance and Audit Act
- Review of Special Deposits Account
- Capital Works Ministerial Committee
- Introduction of Program Budgeting*
- Improved Financial Monitoring
- Early advice on budget allocation
- Financial performance targets and dividends
- Restructuring of *Statutory* Bodies
- Major computerisation program
- Management improvement plans
- Development of management skills in the public sector
- Formation of the Treasury Corporation
- Rationalisation of borrowing and investment powers
- Guidelines for internal audit and an internal Audit
- Bureau
- Program Evaluation
- Management Strategy Reviews
- Efficiency Audits

And last but certainly not least the widening of the powers of the Public Accounts Committee.

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In most of these reforms the Government has been the initiator although it has certainly always been keen to accept advice from the Public Accounts Committee, the Auditor-General and professional bodies.

However, I have the feeling *that* some of the proponents of full accrual accounting may not have thought through all of the issues fully. In the interests of accountability I am sure *that* the supporters of the concept are interested in the broad issues such as knowing the extent of the Government's liabilities and commitments and whether assets are being appropriately managed. I certainly have no argument with these motives but as with any proposal Treasury must closely examine the cost benefit ratio and alternative ways of reaching the desired end.

It is against this background that Treasury will need to examine a range of issues. These will include:

The Size of the Administrative Task

Adoption of accrual accounting would present a formidable administrative task and certainly could not be done without substantial cost. Accounting skills, particularly when they need to be merged with an understanding of computerised accounting systems, are a scarce resource. According to a report in the Australian Financial Review of 6 January 1988 the demand for accountants has grown by about 7% a year in the past decade while the number of accounting graduates has grown at below 5% a year. This scarcity has been particularly felt in the public sector which can not compete on salary terms with the private sector.

As you know when program budgeting was introduced, Departments had to introduce a system of program accounting. Anyone who has read the recent Auditor-General's Report for 1986/87 will have noted that a number of Departments still have not been able to fully cope with program accounting. It will be another 5 to 10 years before the existing financial and administrative reforms are

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firmly entrenched in the State public sector. If accrual accounting was added to the menu in the immediate future I have strong doubts that it could be effectively digested. Indeed we would risk accounting constipation.

The Use that would be made of the Information Provided

There is no doubt that accrual accounting would provide much information which would be very useful in the decision making process. What really needs to be determined is what information is required and how we can best achieve that information.

The Timing Problem

Under existing legislation the Departmental Accounts and the Public Accounts are required to be presented to the Auditor-General within six weeks of the end of the financial year. As you know the Public Accounts are in many respects a consolidation of Departmental Accounts. I can assure you that the consolidation is a major task. It will be very important to determine whether accounting information on an accrual basis can be prepared by Departments and consolidated by Treasury within that six week period.

I would remind you that unlike other States of the Commonwealth; New South Wales operates for accounting purposes in a totally decentralised fashion; with many payments being made by regional or local offices of Departments.

Interpretation by Journalists

The New South Wales Treasury has a good media profile; so I do not want to be critical of the Press. But there have been instances where incorrect interpretation of the States' Accounts by journalists have led to considerable confusion and considerable work in explaining misunderstandings.

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Accrual accounting would appear to give wider opportunity for misunderstanding particularly at Departmental level. It must be remembered that many Departments do not have an income and that therefore their performance cannot be measured on an income and expenditure basis. Accrual accounting might give the semblance of private accounting; but will not provide direct comparability with the private sector.

Confusion Between Funding and Accounting Results

Quite obviously there would be a substantial difference between Budget results prepared on a cash basis and results prepared on an accrual basis. If accrual accounting were to be adopted for New South Wales I would see the need for a major effort to educate users such as Parliamentarians and Journalists and the Public generally. Unless this were done there would be considerable opportunity for misunderstandings. There are relatively few people in the community who understand accounting anyway and while the community may accept profits or losses by a private company a substantial deficit by a Government can be quite another matter.

Economic Impact of the Ultimate Need to have Cash Backing for Accrued Liabilities

One of the major areas of criticism by those who favour accrual accounting is the failure of Governments to fund future liabilities such as superannuation long service leave and maintenance. Most Governments operate on a pay-as-you-go system which of course is quite different from the practice followed in the private sector. But there is more than a subtle difference between the private and public sectors.

A company; particularly in these days of mergers and takeovers may possibly go out of business at any time and at short notice. Hence it is important for them to set aside funds for accruing liabilities such as superannuation and long service leave; to protect employees from company insolvency. Governments; for

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better or for worse, are here to stay with us for the foreseeable future. Long term commitments to employees and others are not at risk since Governments can avoid insolvency by raising taxes. If a Government were compelled to provide full or even partial cash backing for its future liabilities then there is a serious impact on its capacity to carry out its current programs.

Possible Criticism of a Government Having Substantial Funds Set Aside to Finance Future Liabilities

As I have indicated earlier there is an ultimate need to provide cash backing for accrued liabilities. At present the Government has for good and valid reasons relatively small amounts of cash set aside in the Special Deposits Account. Even these arouse suspicion and criticism not only from the opposition, but the Federal Government and the Financial Press. If the Government maintained really large cash balances to meet its accrued liabilities in respect of such things as superannuation and long service leave, I can only too well imagine the howls of protest that would ensue.

The Meaning and Use of the Term Deficit

The term deficit has vastly different accounting and economic meanings. It would take a considerable campaign to remove the confusion from the mind of the users of the States' financial documents.

The Temptation to Spend Cash Reserves

If cash reserves were created to meet accrued liabilities such as for example, long service leave and superannuation in full, there seems little doubt that some future Government would be sorely tempted to spend the reserves during some time of economic strain. It would be essential to design some mechanism to prevent this from happening.

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Non Comparability with Other States

It is difficult to see the extent to which a single State could proceed on its own with accrual accounting. Such a course of action would make it non comparable with other States and could results in spending and/or taxes being shown at higher levels than other States.

The introduction of accrual accounting would not mean the abandonment in total of the present cash system. Information on cash flows might still need to be presented with Budget Documents. What this means in practical terms is that we would need to develop information systems to collect and process the required data for accrual accounting and such systems would need to have the capacity to link back to cash flow management.

I have some degree of concern about the ability of public administration to match the pace of change in policy. As I indicated at the beginning of this paper the Government has introduced a large number of financial and administrative reforms over a relatively short time frame. Scarcity of skilled resources has prevented full implementation in all Departments. The

introduction of a substantial requirement in processing financial information in the short *term* may not be able to be met. An illustration of the type of major difficulty which would be faced is the lack of asset accounting within Departments from which depreciation could be calculated.

It is also important *that* we complete the implementation of the existing agenda of reforms - program budgeting, program performance evaluation, corporate strategic planning, performance agreements between Chief Executives and Ministers, etc. - before evaluating on accrual accounting which would tie up our financial personnel and management for many years to come.

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These are the difficulties that I see facing the introduction of accrual accounting. I have not intended as I indicated earlier to sound negative but it is certainly important that we all recognise that its introduction would be a highly complex long term task which would consume considerable resources. We must be sure that the changes we make to our present system are not made for the sake of change alone; but are made in the interest of efficient cost-effective Government.

Also I believe that before accrual accounting is adopted other more obvious and pressing reforms are warranted. For the past half year Treasury has been working on three proposals with significant implications for managerial enterprise; autonomy and accountability in the New South Wales Public Sector.

The first concerns taking all centralised Government services utilised by Government Departments (such as cleaning; courier% computer and building maintenance services) off budget appropriations, and putting them on a commercial basis so *that* they fully recover costs from user charges. This follows our earlier initiative of charging all private and public utility services (such as telephone% electricity; advertising and publicity) directly to Government Departments; rather than have them funded centrally. This approach encourages Departments to economise the use of such services because they are no longer free of charge.

The second reform which has been endorsed by the Treasurer permits Departments to separate their commercial activities from their social programs; with commercial services to be fully funded from user charges. Revenue from such activity would no longer be paid into the consolidated fund% but into a working account operated by the Department. As with centralised Government services% Departmental commercial services would be taken off budget.

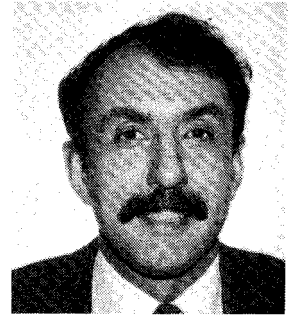
The final reform which still has to be considered by the Government concerns classifying *Government* owned entities into distinct categories for purposes of applying Government financial;

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staffing; program; pricing and other controls in a more rational manner. One possibility to grade a Government organisation according to its degree of financial self sufficiency on the one hand and its market competitiveness on the other. On these criteria; the GIO and State Bank which make profits and face stiff competition would qualify as true "business enterprises"; deserving maximum managerial autonomy.

By contrast "Government Departments" completely subsidised from the Consolidated Fund and enjoying monopoly status warrant the least freedom from Government scrutiny and direction. In between the extremes of "business enterprises" and "conventional departments" exist "commercial services" (such as the Water Board and Elcom which are monopolies; but financially self sufficient) and "community services" (such as the passenger services of the SRA and UTA; which compete to some extent with alternative transport modes% but are heavily reliant on Budget subsidies).

I am quite excited about the opportunity for improving Government efficiency and effectiveness through introducing this triumvirate of reforms and must confess that 'for the moment these have a higher administrative priority than accrual accounting.



ACCRUAL ACCOUNTING SEMINAR

ADDRESS BY MR DAVID A. SHAND

FIRST ASSISTANT SECRETARY, DEPARTMENT OF FINANCE
CANBERRA

Paper presented at New South Wales Public Accounts Committee's Accrual Accounting Seminar
Parliament House, Sydney
5th February, 1988.

Accrual Accounting Seminar

MR DAVID A SHAND

FIRST ASSISTANT SECRETARY DEPARTMENT OF FINANCE; CANBERRA AND

CHAIRMAN; PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

NOTES FOR ADDRESS TO SEMINAR ON ACCRUAL ACCOUNTING

1. The issue of accrual accounting in the public sector is not one to which the Public Sector Accounting Standards Board has so far devoted much explicit attention. However it is fair to say that the importance of accrual accounting is implicit in much of the Board's/work; Statement of Accounting Concepts No 1 on Objectives of Financial Reporting by Public Sector Entities clearly implies the use of accrual accounting in its view that public sector entities should disclose information relevant to the assessment of financial status; performance and compliance. A forthcoming discussion paper on departmental financial reporting will address the issue more specifically in terms of departments. The issue; in conjunction with the Accounting Standards Board; of draft concept statements on assets; liabilities; revenues; expenses and owners equity will improve the consistency and relevance of information reported under accrual accounting systems. A project on the central accounts of governments will be commenced in 1988 and will specifically address the issue of accrual accounting as applied to such financial statements.
2. In this paper I indicate that I am a supporter of a more widespread application of accrual accounting in the public sector. However I have some concern that the benefits of accrual accounting are being exaggerated; and the problems of introducing it; understated.
3. Accrual accounting is widespread in the Commonwealth public sector and will be extended. All Commonwealth statutory authorities; under Guidelines issued by the Minister for Finance in 1983 are required to prepare their financial

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statements on an accrual basis. Government business enterprises such as Telecom; Australia Post; Australian Airlines etc% have long prepared accrual based ~~statements~~ statements which reflect accounting standards also applicable to the private sector; generally with a higher level of disclosure than private sector business undertakings. Non-trading organisations such as CSIRO; the ABC and the Australian National University now prepare their financial ~~statements~~ statements on full accrual basis whereas before the issue of the Guidelines they reported only a cash basis. This transition has not been without some pain or argument% in particular the argument ~~that~~ that enforcing accrual accounting on organisations which are not funded for non-cash outlays will result in their showing financial deficits; But this and other arguments reflect a confusion about the purpose of financial statements. For example; in the case of the ABC their previous cash based financial statements indicated what they had done with the cash appropriated to them by Parliament. For this reason one might argue ~~that~~ ~~it~~ is most important ~~that~~ they have a cash based statement to reflect how the actual cash has been spent% whether it was spent or whether it went into reserves etc. That is; of course; a question of financing and of accountability ~~to~~ ~~Parliament~~ for funds received. On the other hand% the ABC's previous cash based ~~statements~~ statements did not indicate costs of operations (including depreciation)% let alone its financial position (bearing in mind its significant amount of long-term assets). Thus accrual accounting is necessary to report on performance and financial position and is thus necessary for economic decision making. Both cash based and accrual information are required; but for different purposes; one to tell us something about ~~accountability~~ ~~to~~ ~~Parliament~~ for funds received; and the other to tell us something about performance and financial position% and perhaps cost recovery for economic decision making. This move to accrual accounting was designed to enhance the external ~~accountability~~ ~~of~~ these organisations. Obviously the internal management dimension is also important; organisations should

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budget and monitor on an accrual basis (as well as on a cash basis). They should budget for performance, not just for spending.

4. The Department of Finance will shortly be issuing draft Guidelines for the form of financial statements of Commonwealth departments to replace the present detailed information contained in the financial statements prepared by the Minister for Finance under Section 50 of the Audit Act. They will be required to be included in departmental annual reports and in due course audited. There will be a requirement for certain information on assets and liabilities to be disclosed as supplementary information as is required under Victoria's Annual Reporting Regulations and NSW's Public Finance and Audit (Departments) Regulations, but no requirement at this stage for full accrual accounting. We expect there will be some interim difficulties particularly in terms of asset identification and valuation. Independently of this our moves to introduce interdepartmental charging mean that with departments paying for previously free services such as accommodation, their cash based appropriation figures will come much closer to measuring full costs. There is even the possibility of a notional charge for superannuation costs and for certain assets held by the organisation; the latter being recommended by the Joint Committee of Public Accounts. I am not, incidentally a fan of cost attribution as an alternative to charging. Proper charging against an appropriation must take place so that the entity is accountable for its costs, and in terms of management flexibility can trade off that outlay against other alternative outlays.
5. However, it should not be forgotten *that* cash accounting is *very important* in the private sector.. Although private sector budgets may be prepared on an accrual basis, i.e. a budgeted level of profit represented by revenues minus expenses, the forecasting and monitoring of cash flows is a most important aspect of private sector management, even if it does not feature in the financial *statements*. (There have however been

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some suggestions of moves towards a cash flow statement for the private sector by the National Companies and Securities Commission, possibly to replace the frequently misunderstood *Statement of Sources and Applications of Funds*.)

6. The problems with having only cash accounting systems make a clear case for accrual accounting for government entities and can be listed as follows:
 - a. The costs of operating the program are not clear. Thus performance cannot be fully measured.
 - b. There is no indication of the longer term emerging liabilities or commitments of carrying out certain activities. If we are not aware of the rate at which future liabilities are building up we may face financial difficulties in the future. Information requirements in respect of emerging long term commitments or liabilities would include:
 - servicing the public debt, both interest and loan redemption;
 - superannuation commitments;
 - leasing commitments; and
 - long-term asset maintenance or replacement.

However avoiding budgetary lock-in is arguably a management reporting issue rather than an external financial reporting issue as I discuss later. In addition accrual accounting does not fully address the budget lock-in in that not all commitments, including asset management and replacement listed above are regarded as liabilities under accrual accounting.

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- c. Internal control over physical assets is weakened. We may forget that the assets exist and/or fail to provide for their replacement. Although Government departments are required to maintain asset registers% because these do not form part of the,financial reporting system they are not subject to the very rigorous examination. However the priority should be reporting assets in the financial statements of the reporting entities which administer or control them (reinforcing the responsibility of the entity's management for sound asset management); rather than in a consolidated financial statements for Government as a whole. Again we need to be realistic about what accrual accounting can do; it alerts us to the cost of using assets and may provide a guide as to when certain assets may need replacing. It cannot of itself provide for asset replacement; only a charging system based on full costs can assist in that.

 - d. We may pay inadequate attention to collecting debts or discharging our liabilities; because they are not systematically reported. However; this issue may also be handled by requiring departments to report supplementary information on average age of outstanding debtors or creditors in their financial statements; rather than the adoption of full accrual accounting.

 - e. We may either under or over recover the costs of some services which we charge for. This is an important equity question. "User pay" implies covering costs; no more and no less.
7. However much Government reporting has traditionally been on a cash basis. The central accounts of government or the budget sector; such as the statements prepared by the Minister for Finance in the Commonwealth and the Treasurer's Statements in the case of the States are maintained on a cash basis. They focus on receipts and outlays with the balance being the

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surplus or deficit which is in effect a net cash borrowing requirement. No complete statement of assets and liabilities of budget sector organisations is presented; although there is usually a statement of cash balances and other monetary assets and some information on long-term debts or borrowing. In a number of the States the statements are presented in a rather deceptive way; with the reported deficit or surplus figure not being particularly meaningful% e.g. borrowing may be introduced as a current receipt. While the Commonwealth's central statements are not deceptively presented they are too detailed and are not easy to follow. Notwithstanding that it is widely misunderstood (most Australian companies would report a cash deficit using the same basis of calculation) the Commonwealth's deficit (which is its net borrowing requirement) is an important measure of its fiscal performance and an important variable in the operation of financial markets. One important feature of the Commonwealth scene; in contrast to the North American scene; is that we have meaningful consolidated (and audited) cash flow statements for the whole of the budget sector.

8. The cash basis of reporting reflects the fact that the Budget is prepared on a cash basis. It is a financing% rather than a performance document; setting out what cash the government requires to compulsorily raise from the community by taxes the government charges to finance its outlays. Thus% I find the recent statement from the Australian Society of Accountants calling for the Commonwealth Budget to be presented on an accrual basis as in the private sector somewhat peculiar. In the Australian of 18 September commenting on the Commonwealth's 1987 Budget the acting President of the Society stated that:

"... it was impossible to determine the true state of national finances or debt because the value of government assets was not known and future obligations were not recorded.

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The Government should adopt accrual accounting methods - compulsory in corporate sector - in future Budgets."

Apart from what I as a public servant regard as an unacceptable private sector cringe in this Statement, it overlooks the purposes of the Budget as a financing document could not be achieved using an accrual approach. While I agree that we need better information on government assets and liabilities on costs and major long-term emerging commitments, and to avoid the problem of budget lock in I have some reservations about the utility and thus priority of consolidated *accrua* statements. What is the informational value of a statement which combines the New Parliament House (valued at \$1.1 billion?) and the Air Force's new F-18 fighters? As I shall indicate later we need *different statements* to disclose the sort of information sought by the Society i.e. we need to recognise the need for *different statements* for different purposes. The issue of cost control, liability containment and asset management are more appropriately considered in the context of the financial statements of individual government entities, reinforcing the financial management responsibilities of the heads of these entities.

9. The ASA Statement thus indicates confusion about the purpose of the annual budget. To quote Sir Charles Court, speaking at the 1987 National Government Accounting Convention "... we must continually remind ourselves *that* cash accounting in government follows from cash appropriation and the fundamental issue of control of the public purse by Parliament. But, this is no reason why accrual accounting principles cannot be used more widely in government, as long as we never overlook the importance of Parliament, its cash appropriations and its ultimate control of the purse"

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10. One is stuck by comments that accrual accounting applied to the financial statements of the United States Government results in a larger deficit than under cash accounting, with the implication that the use of cash accounting is understating the "true" deficit. But clearly these two figures are measuring different things; one cannot usefully compare apples with oranges. A deficit on an accrual basis would reflect the fact that the government had not used its compulsory revenue raising powers sufficiently to cover all costs, i.e. it would indicate the extent to which future unfunded liabilities are emerging, (an inter-generational equity issue as well as a financial one). Under cash accounting the deficit measures something completely different viz., the net borrowing requirements to fund current cash outlays. To avoid a deficit under accrual accounting all liabilities would need to be fully funded and significant cash reserves accumulated before money was required to be paid out, a significant change on existing policies and not one which would be followed in the private sector. Thus the introduction of accrual accounting for such consolidated statements would need to be accompanied by either careful explanations as to what the deficit meant or a radical change in existing Government financial policies.

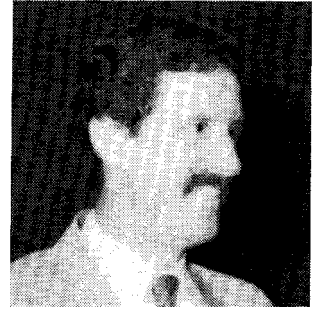
11. As indicated I have some difficulty with the view that consolidated accrual statements will assist in avoiding budgetary lock-in. Many of the commitments would not represent liabilities either under present or extended definitions of liabilities. e.g. future salaries of staff. Only forecast cash flow statements will reveal the full extent of *overcommitment*. What is essential is *that* Governments operate adequate systems of forward estimates to provide a multi-year perspective, and commitment controls. I believe in the Commonwealth we have a reasonably good handle on both these, although probably we need a system which looks beyond the three years of the forward estimates. I believe the issue of emerging commitments and budget lock-in may be best handled by the following reporting and managerial arrangements:

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- a. Public debt: a separate and upgraded paper on the public debt (as is now published in Victoria); with the future commitments for respect of budget sector debt incorporated into a forward estimates system for management purposes. In the Commonwealth we do have adequate consolidated figures for budget sector debt now.
 - b. Superannuation commitments: reporting of liabilities in the financial statement of each Government entity plus adequate reporting of long term liabilities in the financial statements of Public Sector Superannuation Schemes; plus of course incorporation of payments from the Budget into the forward estimates system.
 - c. Leasing commitments: reporting in the financial statement of the entity concerned,, with budget sector organisations incorporating this in their forward estimates.
 - d. Long-term asset maintenance or replacement: this requires a separate budget planning mechanism to survey needs over a period of years ahead.. Although accrual accounting for individual entities at least makes us aware of the cost of asset usage through the depreciation expense it is not sufficient of itself to provide the signals for asset *maintenance* or replacement.
12. In summary I see accrual accounting as fundamental for all government entities. I am less certain about its priority in respect of the central accounts of Government. While I come to praise accrual accounting rather than bury it; it is not a panacea for overcoming budgetary problems. Nor is lack of it a significant cause of such problems; at least in Australia. American analogies are not generally appropriate; the American federal, State and local governments generally lack the strong centralised budgeting and accounting systems that all

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Australian Governments operate. Most American governments lack a strong, executive budget organisation and have a highly fragmented budgetary process; with both the legislative and the Executive having real decision making power over the Budget. No wonder they seldom know where they are at! These are the major causes of their budgetary confusion; lack of accrual accounting may not help their situation but it neither does cause it.



ACCRUAL ACCOUNTING SEMINAR

ADDRESS BY MR IAN PLATER
PARTNER
ARTHUR ANDERSEN & CO.

Paper presented at New South Wales Public Accounts Committee's Accrual Accounting Seminar
Parliament House, Sydney
5th February, 1988.

Public Accounts Committee

MR IAN PLATER

PARTNER
ARTHUR ANDERSEN · CO~

UNITED STATES ~REFERENCE

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INTRODUCTION AND SUMMARY

The position of Arthur Andersen & Co. - U.S. experience in government accounting; engaged by N.S.W Treasury to support a study tour of U.S.; consultant to a number of N.S.W. Departments and Authorities.

Accrual accounting is an extension of cash basis accounting offering more comprehensive and business like financial management which helps to more satisfactorily meet the increasing demands for public accountability.

- * The U.S. is leading the way in the introduction of accrual accounting in government and for good reasons.

External pressures of deficits; credit ratings and decreases in standards of living are added stimuli to the introduction of a more disciplined system of financial responsibility.

- * Accrual accounting is not a panacea in itself; however it does provide a framework to address policy issues; the choices ultimately being political ones.

SOME CONCEPTUAL ISSUES - ACCRUAL VERSUS CASE BASIS ACCOUNTING

- * Cash basis accounting is a component of accrual accounting.

Cash basis accounting - cheque book stewardship.

- * Accrual accounting shows the full cost of programs when they are adopted (especially future liabilities).
- * The basis of accrual accounting is the Generally Accepted Accounting Principles (GAAP) of private (and statutory) enterprise.

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- GAAP provide an established yardstick for accountability.

WHO APPLIES ACCRUAL ACCOUNTING IN THE UNITED STATES?

- The stimulus was New York City's 1975 fiscal crisis.
- U.S. Federal legislation now encourages all state and local governments to apply GAAP to financial reporting.
- Today 28 States of America apply accrual accounting.

THE NEW YORK EXPERIENCE

New York City

In New York City's case, it had in 1975 accumulated approximately US\$6 billion of short term borrowing, represented in deficits rolled over from year to year -loose fiscal systems easily manipulated by public officials and developed.

* A Securities and Exchange Commission Report stated:

"The City employed budgetary, accounting and financing practices which enabled (it) to issue about 4 billion dollars in short-term securities at the very time the City was on the brink of financial collapse".

"The City dramatically increased its short-term debt six-fold - from 747 million dollars to 4.5 billion dollars - in the six years from 1969 to SO June 1975.

"Since 1970-71, every expense budget has been balanced with an array of gimmicks - revenue accruals, capitslisation of expenses, raiding

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reserves, appropriation of illusory fund balances, suspension of payments, carry-forward of deficits and questionable receivables, and finally, the creation of a public benefit corporation whose purpose is to borrow funds to bail out the expense budget.

"Reliable financial information was unavailable, and the adjusted deficit could only be estimated because, among other things, the City's internal accounting control system had been deficient in material respects.

"The estimates Of receivables were overstated by the accrual of revenues, including federal and New York State aid receivables and real estate and other local taxes which were unearned, uncollectable or non-existent".

- * Since that time New York City has conformed to GAAP, installed an automated integrated financial management information system (IFMIS), eliminated its deficit, balanced its budgets, generated year end surpluses and received numerous credit upgradings.

New York State

- * Taking New York State as a further example, they commenced in 1979 to apply GAAP with a major commitment to staff and the hiring of consultants - 2 years later with the introduction of a new central accounting system partial GAAP accounts were subjected to audit - in 1983 programs to cap the deficit and borrowing and roll back the deferrals over a number of years were introduced - amendments to the State Constitution and statutes were drafted - in 1988 New York City produced its first budget balance to GAAP.

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Some events of note were:

- payments to local governments; some two years late were brought current with a one-time payment of US\$163 million;
- US\$360 million of personal income tax refunds were rescheduled to be made on a more timely basis;
- a two year liability of unpaid State pension funding was brought current by amortising payments over 17 years;
- increased State aid to education is now appropriated on a current basis; with allocation of US\$65 million during 1987 (Spring borrowing to fund projects prior to the next budget has been dramatically reduced);
- US\$1 billion has been set aside to permanently reduce debt and deficits;
- borrowing; in terms of operating budget; and annual interest payment have halved;
- the State's credit ratings rose for the first time in history; and
- in short; spending and taxing decisions are now made in a more open and disciplined environment; where the level of financial liabilities shifted to future generations is automatically recorded and reported.

THE POSITION OF THE U.S. FEDERAL GOVERNMENT -

(the largest organisation on earth - a trillion dollar business)

In contrast the U.S. Federal Government does not produce GAAP financial statements - of its 427 accounting systems; 226 are in non-compliance.

In 1975 and 1984 Arthur Andersen & Co.; as a voluntary exercise; prepared consolidated financial statements for the U.S. Government - these exercises produced some interesting results:

- the 1984 cash based accounting accumulated deficit (the amount of Government bonds issued) of US\$1 trillion translated to \$3.8 trillion when recording the excess of all liabilities under GAAP over all the Government's assets at cost.
- the national debt (the amount to borrow to cover past shortfalls) of US\$1.6 trillion; under GAAP reduces to US\$1.3 trillion as amounts the Government owes to itself are included in trust funds in the national debt figure.
- the 1984 cash deficit of US\$185 billion under GAAP becomes US\$333 billion - the GAAP figure includes provision for social security obligations on a similar basis to accounting conventions that corporations must follow in accounting for retirement programs; pension expenses for military and civilian personnel; and a depreciation charge on long lived assets (buildings and computers) over their useful life.
- expenditure on defence (excluding pensions) increased only slightly from 1974 to 1984; however; the cost of military pensions rose sharply;

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accounting for half the increase in the inflation adjusted cost of defence - in a sense, payments for two armies, one in and one out of uniform.

- (it is worth noting that tax revenues on a GAAP basis are essentially equivalent to those on a cash basis) the GAAP basis deficit for 1984 exceeded total revenue from individual income taxes, the largest single source of government revenue - a 113% increase in individual taxes would be required to erase the deficit!

PRESSURES SUPPORTING THE INTRODUCTION OF GAAP

- * The American experiences as mentioned-' provide a direction for the future in western democracies.
- * Australia's position in the international financial market place requires greater attention be paid to its financial viability and attractiveness as seen through the operation of credit ratings and flow of funds for borrowing and investment from both overseas and domestically.
- * Difficulties in managing the economic deficit in a recession climate, where the electorate is requiring greater accountability of government because of decreases in living standards and the impact of perceived high (and indexed) tax rates.
- * The developing interest in GAAP and its application to Australian Government is demonstrated through actions to date including:
 - supplementary information to Victorian and South Australian State Department's annual reports are produced on an accrual/GAAP basis;

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- the work of the Public Sector Accounting Standards Board - there are at present 9 Statements of Accounting Standards applicable to the Public Sector;
- the application of GAAP by government statutory authorities; and
- , support of the wider application of GAAP by the N.S.W. Auditor-General.

POLICY IMPLICATIONS

- * GAAP provides a framework for improving and broadening decision making by providing information on the full, long range cost of public undertakings - the public or political choice being more informed - especially in the case of estimating future liabilities.
- * Some policy implications can be illustrated by referring to the "mock" consolidated financial statements of the .US government:
 - recent increases in the government debt owed to investors other than government agencies as a percentage of GNP increased from 25% in 1974 to 36% in 1984 and is still growing - this has created a serious situation in light of the other demands for capital by the private and state and local governments!
 - an increase in exposure to non-government investors through bond holdings by overseas investors from US\$57 billion in 1974 to US\$176 billion in 1984.
 - as mentioned previously the increase in the GAAP deficit places a very difficult burden on present and future taxpayers.

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- the retirement benefits for government employees and social security are a significant portion of the total cost of government - will this substantially restrict the future financial flexibility of the government?
- the same is true of medical programs - the government must balance the cost of healthcare with its desire to provide access to good medical care for all citizens.

ACCOUNTING ISSUES

The practical implications of introducing accrual accounting are continually being addressed in the U.S.

- * The US Governmental Accounting Standards Board (GASB) has recently produced its second edition of "Governmental Accounting and Financial Reporting Standards" (some 500 pages) - some chapters from the publication include: GAAP and legal compliance; the budget and budgetary accounting; the comprehensive annual report; pension activities and employer reporting; and, colleges and universities.
- * the development of the Standards is evolutionary - the GASB has recently issued an exposure draft "Measurement Focus and Basis of Accounting -Government Funds" and a discussion memorandum "Reporting for Capital Assets in Government Entities".

RECOMMENDATIONS

- * The introduction of accrual accounting, based on the U.S. experience, requires considered strategic planning and timetabling.

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A goal, of say 1993, should be set for the preparation of annual NSW government consolidated financial statements to be prepared on an accrual basis in accordance with GAAP - forecasts for the following four years would also be included

- * This information would be additional to the cash based budget and forecast prepared now..
- * Performance indicators for major programs would be included in the annual reports.
- * The financial reporting function would be centralised in a single agency that would be responsible for implementing accounting policies and reporting standards, providing advice about the design and installation of accounting systems, preparing the consolidated financial statements and publishing the comprehensive annual reports - other agencies would provide financial information to the central body as well as providing their individual annual reports.
- * The financial statement audits would continue' to be controlled by the State Auditor-General.
- * A phased approach to the introduction would allow early benefit recognition and allow for effective management of resource allocation - this approach would include:
 - diagnostic review and strategy formulation;
 - implementation of immediate improvements;
 - implementation of a training program;
 - systems design and installation;
 - development of reporting policy and procedures.

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- * Other implications would be:
 - following a proven methodology (from the U.S.) to assure quality results and minimise risks;
 - commitment to program goals by political leaders and managers;
 - the development of solutions tailored to individual entities;
 - the use of consultants to provide efficiencies and minimise risks;
 - planning at the design state to satisfy GAAP and audit requirements.

In Conclusion

- * The social and economic environments are demanding greater financial integrity from government, accrual accounting and GAAP provide a practical and achievable option to meet these goals. The accrual/GAAP framework is an answer to these calls for the greater accountability and economic welfare of this State - as such it cannot be ignored.

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QUESTION TIME

MR WALSH:

Ladies and gentlemen, I am Allan Walsh, the Member for Maitland, and a Member of the New South Wales Public Accounts Committee. I will be chairing the question time would like to thank

Professor Walker for his presentation of very incisive and at times, witty - here this morning. There is only one micro-second, in my mind, strayed from the presentation, and that was when the good professor was talking about dogs.

It reminded me, recently, of a dog and an accountant, when I had a constituent come up to me with a problem, a pensioner, complaining about the fact that my local council would not give him his dog-licence concession which was due. The accountant insisted on a vet's certificate proving that the dog was incapable of reproducing, and you can imagine the expletives my constituent let forth when he said, "Mr Walsh, my dog is 19 years old, and he can hardly lift his leg to go to the toilet, let alone to reproduce."

So I thought that was a - if you did not mind, professor, that was a slight stray there. For the relief of those present, you would be interested to know there are politicians from the capital city, Canberra, from Tasmania, Victoria, the Northern Territory and Queensland. If Ken and Bob - would you like to come up, at this stage, please?

PROFESSOR WALKER:

If I can lift my leg.

MR WALSH:

Ladies and gentlemen, we will have question time. If you could direct your questions through the chair to our two guest speakers. If you can make it to a side mike, please do so. If you cannot,

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raise your voice, and could you please identify your organisation and locality. Questions are to our two guest speakers. If we do not get some good questions, there will be no morning tea.

MR SMILES:

I wonder if I could start the ball rolling.

WALSH:

Phillip Smiles, you will know, the Liberal Member for Mosman.

MR SMILES:

Gentlemen, I would appreciate your comments from a logistic and graphical point of view. What are the political constraints that you see from your perspectives, with regard to the introduction of accrual accounting, as you would like to see it, to save confusion?

MR KEN ROBSON:

No. I am not an expert on politics, Bob. I try to stay away from politics as far as possible, thank you. But political constraints, Phillip, I think probably the most overriding constraint would be the fear of what is going to be shown as a deficit or a surplus result.

SMILES:

Yes.

MR KEN ROBSON:

Traditionally, I would think that politicians are very anxious to come out to what is termed this balanced budget. Now, I would think that if accrual accounting was adopted, within certain guidelines or rules that Bob suggests, that we are not going to

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come out with this - so much of a balanced budget. There will be a lot of below the line items, for transfers to reserves and that, so there will be shown either a surplus or a deficiency.

Now, if there is a surplus, the public themselves, or the taxpayers, say: Well, you are over taxing us. Drop the taxes. Or some effect like that, or if there is a deficiency, then they say it is bad management. So that is the political constraints that I can see, as far as the introduction of accrual accounting. Now, apart from that, I really do not think there is other constraints, apart from the need to train public servants as far - or the accounting profession in the public service to be able to cope with it, and to have the accounting systems that I said will -there will be need for training and to take it very slowly to ensure that the proper systems are there.

But like, as I say, there is the other side of the coin, there is all the benefits that I think can come from it, particularly in asset utilisation.

MR WATSON:

Sir, John Watson from the Commonwealth Public Accounts. What is the additional cost, in terms percentage increments of the accounting function to be able to implement accrual accounting? Have you examined this on a departmental basis?

KEN ROBSON

No, I have not, John. But what I am advocating here, and I said that I want a proper and thorough research done into it, and I am not saying: Yes, we have got to go headlong into accrual accounting. I want people to look at it and say: Yes, this is a better way of doing it. Then we can go through the cost-benefit analysis. I am afraid I have done no sums at all on the increment cost of it.

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Professor?

PROFESSOR WALKER:

You can alternatively restate the problem, and say: What is the cost of not doing it? To my mind talking about the cost of implementing accrual accounting are curious, because, frankly, the incremental costs of an information system which incorporates those kinds of year-end adjustments would be pretty marginal. If you have a situation where an organisation is already maintaining asset registers, which you expect it to be doing, to be maintaining appropriate controls over its resources.

If it is maintaining appropriate controls over the probity of its transactions, to my mind the adoption of accrual accounting in many settings would be very marginal.

MR KEN ROBSON:

Just on that, Bob, if I could add, as far as the statutory authorities in New South Wales are concerned, their asset recording is okay. It is tied in with the financial statements, except for those on this modified accrual system, which I am trying to get them to go away from. But when it comes to departmental accounting, there are asset registers, but they do not tie in with any financial controls.

So to get those up and running, I think there is going to be a need to develop systems, and there will be costs, but what I say is the off-spin, once you have got this asset base, data base, I think there are great benefits to be achieved from it.

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MR NEIL ROBSON:

Nell Robson, Tasmania.

MR KEN ROBSON:

Good day. I like your name, Nell.

MR NEIL ROBSON:

Years ago, I wanted to buy my wife a dishwasher, and it took me ages to get it in, mainly because she was the practitioner in the field, and our kiddies had left home, and there was not so much to do. The other day I was speaking to the under-treasurer, and I said to him, "I'm looking at accrual accounting." He said, "I hope they tell you all the disadvantages."

So therefore my question is to the two on the stage, have you seen experiences in the public service where they have modified and gone over to accrued accounting, and what was the programme that they employed. I guess that there must be many people who consider accrued accounting will put them in a worse spotlight, because it shows things in a clearer manner. Have you any experience in that area? Is there anybody here who has any experience in that area? I know you would have to go slow, but what were some of the programmes that you did?

PROFESSOR WALKER:

Well, I am, of course, an academic, and not terribly practical about these things, but just as an observer of financial reporting in New South Wales, when in 1982, 83 there was a review of superannuation commitments, and that flowed through to some form of improved, in my view, of financial reporting by statutory authorities, and it required some calculations being done by the government actuary for those authorities.

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Once the programmes were written, and the basic work was done, I understood it took about half an hour of computer time to run it through for some of the larger authorities. I do not think it - I am not sure about what costs needed to be spent there to upgrade that system. This was just to introduce quite a major change in one of the most technical and difficult areas of accrual accounting. The end result has been financial reports which now disclose those figures from year to year.

It has required some time, I think, on the part of public service managers, to come to understand what is going on, and I frankly believe many of them do not understand the significance of the numbers, but the pay off has been, I think, has been greater sensitisation to the costs of quite significant programmes - benefits being given to employees. In the case of universities, my own university has got an unfunded liability for superannuation of about quarter of a billion dollars, which is more than the annual budget.

The aggregate figures in New South Wales are also quite frightening, but, you know, I think, one of the pay-offs is - it costs a bit, but one of the pay-offs has been greater sensitisation to what the cost of offering these benefits to employees, and the need to review or keep them under control. And against figures like quarter of a billion dollars for one university, some executive time on accrual accounting, I think, is a pretty insignificant immaterial expenditure.

MR KEN ROBSON:

Nell has got the same surname as me, but he comes from the convict side of the Robson family, because he is from Tasmania. Let us not kid ourselves. When you switch to full accrual accounting -and I use the term accrual accounting loosely - Bob, there are heartaches involved with it. Organisations are terrified to show what their commitments or liabilities are. When we went to full

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accrual accounting in New South Wales, with our statutory authorities, there were some frightening results to bring to account - the accrued liabilities.

Now, that has all settled down, now, and I think that the financial statements produced, in this state, of statutory authorities, are very meaningful and very informative. There are - it does take a lot of time to do. I can see some friends here from the Water Board. The Water Board asset recording, up to a couple of years ago, was not really with it. They did not depreciate, they had a system of providing money to a renewals reserve.

They finished up with a profit or a surplus of about \$2,000 on a \$300,000,000 turnover, though. A terrific accountant, there was no doubt about it. But they had this renewals reserve that they used, and it sort of took the place of a figure for depreciation. But the Water Board in the last couple of years, have worked strenuously to turn that position around and have a proper asset data base, and to bring to account depreciation against the operations for the year, as it should occur.

And I think that next year, when it is really finalised, hopefully, that their financial statements will stand up against any water industry's financial statements in the world. But there are - like I say, do not kid yourself, there are heartaches involved, but in the end, like Bob says, I think, the end result, it gives the body themselves, the decision-makers and the public much more information, that they really need.

SENATOR BRONWYN BISHOP:

Bronwyn Bishop, from the federal Public Accounts Committee. Mr Robson, the last time I heard you speak was indeed at that Seminar where Mort Egol and his compatriot from the State of New York spoke. Today you have said that you would like to see accrual accounting implemented, but gradually. I recall that some of the papers that were given on that occasion stressed enormously

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the advantages which New York State had derived, indeed, probably a halving of the deficit of the State, that it has at this year, as they would have, had it not been implemented.

They also gave very practical examples of how assets are treated. For instance, he spoke in fairly emotional terms, in a way - of the way certain bridges in the United States have collapsed, which he said was simply due to the fact that cash accounting had allowed the maintenance or the lack of maintenance of things like bridges to be hidden for decades.

So my question to you is: how gradual is gradual, and how long can we afford to put off the implementation of accrual accounting?

MR KEN ROBSON:

Thank you, Senator, you are on my side. The New York State, I do not know whether we can really compare it with, say, the various States of Australia, or the Commonwealth. I am not all that familiar with New York State accounting. I think there was some reference earlier today to the fact that the Treasurer has formed a task force to look at accrual accounting, and I am pleased to see the two people from the Treasury here today, who are going to New York this month, as a matter of fact, to have a look to see what happens.

So it is going to be very interesting to see what they come back with from New York. But as far as gradual is concerned, I do not think you say: Righto, right, here is accrual accounting, take one gigantic step forward, and there it is. Like I said, there are difficulties. One of the organisations I can see difficulty in would be the Department of Education in New South Wales, because they have so many assets. There is so many schools, so many properties. And they have not got the data base set up.

So they would be the last ones I could see go into this accrual accounting. The smaller departments, no difficulty. I cannot see difficulty in them. But, as you jump to the bigger departments,

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Public Works, for instance, and Education, I think there would be some difficulty and they are the ones who you cannot say, straightaway: As at for the year 1988-89 you will be on accrual accounting. I think that would be silly. They have got to get their systems in order before you can go on.

And that is what I say about take one step at a time.

MR MOORE:

Barry Moore, management consultant. Professor Walker raised the question of: can creative accounting prosper or not prosper in an accrual accounting system? I think he said, 'Yes'. I noticed in the Auditor-General's last Annual Report, he identified 76 practices which I might describe as creative accounting, and I would like to ask the Auditor-General, therefore, if the State goes over to full accounting, accrual accounting, will this increase or reduce the opportunity for the identification of such practices?

MR KEN ROBSON:

Thanks, Barry, I would say I do not know. The creative accounting areas, a lot of that is to do with people in competition with other organisations out in the commercial field and the commercial area, they go into creative accounting, and naturally the subsidiaries, etcetera, of statutory authorities, who are in direct competition, and they have to match blow for blow, and that is a lot of the creative accounting coming in there.

I would hope, when it came to departmental accounting there would be no need for creative accounting. It will be necessary, when we do go to accrual accounting in departments, 'that we do get the ground rules set up, and the rules in place, like Bob Walker has suggested. Now, hopefully, I would not foresee creative accounting in government' budget departments.

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WALSH:

One last question.

MR CAMPBELL:

The aspect of cross-subsidisation, that we do have in the public sector, as against the private sector, could you expand on how you think you can overcome some of these aspects that take account of cross-subsidisation in accrual accounting.

MR KEN ROBSON:

Yes, if I could, Bob. I did make mention of the New South Wales Treasury has had a review done, and they have made a report to the Treasurer. Is that available yet, Percy, has it been approved, the cross-subsidisation, the allocation of charges?

MR KEN ROBSON:

Yes.

MR ALLAN:

Yes. Both of those bulletins are now publicly available.

KEN ROBSON:

They are publicly available now. I believe what the Treasury in New South Wales has done with this review, and the recommendations they have made will overcome that aspect of cross-subsidisation. They are going to charge - each government department is going to charge the other for the services that they are - well, basically, broadly, for what they provide. So it is particularly in the

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service areas, the Treasury, at the present time, in New South Wales, meets payroll tax. Now, that is going to be spread over the organisation.

It is a concern. They are going to have to meet that cost - well, it is going to be met from their budget in future, and it is going to make - you know, that is probably a bad one, but where services are given, at the present time they say: Well, we are not paying for it, yes, just get department A to do it for us, but when they have got to pay for it, they might think twice about really going - do we really need that service?

And the costs to government, I do think, will shrink if that is brought into account.

PADDY MCGUINNESS:

What about cross-subsidisation involving customers, for example, railways?

KEN ROBSON:

How do you mean, like the subsidy from the Treasury to the State Rail Authority for - or the ministry for concession fares?

PADDY MCGUINNESS:

For example, subsidies to country lines, from suburban lines, or vice versa?

MR KEN ROBSON:

That is within an area of the one organisation, the State Rail Authority. that is not from one organisation to another organisation. The cross-subsidisation from a suburban line to a country line, or vice versa, that is a matter for - that is not an

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accounting matter, as far as I am concerned, that is a matter of policy decision by either the government or the chief executive officer of the State Rail Authority.

PROFESSOR WALKER

I am not sure that you can completely solve the cross-subsidisation problem at all. I think it is intractable. In fact, accountants, talk about cost allocations being incorrible. You are always going to have some situations where costs are going to be allocated between programmes, and how do you do that? Basically in a fairly arbitrary way, or perhaps with an eye to what kind of outcomes you want to achieve by enhancing the costs of one programme and reducing the costs of another.

In many ways accounting numbers are used as symbols in political debates within organisations. Whatever - however you lay down the guidelines, you can say that in principle, we will use transfer prices, at market rates, and so forth, you are never going to completely eliminate it, and I think that it is important that people who are relying on financial reports be conscious of that fact, and one way, at least, of making them conscious of it is to have disclosure requirements which highlight, at least, those transfers, and indicate the basis upon which they were calculated, at least for the material item.

MR KEN ROBSON:

Just on that, Bob, my comments for cross-subsidisation from department to department, not programme from programme within a department.

PROFESSOR WALKER:

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Well, what ---

MR KEN HOBSON:

I agree with what you say there, that that is always very difficult from programme to programme within an organisation. There is some arbitrary seat of the pants judgments.

PROFESSOR WALKER:

Well, even from department to department, too, to some extent. I mean, if the New South Wales Treasury pay the leases on the trains, and it is not charged up to the State Rail Authority, that means that you have to interpret the State Rail Authority's accounts in a particular way.

MR KEN ROBSON:

Yes, yes, that is cash.

MR WALSH:

Thank you, president. Ladies and gentlemen, would you please show your appreciation of the guest speakers this morning.

MR WALSH:

Thank you, Michael, for those presentations.

Ladies and

gentlemen, we do have a few minutes before lunch for questions, a couple of questions, so who would like to lead? Phillip Smiles, Member for Mosman.

MR SMILES:

Allan, my feeling is that the accounting profession in Australia is somewhat pulling the wool over us politicians eyes and my feeling is that the people from the public sector, the senior public servants, are doing their best to pull the wool over our

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eyes. Maybe they have been successful in the last 11 years - and this is not part of the problem, of course - but they cannot be successful in the coming 11 years because, quite frankly, if we are talking about the need for effective asset management and if we have got the pressure from Percy Allan and his colleagues to get into place asset management for every government department and authority in New South Wales, I cannot see that it is that much bigger jump to move from an effective asset register to accrual accounting given that in the period of the 3 to 5 years that Michael indicated a moment it would take to introduce accrual accounting, but we will not have to run both systems.

So my challenge to you, gentlemen, is: is the public servants and the profession really doing a snow job on us politicians? Are you making it seem much harder than it really is?

MR WALSH:

Well, who would like to lead? Percy?

MR ALLAN:

Well, let us take the asset register. If we are going to have accrual accounting and we are going to start accruing the maintenance for assets, we have to work out the value of those assets. That asset register registers assets. It registers some broad values that they have on some of the assets, but things such as the railways and national parks have not been valued; that would be an enormous task and we would have to come to grips with that on how we would value it. We are doing quite a bit of work in Treasury, just on the few commercial authorities on how to introduce rate of return reporting and dividends and that has taken us, what, 2 years now, with various technical bulletins, trying to come to grips with it, trying to get private consultants in to help us to come to grips with really what is current cost accounting, which we are trying to introduce in the government area when it defeated the private sector some years ago. They just gave it up as too hard.

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We believe in the New South Wales Treasury we are going to be one of the first in the world to introduce it and we are doing some pioneering work here. We do not believe we are going to be defeated by it. But that is taking us ages, just in a handful of commercial authorities to introduce it. Now, to introduce accrual accounting, we would need, first of all, to be able to value the state's assets and we have already heard that there is not a settled science on how we do that. There are not any settled principles. We are just trying to do it now for some commercial authorities. We are having trouble there, to do it right across the board in Youth and Community Services, elsewhere, dealing with assets which in many cases do not have a market value.

If you put up the Parliament House for sale maybe you could sell it as a convention centre if democracy were to end in this State, but who would bid for it in its present form? They would want to turn it into an office block or some other use it could have. Likewise, police stations and schools, how do you value these things? So it is a very difficult matter. Accrual accounting would have tremendous benefits. I can see that. What I tried in my talk to ring out was, there are tremendous difficulties, administrative ones. We have a shortage of accountants. At present, the auditor-general is citing departments for not getting cash accounting right.

To then say: You've now got to introduce accrual accounting, we have got to get a body of accountants and senior financial controllers and we do not have sufficient of those people at present to fill those gaps. So there are some real problems in introducing it. And I think the point also made, it requires political will. The problems I went through of ones of declaring a large deficit on an accrual accounting basis, might be a very worthwhile thing. This would apply to all governments in Australia and all governments in the world because we are doing it only on a cash basis.

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We are doing a little more on an accrual basis than other states, as I mentioned, but we still do not put funds aside for accruing liabilities for superannuation or depreciation of those matters, that is no secret. But politicians are going to have to decide that they are prepared to say that the accruing liabilities will be included as deficit in the budget and we will declare that as a deficit because the immediate political backlash they will face is: What is being done to fund that deficit?

Now, if we do introduce accrual accounting, I think it is going to have to be in stages. I think the first thing - and we are already doing that in this State - is declaring what our superannuation liabilities are. Most States do not declare it. In this State it is over \$10 billion. Mr Hills, the Minister for Industrial Relations, has already said that in Parliament. Each 3 years the government actuary tables in Parliament his estimates of the liabilities on superannuation. So we do publish that. Whether we then put that into the budget or whether we just publish it separately and deal with that as a problem, are some of the things the politicians have to face up with.

But I think in this State we do disclose more information than in other States. It is a question now, do you want to bring all that information together in a budget and then say: That is the State's budget, or do you want to produce the information separately, because putting it all together in a budget is going to require a great deal of political courage and it is going to also, as I said before, if you are going to start saying this is a deficit and recognise it as a deficit, like you would with a private company, the question then comes up: Are you going to raise taxes or reduce your expenditure? How are you going to fund it?

The opposition in this State I think is the only government or opposition in Australia that is committed to accrual accounting. Without being political, I would like to ask the opposition this

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question: If you do introduce accrual accounting - and I think that would be a very courageous move - how are you going to fund it?

MR WALSH:

Thank you. Michael', do you have s response at all, just a quick one?

MR MICHAEL McGINNISS:

My only comment would be that I think it has to be a staged introduction. I do not think it is all at once. I do not think it is anticipated going straight to the budget situation. I think the overall budget is not the document that I would use initially for a source of accountability. It would be more down at the department level. And introducing it on a stage basis would allow that improvement.

MR WALSH:

Thank you, Michael. Well, ladies and gentlemen, we have not any time for more questions, so can we show our appreciation to the two speakers. Some machinery matters of great importance. Lunch will now be served up in the foyer around past the fountain in the Strangers' Dining Room and back here at 2 o'clock. I am sure if some of you wish to have a short look at the Parliament to assess its asset or whatever, I am sure the attendants at the front desk would be available to help in that direction. Thank you very much and see you back here at 2.00 p.m.

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LUNCHEON ADJOURNMENT

MR MURRAY:

Ladies and gentlemen, as we indicated earlier on, we have an open forum now and I invite all those speakers who have participated to come forward and I ask you, the audience, to pose some questions or make a statement. Who is first? John Manning. John is from

MR MANNING:

Macquarie University

Thanks John.

MR MANNING:

Peter, I have already been up. here today.

MR MURRAY:

Well, let us direct our questions, if possible, to the latter speakers but keep our..... will still answer them.

Well, there were two issues or two comments I really wanted to make, but since you have invited me to address the latter speakers, John, I will start there and thank Mr Shand from a most illuminating and entertaining address. He achieved in half an hour the result of enabling me to understand something that has escaped me for 30 years and that is that he has helped me understand why this country is on the brink of economic disaster.

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He has given new credibility and meaning to Clive Cameron's assertion that Canberra is a good sheep run ruined. I find the distinction that he seeks to draw between the requirements that he, and he suggests government, would put upon departments, and statutory authorities as opposed to the requirements of central accounts of government; quite extraordinary. His arguments contained in my view an extraordinary contradiction.

It seems to me that what he is really saying, if his views in fact represent the views of government in Canberra, is that the government demands that its departments and that its statutory authorities meet accounting, management and performance standards to which the government itself is not prepared to submit. I find in fact that in his own paper he argues against himself on page 2 where he tells us that cash accounting is all about accountability to Parliament for funds received while accrual accounting is the basis for economic decision-making.

I have been under the impression that it was government responsibility for economic decision-making and if that is so then they should be operating at the full government level on accrual accounting.

MR MURRAY:

Now, David, do you wish to reply to that? 1 minute.

MR SHAND:

I am not not even going to complain..... for a minute. I

think the fact of the matter is that in terms of the improvement of government financial management it seems to me that the key area is to stress the reforms that both the Commonwealth government and the New South Wales have been talking about, is in terms of putting individual financial management responsibility on departments themselves.

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I think that is the key issue. Now, I did not say that we should not move to full accrual accounting for the budget sector as a whole. Like Percy I have suggested that that is the lesser priority. If you really want to get results the issue is going to have - the issue, as night follows day, will have to focus initially on individual government enterprises.

My priority in terms of improving the financial reporting and the performance of government rest primarily with individual government entities because that is where we are saying that the financial management responsibility should lie. That is not to say that we will not move - we cannot move in fact, as Percy indicated. You cannot talk about moving to comprehensive accrual accounting the government as a whole until you have got it in the individual entities otherwise there is nothing to consolidate.

The point I am trying to make about consolidated financial reporting by government as a whole on an accrual basis, and I think this again is the point that Percy was making, is that you cannot do that until the individual entities have accrual accounting in place. Secondly, when you do, you have got to be quite clear what it is that you are going to explain to people as to what the deficit represents.

Now, of course, I am a mere bureaucrat, so I do not have the task of explaining to people as to what it means when the Commonwealth government has a set of financial statements which indicates it has an enormous financial deficit because of the fact that we have a social security system which is unfunded.

Now, all I am alerting to is the fact that somebody is going to have to explain that situation and to justify why the existing social security arrangement, as an unfunded system, should be continued.

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FLAY:

Good, thanks, David.

As a mere bureaucrat - as a mere bureaucrat that is not my role. The role is for the politician to do that. All I want to be aware of is - all I want to be concerned about is the fact that the politician realises that under full accrual accounting for the budget sector that the politician will be required to explain the nature of that deficit and why it should continue; ie. why we should continue unfunded social security schemes in Australia and those are the implications that we all need to be aware of.

Good: up the back.

MR ISAACSON:

..... Isaacson, Northern Territory. At the risk of not getting David Shand to his feet again, I would like to make a statement regarding his comments. The question of when, I think, is not unimportant in those statements that he did, that I did hear lack in this rather lengthy theatre but one comment was that our experience in Australia could not or should not be likened to that of the American experience particularly, of course, New York.

My comment is that do we wait - do we really go bankrupt in Australia before we move?

MR MURRAY:

Who would like to respond to that? No, David, give somebody else a go. Percy, do you want to say something, because you have obviously had an understanding of New York's finances?

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The credit rating of New South Wales and other States in Australia is AA plus as is the Commonwealth Government. It is one of the highest credit ratings of any Country or State in the World. I do not think we are on the brink of the New York situation. So, I think to start comparing us with New York back in 1975 is not really a comparable situation.

If I could just make one or two points while I have this opportunity. I think it is important to understand that in New South Wales we have introduced, was it nearly 4 years ago, accrual accounting for our commercial authorities. I thought today's debate or discussion would be about whether it should be extended to our community and social departments of government. There is no, as far as I know, no government in the Westminster system around the world that has done that. I am open minded about that. I can see a lot of administrative problems that could require that process to take 5 or 6 years. It would not come instantly.

That is why Don Nicholls and Bob Scullion are going to the United States this month to find out exactly what has happened in the United States. Listening to our friend from Arthur Andersen about, I think it is called GAP or GAPE in the United States, it seems to me a lot of things in GAPE has already been introduced, certainly in this State, such as moving towards total payments and total receipts where we show in the budget all our receipts, total payments out. We show the entire jigsaw puzzle.

I think in - under GAPE where they have started consolidating a lot of things off budget, we have already done that. We have done those aspects of GAPE. We have brought in performance indicators. We have brought in a consolidation of our receipts and payments. We have brought in strategic corporate planning.

What I am interested really in is the accrual aspects of that. Having listened to Arthur Andersen this time and also when Mr Egol came out and Mr Regan, I certainly asked them, I know other

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Speakers asked: exactly what have you accrued in these 26, or 28 States in the United States? Have you accrued superannuation?

Have you accrued long-service leave?

Have you accrued depreciation?

Mr Regan, who was the - his controller and the man who championed this in the United States said, "That's a technical question. He'd leave, that to Arthur Andersen." That is the basis of accrual accounting and if you are going to champion it I would put it to you those three things, which Ken Robson says we ought to accrue here, I still want to know: have they been accrued in those 28 states in the United States?

MR MURRAY:

Jim Longley, Member for Pittwater.

MR LONGLEY:

Actually if I could just follow on very much from what you were just saying, then Percy, one of our comments in your paper was regarding the risk of accounting constipation and the lack - whilst I recognise the lack of the accounting professionals and the shortage in Australia generally, I find it difficult to understand how we could be - given that there are those positive benefits to introducing accrual accounting, how we could be delaying that given that some of the programmes you are talking about that were already in existence which would be the original basis of the constipation, if you like, are sort of programmes which are talking about efficiency orders, management strategy. How can we go about looking at efficiency when we do not even know the assets which are being managed by a lot of these within the government sector, how can we have serious efficiency programmes, if we do not have accrual accounting in both.

So that whilst I recognise the difficulties because of the manpower shortage, I do not see how we can avoid doing it if we are serious about efficiency in government.

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MR MURRAY:

Yes. Percy, we are ready.

MR ALLAN:

The first step here, of course, has been a registrar of assets and I think we are the first in Australia to do that where every department, authority, has to start recording their assets and then to try to put some nominal values on them. At present we are working to try to introduce, as I said, rate of return reporting and dividends for the two Water Boards and the Electricity Commission.

Just trying to get that in place, that has taken us 2 years. I think we are further down the track than other governments in terms of this registrar but we have first got to get that right. You have first got to be able to value the assets, as you say, before you can start working out what should be the maintenance, what should be the depreciation on the assets. I am simply saying this thing has to go in steps.

We are following certain steps at present and to say that we are going to consolidate all those steps, ring them forward into a concept called accrual accounting and do it all in one go, it will not work. What we will need to do is do this in steps. We are going down the path, obviously, of getting the information for accrual accounting. But until we have got all that information to wave a wand and say: We will introduce accrual accounting, you will not get it. You will get some - something which we can call accrual accounting.

I think in Yes, Minister, there is one famous chapter where they are introducing a particular bill and Sir Humphrey says, "Put it on the cover, the minister will not read the rest of the document." We could go through that exercise and do what Phil Smiles said and snow everybody. But I think one thing we can be proud of in New South Wales, and I will not compare with other

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governments, is that when we have introduced reforms in this State we have made sure that the reform has been introduced; programme budgeted, annual reporting, the other 30 reforms we have spoken about. We are - we want those reforms to be introduced not just to be a glossy document with a cover which says the reform is introduced and then everybody forgets about it and we satisfy the symbolism of having done it but not the reality.

MR LONGLEY:

..... of long term - longer term. MR ALLAN:

Of course with superannuation, with regard to long-service leave, with depreciation, that kind of information will be necessary. The question which I thought we were going to address today is whether we are going to take all that information and put it into the budget and into the public accounts and then produce a bottom line showing a particular result or whether we - as we do already with superannuation, measure our liabilities as the actuary does every 3 years and tables in Parliament, and we can get a separate statement on our superannuation liability; how that is mounting up, the problems with regard to that.

What we are talking about today is bringing all that information together, presenting a budget to parliament in an accrual accounting form and public accounts, putting cash accounting aside. I do not know how you appropriate in those cases. I have not thought this through. If we do not appropriate cash, that is what Parliament does at present, it would be accruing - accrued liabilities.

Now, that - I am not quite sure - as I said that is why Don Nicholls and Bob Scullion are going to the United States to see if they actually do that. But we do need that information but whether we then bring all the information together in a budget and

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say: that shows an underlying deficit or surplus of that amount. That is what we are going to the United States to find out whether we should do.

MR MURRAY:

I have two questions and I am seeking a third one. Right, Nell?

MR ROBSON:

Yes, I would like to just talk about what David said, David Shand. First and foremost Confucius said that if you are tearing up the wrong road, what is the point in tearing hard? The second thing is that with regard to saying that Members of Parliament - and I am saying Members of Parliament as opposed to politicians - I say what is the point in worrying too much about how we have got to explain a deficit.

I will bet you 99.9 per cent of the people out there today do not even know the wherewithal of the current deficit let alone under accrual accounting. I bet they do not know how the current one is explained. So therefore if you go over to another one, what does it matter? What does it matter whether it is a deficit under one or a deficit under another. They will not understand. Just the same as 99 per cent of people do not understand that an asset is a debit account. You try and explain that to them and see how far you get.

And the last thing is as to our Secretary of the Treasury for New South Wales I would say, yes, what he is saying is true. We have got a big job in front of us but let us get the job and let us get going. Do not say that it is too big for us. Just grab something and go.

Can I get Ken Robson to answer that because he started the all rolling.

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ROBSON:

Well, I think that is unfair. It is my namesake up there, but -and really there is only ---

MR MURRAY:

No, I think it was addressed to David.

ROBSON:

It was. It was. There is only half a million people in Tasmania, too.

MR MURRAY:

Tasmania.

MR SHAND:

Well, I think what Neil Robson has raised is to - we talk about the two-deficit problem. We have got the problem of the budget deficit on a cash basis; we have got the problem of the overseas deficit and now Nell has raised a third deficit problem which is the deficit under an accrual accounting system. Now, I mean, I know a lot of politicians are inclined to answer these things by saying; it is all a matter of education.

Now, I do not know - I do not know whether that is true or not. All I am saying is that it is important in any changes we make that we make clear just what the deficit means. A deficit under a cash-accounting basis is the net borrowing requirement of a state government. Now, let me just digress here. One of the problems -and, of course, this is not a problem of the Commonwealth - but it is a terrible problem in the case of the States, is that they do all sorts of creative things on their cash-accounting deficit to

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say - and the Treasurer stands up each year and say: I am pleased to announce as required by the public account X, Y, Z, the consolidated fund has been balanced.

Now, that sort of statement is not worth - in most cases, Neil, the paper it is written on, because you can include all sorts of things about your current receipts and some states have to include borrowings and their current receipts, so it is not difficult to avoid a deficit to balance the - to balance the consolidated fund, if you include borrowing as a current receipt.

All I am saying is that there is a real political education and a real political integrity problem, in my view, about what these deficits mean. A cash deficit means a net borrowing requirement. That, in the case of the Commonwealth is clearly reported. Everybody - all financial writers by and large understand and discuss the nature of the Commonwealth governments federal cash deficit which I might say, Nell, is incurred largely by on behalf of the States. But that is ---

MR MURRAY:

You mean the claimant States?

MR

But that is another issue. What I am saying is that if you are going -Neil has raised the issue of explaining and discussing a third deficit and that third deficit is: what is the meaning of a deficit under a system of central budgeting or accounting under an accrual basis. As I previously tried to indicate what that indicates is the fact that government has not used its compulsory tax-raising powers or other revenue raising powers sufficiently to fully fund - to fully fund its emerging liabilities.

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Good, thanks, David.

MR SHAND:

That needs to be explained.

Thanks very much. Senator Bronwyn Bishop?

SENATOR BISHOP:

Thank you, Mr Chairman. I am particularly glad that Percy Allan raised Sir Humphrey because I was quite concerned when I heard your address today that it would have been brilliantly presented by Sir Humphrey. I thought to be harsh a good summary could well have been (a) it would result in the government of the day being criticised and secondly it was all too hard and that was a good reason for not doing it.

I really do not think that is good enough. I also thought that the statement you made that they - the general public do not understand accounting anyway - had implicit in it a corollary that simply said; and we rather like it that. I do not think the electorate is quite as stupid as many people like to point out. There are two or three other points that I would like to make about that paper you presented because in all honesty I can only wish to believe that you were playing devil's advocate because I really think I would have expected better. I like Mr McGuinness's analogy with Coles Myer and drawing its size and competence and ability to accrual account with the size and degree of expertise that may be expected to exist in a government department because implicit in your statements that it was too hard and it would take too long was almost saying that our lot are not up to it.

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I do not believe that for one minute. I believe that those people who are employed in the public sector are just as able as those people who are employed in the private sector and if the task that they receive is to accrual account they can do it. The discussion that is related to motivation and political will I think is probably what it is all about.

Now, Mr Regan, from New York State, and I think it is important in this discussion not to confuse New York state with the City of New York, which had two entirely separate problems. He said that his main opposition came from within because there were a group of people who had the secret society techniques of manipulating the economics of government, if you like.

What he was talking about was sharing it. He was a man who said he came from a situation of ignorance to the position of crusader because he believed that there had to be a sharing of information and a knowledge of what government was about. When you said, Mr Allan, that government - when you said of Nick Greiner's commitment to introduce accrual accounting you would ask of him how he would fund the deficit.

Again, implicit in that statement, is that somehow accrual accounting creates the deficit. That deficit is there now but it is hidden. It is not a question of somebody new coming in to fund it. The question is how is it being deal with presently and why are not we, the people, entitled to know that we have put future generations into hock.

MR MURRAY:

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Bronwyn.

SENATOR BISHOP:

I think that is fair. I think I have had a fair go at it. Mr Allan, I think what I will say to you is Sir Humphrey would have been proud of you but next time you may not be answering to Jim Hacker.

MR MURRAY:

Who ever said that accountancy seminars are dull functions. Percy, take those gloves off.

MR ALLAN:

Well, first of all, Bronwyn, I am not Sir Humphrey and I think in New South Wales, if anybody knows my background, I have fought for financial reform in this state for a long time. It was a reason I left the Treasury temporarily at one state because I did differ with my predecessor on various reforms. I am glad there are a lot of people in Treasury who fought for those reforms as well, like Don Nicholls and Bob Sendt, and Ian Neill and others, and those reforms have come about.

As I have said there have been 30 major reforms in the last 5 years. That is about 6 reforms a year. At present we have a genuine problem in that there is a lack of financial skills throughout government because of the pressures we have put on departments for those reforms. I am not saying those reforms should be slowed down. They are in place but they have got to be implemented.

And to implement them if we were to introduce accrual accounting tomorrow would mean that many of those reforms would fall beside the wayside. They would not be fully implemented. They would be

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on the statute books but would not be introduced. That is why if accrual accounting is introduced - I am not against accrual accounting - I am keeping an open mind until this report comes.

I can see a lot of value in bringing better - a better idea of accruing liabilities for superannuation, for long-service leave, for maintenance. It just involves quite a lot of work. To do that I do believe that it is a matter of priorities. That there are a number of things - we are trying to commercialise various things in departments at present.

We are trying now to apportion the debt charges and superannuation to each individual ,department - its programmes. Instead of Treasury just paying it centrally so we can get a better idea of the costings of programmes. We try to get departments to set up a commercial arm so when they earn money they do not have to send the money to Treasury and then come to us cap in hand and ask for the salaries and the costs of running those commercial services.

Last week those reforms were announced. That will take time as well. We have got to do one thing at a time. If we try to do it all at once what will happen is that the reforms just will not be introduced. They will simply be on paper. I am not saying it is too hard. What I said in my talk was that there are some major administrative difficulties with this and that if we do introduce it then we have got to do it gradually step by step and we have got to identify those difficulties.

I do not believe today's seminar has really brought out what has happened in the United States; what are the real problems with introducing accrual accounting that we, as administrators, have to tackle and that is why Bob Sendt and - rather that is why Bob Scullion and Don Nicholls are going to the United States to identify those programmes.

We are not saying we are against accrual accounting. We are just saying we can see some problems. We have got to find out how we can tackle those problems and then when we have had a look at it

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we can put to the government what is involved with accrual accounting and then the government can decide. In the end it does require political courage for the reasons that Bronwyn has mentioned.

It may disclose a very large deficit because of the accruing liabilities. The question I put to the opposition was a serious one. If we are going to introduce accrual accounting, and I am not against it, the only thing I am saying is it may take 5 years to do, not 1 year or 5 or 6 years, then I think the opposition does have to answer the question: does it intend to fund those accrued liabilities. Because listening to Bronwyn I think she feels it is outrageous that those emerging liabilities are not being funded.

I put that question to her. If it is outrageous will the opposition fund those accrued - accruing liabilities because in the end I do believe it is going to be very difficult to publish a set of accounts where one says: We recognise all these accruing liabilities as a deficit that ought to be funded now, but we are not doing anything about it. In the end if one moves onto accrual accounting I think there is going to be very strong political pressure to cover that deficit.

I am not against covering it - that deficit, but I think it is an issue that politicians have to face not the administrators.

Good. The gentleman here?

MR LINDSAY:

Thank you, Mr Chairman, Brian Lindsay, Hawkesbury Agricultural College, and I am not sure who I want to address the question to but ---

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MR MURRAY:

David Shand?

MR LINDSAY:

--- it relates to the - something Percy was just touching on at the end there and that Ken Robson mentioned earlier. In New South Wales commercial training authorities are already on full accrual accounting and I guess it would be fair to say that Ken is suggesting that colleges and universities should move as quickly as possible to full accrual accounting. They are not commercial training authorities and so for the first time we will have an authority that basically relies on the budget for its funding adopting full accrual accounting including depreciation and declaring on the face of its accounts the superannuation liabilities.

Certainly the Public Accounts Committee in New South Wales has recommended that superannuation liabilities for those authorities be fully funded and yet the government is giving no leave whatsoever, either the government or the opposition, in my view, as to whether it intends to see as a policy statement, those amounts fully funded. And equally when we calculate depreciation, and we know what the annual charge is, what is the government going to do with that?

Is it going to look at that meaningfully from the point of view of what I will call replacement of assets or is it merely going to file the reports as we fear is happening right now? So I guess I am not opposed to putting in the work and the effort, and I certainly believe we could find the resources, to adopt full accrual accounting in much less than 5 years, but only if it is going to be a meaningful exercise with the government providing some guidance and some lead as to what they are looking for on the funding side as well as the declaration of liabilities side. I wonder if anyone in the panel would like to comment?

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MR PLATER:

As a totally impartial observer I just say that that is quite unrelated to the issue of accrual accounting. The issue of accrual accounting is simply the measurement and disclosure of what that position is. Then what you do after that is a policy decision which is not related to whether or not you adopt accrual accounting. That is just the - I mean you are quite true that it would be nice to know what they are going to do.

But they can change their minds. Politicians can change their mind and decide to fund it through taxes 1 year, borrow it the next year. The only issue we are saying is that accrual accounting would tell you what was the affect of their decision to disclose it so that it is up to you, the constituents, and the readers of those financial statements to see what has happened and to be able to make their own judgments and react to that.

That is all accrual accounting is about. It is not actually forcing you to make a decision as to whether you finance it in any particular way whatsoever, it is simply disclosing what is being done.

MR LINDSAY:

That is fine for a total sector but what about for an individual entity?

MURRAY:

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Bob?

PROF WALKER:

I am reminded of a story about ancient Egyptians who used to simultaneously believe in the same Gods at the one time; Gods of love and peace and Gods of War, and this characteristic was described as syncretism. It seems to me that David Shand and some of the other speakers are displaying syncretism tonight. David Shand wears the hat of Chairman of the Public Sector Accounting Standards Board and promotes the notion of accrual accounting which shows all the liabilities the same as you have in the private sector because "philosophically" that is the only justification of the assertion.

Philosophically you should treat the transactions in the same way and at the same time having said that we should have the same techniques as in the private sector he then says he has got doubts about whether that information would be very useful. It seems to me there is a terrible contradiction going on there and that a lot of the concerns that is being expressed today as the down side of adopting accrual accounting are really the product of not really thinking through what kind of accounting concepts you want to use in the public sector.

It seems to me there are very good reasons not to try and put values on the Harbour Bridge and Parliament House. Not to try and treat the present - the estimated present value of future social welfare commitments as a liability. I think that is absolutely a nonsense and I think a lot of opponents of accrual accounting are using that old - you know, fallacious argument of dragging out an extreme example and using that as the basis for knocking a set of procedures which are fundamentally only concerned with ensuring that readers and interested parties and managers are provided with information about what the current state of affairs of our government and public sectors would be at a particular time.

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MR KEN ROBSON:

Well, I think I might have to say something there to address Brian, because my office produced a report on tertiary education institutions. What I am advocating, as far as accrual accounting in universities and CAEs, you spoke of CAEs, I bring universities in that as well, is to let the people of this country know how much the tertiary education is costing. At the present time, the way financial statements are prepared, nobody knows, then it is up to the policy makers of this country, be the federal or State politicians, to say: Yes, we are going to fund that, or no we are not going to fund that, and then probably charge fees for people going to institutions.

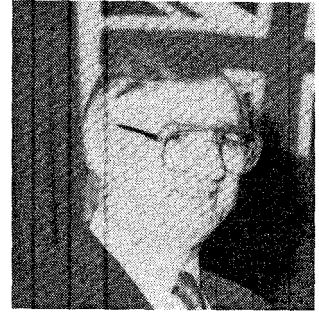
I do not advocate any. All I want is the true cost of putting these people through tertiary institutions to be shown in the financial statements of those organisations. And if you have not got accrual accounting you will never know what the true costs are.

MR murray

Right, thanks, Ken.

REPORTED: NOT TRANSCRIBED

AT 4.40 p.m. THE MATTER WAS ADJOURNED INDEFINITELY.



ACCRUAL ACCOUNTING SEMINAR

COMMENTARY

BY

MR MICHAEL MCGINNISS

PARTNER, PRICE WATERHOUSE, MELBOURNE

Commentary delivered at New South Wales Public Accounts Committee's
Accrual Accounting Seminar
Parliament House, Sydney
5th February, 1988.

Accrual Accounting Seminar

COmmENTARY

MICHAEL MCGINNISS

SENIOR AUDIT PARTNER - PRICE WATERHOUSE

I guess I should declare my hand up front. I don't believe it's possible to assess the cost of services, the financial liability or all aspects of resource management through the sole use of cash accounting. I just don't think it's possible to do that in an efficient way. So from here on in, keep that in the back of your mind.

My brief was to review the papers of the three earlier speakers, this morning. It was done in something of a hurry, because I only received the last one late Wednesday afternoon.

And I'm told whenever one reviews the presentations of somebody else, the first thing you say is "with the utmost of respect", so you can keep that in the back of your mind as well. With anything that I do say that it is "with the utmost of respect" because there are different views.

Bob Walker described himself as a 'bastard'. At times when I read his paper I thought exactly that. Most of you probably haven't had the opportunity to read it. I did read it through and I must confess I was very relieved when I got to the last paragraph, and he said he did like Accrual Accounting. It was somewhat doubtful between the first paragraph and the last, whether that was the case. But there was an even bigger surprise than that. He described accountants in that paper as passionate people and then he went further this morning and described them as entrepreneurial people. And I do worry about poor old Monty Python and his bowler hat and frilled umbrella and jokes about actuaries and accountants, they all have to be rewritten after that academic interpretation of "passionate entrepreneurial accountants".

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But we do get passionate about subjects and this one is no different. The debate is not all that old in Australia as I think somebody said earlier this morning. I can only recall perhaps going back four years to my first meeting with the Public Sector Accounting Standards Board. When Accrual Accounting was mentioned we said yes, it's very important, but let's just not tackle it directly yet, it's too big. It's probably still too big although I'm very pleased that David Shand will mention in his paper this afternoon, that there will shortly be a paper on departmental accounting coming out from the Public Sector Board and I'm sure that will have a discussion of Accrual Accounting.

My interest has come through that Board and the Committee headed up by Sir Fred Wheeler, in Canberra, where each year we have a look at the Federal Government's Annual Departmental Reports. I was asked to join that Committee to have a look at the financial aspects of the reports. Some of you probably helped prepare those reports. Some of them run to 180 pages long, some even more than that. They're full of pictures of tractors and airports and politicians kissing babies and what have you. But the financial information is very, very thin. To try and work out how a Federal Government department has actually used its resources, from looking at its annual report, is a very difficult task.

It's buried in there somewhere, but you really have to be a genius to find it. Very few of them have any information on creditors and very few of them have information on debtors. Hardly any of them have information on the assets they use to produce the services that you and I use everyday. Now you have to ask yourself, what's the purpose of the report? Obviously, it's to show how much cash they were given and what they spent it on. Just cash in cash out. And that's how most of them 'go.

One of the things I think we get mixed up, I think we have seen it this morning, is we try and say that Accrual Accounting and Cash Accounting are intended to do the same thing. So I think they're trying to do quite different things. I criticise cash accounting

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because it doesn't talk about resources investment and resource management. But it's not supposed to, it's not what it's designed to do. Accrual Accounting goes more along those lines.

So I think when we debate this subject, when we talk about it, when we research it, just keep in mind those two different objectives because if we get them mixed up, we'll get into a very defensive position with cash and I don't think we'll make any progress.

There are various ways of tackling issues under Accrual Accounting. And accounting standards are an implicit part of those Accrual Accounting methods. I don't think we can deny that. I think in the last five years accounting standards in Australia have developed very significantly, and they are still developing.

Having sat on the Public Sector Board this area of standards and accrual accounting has come to be a very difficult task. Some of you might not think so, but it is indeed a difficult task. At times a frustrating task to try and get something out. The research that goes into those standards is immense. And I'm sure that Bob himself will appreciate that. He did sit for some time on the Accounting Standards Review Board and in fact was part of the legislative power given to Australian Accounting Standards. So I guess I'm with utmost respect that I am at a little bit of a loss to understand his fairly significant criticism of accounting standards. The accounting bodies have some powers of persuasion but the ultimate of course is with the legislation.

In the terms of the Public Sector, I did happen to receive yesterday in the mail my current copy of "Australian Business". I think somebody up the back there asked a question earlier of the New South Wales Auditor-General. But Bob in fact did mention in the article "Australian Business" dated February 10, the experience of the Commonwealth Auditor-General in the last year. He examined 109 reports and there were 34 of those reports qualified. Of those 34, 11 had substantial qualifications

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compared to 24 last year. I haven't done that research but Bob might be able to elaborate later just to whether they were on Accounting Standards matters.

So there are people monitoring the application of standards. I don't think we're ever going to get to a situation where we have a set of rules so tight that there aren't alternative ways of going about accounting. I think that would be physically and intellectually impossible to do. What we can do is tighten them, and I think that process is in quite good hands. We do have the Auditors-General, we do have the Parliamentary Committees and we do have you and I out there who are looking at these particular things as they're published. And if we object to them, there's only one way to change them, that is to get in touch with the various authorities that can do something about them.

There is some comment in Bob's paper about the Public Sector Board, about the monitoring of its results and about the way it operates. His "Australian Business" article does make a point that perhaps there has been delays between the public and private sector accounting standards because of the delays caused by the private sector having a different set of criteria and a different requirement from the public sector. Well I think that's right but you must think behind that. You think about a transaction - in principle transaction A in the public Sector should be really reported no differently, shown no differently from that same transaction in the private sector. So in the private and public sector the treatment really is the same and should show the same approach, the same accounting logic. And that's the philosophy behind the Public Sector Board's approach to starting off with the private sector standards and applying them to the public sector.

We do appreciate that there will be different circumstances. You don't in most departmental instances have a profit measure. So to start trying to apply a profit and loss standard, which is under revision, to a public sector situation, obviously is not on. And I think if you read the standards and the writings on the standards, you'll find that that's the way the Board is going. I

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hope David Shand as Chairman won't contradict me too much this afternoon, but that's the way I see it. Philosophically things should be treated the same but obviously we have to take notice of the different requirements and the different objectives. And I don't think in my four years that there has been a delay caused by those philosophical differences between the two, the Public Accounting Standards Board and the Private Sector Board. We did work closely together and we met quite regularly.

There is also in Bob's paper a request for more co-operation between the Federal Public Accounts Parliamentary Committees and the State ones. I understand there are moves afoot to establish such a Committee in Queensland. I believe that this co-operation is coming and perhaps this Seminar is an indication of that today. Certainly, the Public Sector Board in its role of developing and helping improve public reporting guidelines, has met with each Public Accounts Committee in each State and in the Federal Parliament. So we haven't been backward in going forward and taking our ideas for improved reporting, improved accountability to the politicians and I'll come back to that with the political situation later on. So we've tried to play a role in pushing that line of the Federal/State approach.

This question of public versus private sector standards in Bob's paper: he does mention that he's not aware of anywhere in the world where the profession has adopted the same approaches as that in Australia, where we're saying there is a common philosophical base. I think in fact the International Federation of Accountants and one of the previous speakers mentioned this, in their Hong Kong meeting last year did affirm the point that I was saying earlier, that the same transaction on a matter of principle shouldn't be reported differently in the public and the private sectors. So they're going along that line.

Bob concluded his paper, by, I think, agreeing with the same conclusion that I would come to, that Accrual Accounting by itself doesn't provide all the answers. But then again nobody would

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expect it to because it's designed to fulfil a different function. It's a wider function than that of the cash based accounting system.

Percy Allan moved on to what I thought was a very precise paper, I'm not sure whether he is positive or negative regarding accrual accounting I did have some doubts as to what he was when he said he was not negative because basically what we have been given was a series of difficulties. Now I think in the situation of Treasury one would expect that. The whole situation will be examined before any move is made to what would be a huge task and I think he has identified most of the difficulties that one would expect to see.

Perhaps if I can just comment on one or two of those difficulties, I certainly can't solve them because they are real and very difficult ones. The size of the task is immense. Those of you who attended the presentation by the two American visitors before Christmas, Ned Regan, the Comptroller of New York State and the Mort Egol, the Arthur Andersen partner, would have got some feeling as to the size of that task. I think the task went over something like five years. Consultants fees and this pertained to a question earlier on, were something like \$10 million. Not to mention the staff time of the New York State Treasury organisation. So it's a huge task both in time commitment and in cost. They did come out of it with a new accounting system and interestingly enough they did identify some very clear benefits. And I think that's something that we're perhaps not doing enough of. But looking at the whole picture and looking closely at implementation issues, I think many of the New York benefits would be similar to ones that we find here.

One of the difficulties we have is, what are assets and what are liabilities? That's implicit in things like Botanical Gardens and this Parliament House. How does one measure this, is it an asset in fact? An asset is something that generally is regarded as having economic benefit. I won't debate that issue at this particular place. One other way of looking at that, is looking at

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the service potential that one might get out of a public asset. And they're the sorts of things that are going to have to be looked at. I think the information has got a use, the biggest use is in resource management. And without the fuller information given by Accrual Accounting, I think resource management cannot be properly done.

Another very important point that was mentioned by Ned Regan was the question of understanding, and Percy Allan did touch on this. It's a very important point. Back in his paper and I read it again last night, Ned Regan did say that every press conference he had, half way through the TV lights would be turned out and the camera man would troop through the people in the audience out the back door. And those of you who have been to press conferences, know that's a fairly unnerving experience. That's what happened to him but he stuck at it. There was just no understanding of the issue.

I think this question of education is a very major issue and I think the earlier question asked from over on the side here, on the political constraints - I think education is one of the great political constraints. That'll have to be addressed in introduction or otherwise in Accrual Accounting. If education at many levels, there's firstly the legislative level, there's the electorate level, there's newspapers, there's users. And it's going to be a very, very difficult task to get that message over. But I hope that when the message comes, that it's not cash just versus accrual. I think it should go more towards what better information can the accrual base system provide over and above that useful information that we're already getting. We're getting it for a different purpose. So I take Percy Allan's point of view that education is a major task and will be a major difficulty.

The funding and the recognition question, I think superannuation is most often mentioned here. I was a bit puzzled by one of the comments, if I can just quote it "Long term commitments to employees and others are not at risk since governments can avoid insolvency by raising taxes". There is one very good way for a

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government to become insolvent, insolvent is the the wrong word but non existent is probably the right word and that's to start to raise taxes ad-infinity, to keep paying for liabilities. What I think the electorate can do is ask what is the liability? What have we been landed with in terms of a commitment that this government does not have to meet but some government in the future? And I think that is a relevant question to ask. So if we keep raising taxes, well that to me is not an excuse for not publishing what the superannuation liability is and what the superannuation expense is. One just has to think of the wage case this morning. We have another wage case, we have another increase, we have another round of increased commitments on the superannuation line and the liability of course is just buried underneath it all. It's not recognised.

In terms of having funds set aside to meet that liability, I don't believe that anybody is advocating that the total cash be there to meet the total liability that might come up in 50 years time. Ken Robson commented on this, that the funding and the recognition questions are different questions. And I would agree with that. But I don't think the fact that people might demand that the situation be fully funded, is one to promote the idea that liability should not be recognised. So I believe care should be taken in confusing those two questions of funding and recognition.

There is obviously a great difficulty with the lack of recognition of assets in the public sector where we haven't had an accrual basis in past. Often capital assets haven't been recorded - in many instances they have. Many public sector organisations have got good asset registers but I'd suggest the majority particularly at the departmental level haven't. The other ramification of this of course is potentially a lack of physical control over assets if you don't know what you have.

Some years ago at the Government Accountants Conference in Perth, a senior man from the education department there, told me that they discovered a school that they didn't know they had. Just how that happened I'm not sure but he was quite serious when he made

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that comment. Because it was so big, and the asset recognition or asset recording was so out of control, it popped the school. Now, one just has to ask about resource management in the cash accounting environment. It is a difficult task but that doesn't mean to say that we have to ignore it. Indeed if I can put a plug in for Victoria, the Treasurer in Victoria has instituted a programme across departments, where asset recognition will be brought into account over the next two to three years. The announcement was in the last budget papers and there is a major effort being undertaken at departmental level to recognise and to record those assets and then bring them to account.

So these are a few comments on some of the difficulties that the New South Wales Treasury sees, I don't deny them - I think they are very real difficulties, I think they are going to require a very large effort to overcome. But because they are of such magnitude I don't think it means that we should just ignore them for another two hundred years and one week.

I was reading the Financial Review earlier in the week. I saw this headline "New South Wales Moves to a Commercial Approach by Departments", that was in Wednesday's Financial Review, and I thought all my problems are solved and I can just read this article on Friday and all the answers will be there. But these are part of those reforms that various speakers have mentioned this morning. If I can just quote "However many programmes are under costed because so far they haven't been charged for overheads and centrally funded services, particularly big items are not previously allocated to programmes of debt charges, superannuation contributions and payroll tax". Well I would hope that built into that new commercial approach, as it's called, is some recognition of Accrual Accounting. It may be part of the modified Accrual Accounting because without some recognition of Accrual Accounting in that process of allocating charges, I just cannot see how the full charges will be allocated. But obviously it's a very good step forward and one which hopefully will show the benefits that the Government is expecting from it.

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The third paper was from the New South Wales Auditor-General and I must confess that I didn't have a lot of difficulty with that one because I think we are probably of the one mind. He did make a couple of comments, perhaps I can just highlight, "There is a requirement for annual reports to show all transactions affecting the respective organisations". I'm not totally familiar with the New South Wales requirement. But 'if that's the case, that all transactions have to be shown in the accounts, that presumably would include departmental accounts, which would presumably require Accrual Accounting. Whereas under a cash based system, one doesn't record the transaction until effectively the cheque is drawn. The transaction can be entered into, but if it's not paid for, for some time, then presumably under the cash based system the current transaction is not recorded. The Treasury requirement is very difficult to meet on a period basis if accrual accounting is not adopted.

By and large, I think Mr Robson attacked the question of accountability, attacked the question of resource management, in sympathy with the private sector. He also would argue I believe that we are not suggesting that the same approach "in toto" be applied. That would be a ridiculous way of going about it. But if you are going to go along with user pay principle, then I can't see how you can avoid Accrual Accounting or some aspects of Accrual Accounting.

I've been involved with a Federal Government department in Canberra which provides services to the community and to various operators on a user pays basis. That department is a long way down the track to accounting internally on an accrual basis user pays system. They are not suggesting that they account for their Government budgetary allocation by other than the cash basis because that's inherent in a government system where the tracking of cash resources takes a major point of importance. But in addition to that, to help them manage their resources, to help recover those charges from users, they believe an accrual based

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user pays situation is appropriate. Within our Federal bureaucracy we've now got a department which is a long way down that track for management purposes.

Perhaps if I can just look at one or two other issues. I briefly mentioned my response to the political constraints question. There is I think a fear of disclosure, there is a fear of the unknown. We're just not quite sure what Accrual Accounting will show. Most of the debates seems to concentrate on liabilities. We keep on hearing about superannuation. But the government have got a lot of assets that are not shown as well. And that's a plus factor that they would show those assets to offset the liabilities in a balance sheet situation.

Obviously the next question is how are they using those various assets, which perhaps is another fear of the unknown. The rule seems to be not to disclose anything that doesn't have to be disclosed. This reflects in efficient resource management. Most State Governments and the Federal Government these days seem to be going towards non-financial measures of performance. The wheel is in motion to try and exhibit those resource allocation questions.

One of the very difficulties with Accrual Accounting will be the effect on manpower. I'm aware that certainly Victoria has a freeze on manpower appointments. In the State Government situation, one would expect I think with some confidence, that extra manpower allocation would be needed for the introduction of a full accrual based accounting system. There will be an additional cost.

In terms of Senator Bishop's question on the timeframe situation, I guess I would see about a three to five year type of timeframe. That certainly wouldn't be a full introduction of Accrual Accounting, but it would go a long way towards solving many of the problems. I can't see it happening within that three to five year situation.

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I think in the New South Wales Treasury paper, Percy Allan suggested it's going to take him three to five years to implement his current reforms and on top of that, he'll have a further problem with Accrual Accounting. So we're talking three to ten I suppose. But at least the debate is underway and we have started. Is it going to happen? I have a personal conviction that it won't happen unless we have a political will to make it happen. We can talk as much as we like on a non political point of view but if the politicians don't drive it, it's not going to happen.

In the New York State situation, Ned Regan, although he is the controller of New York State, was an elected official. He is elected on a, I'm not sure whether it's an annual or a triennial basis, but he had the political will to carry that through to his electorate. And without that I don't think we're going to get anywhere so that's part of that education process. The "political will" I think, will drive or not drive this question of Accrual Accounting.

Some Federal and State Government Departments can be aligned directly with a commercial organisation. I've had some association with the Coles/Myer organisation. That organisation has an annual revenue, of something over \$12 billion, it's got, a very large number of stores spread from Tasmania to the Northern Territory. Everyone of those stores has to account. Everyone of those stores has accounting problems. They have departments within that organisation, that are not direct profit making departments, they employ something over 30,000 people. They seem to manage Accrual Accounting fairly well. They seem to manage doing it on a timely basis fairly well. But they're used to it, they've been doing it for Many, many years. But I can't help thinking that there is some coincidence between that sort of organisation, between the size of Australian companies that have got many overseas operations and the size of some government departments. Some of the issues are going to be similar, and in most situations they seem to have been addressed in the private sector.

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One of the things we have to work out is what's the reporting entity? Who are we reporting on? Is it government as a whole -New South Wales Government, Federal Government or whatever, or is it just a particular department or indeed an area within a department? Some departments will have clearly defined and clearly distinct businesses within those departments. These are some of those research areas that will have to be addressed. I am aware that the Public Sector Accounting Standards Board is very active on this particular question at the moment.

I mentioned earlier, that fixed assets are almost the single biggest problem. Where are they, what are they and what are they worth? But the sighting of those fixed assets and the recording of them will be a mammoth task. But without that information, how can one properly manage the resources?

It is a question of materiality and I'm not suggesting that every little desk and chair be recorded. One has to approach a task like Accrual Accounting in the public sector on a materiality basis. There are estimates in accounting and such estimates are often subjective. They won't be exact to the last dollar as a cash statement can be. Those estimates will be inherent, those various interpretations of accounting standards will be inherent in Public Sector Accounting. But I believe between the various Parliamentary Review Committees, the Public Sector Accounting Standards Board, the Private Sector Board, your own professionalism, the political will, that those estimates can be reduced, and those interpretations can be reduced to a manageable approach to better financial information.

Superannuation has been mentioned a number of times. People say what do we do with the deficits? It's not uncommon for these things to be brought to account, to be amortised over a number of years. Under the US standards I think I'm right in saying if there is an unfunded superannuation situation, they're brought to account over a fairly lengthy period of time.

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Amortisation of various costs are written off over various periods of time. This opens up Bob's question of interpretation and application of accounting standards, I can't argue with him there, I agree there are various interpretations. The only thing I can suggest is having appropriate disclosure so the information is there for people to make up their own minds.

Where do we go to from here? There have been a number of seminars on accrual accounting in the last couple of months with perhaps the most effective early one being sponsored by the ASA before Christmas. Now this one where we have people from all over Australia. Hopefully these sorts of meetings will promote further debate. Hopefully those politicians amongst you can think about it, can decide whether or not there's going to be a benefit there. Without being too cynical, probably the Opposition politicians will think it's great and the Government politicians won't like it very much, but the wheel does turn. So it is food for thought at the political level. It is food for thought I think amongst the professional managers in the public sector. Will it help you manage your resources and provide better services? Now we're all thinking that it will. The proof of the pudding of course will be in the eating.

There is that education question I mentioned. Not only amongst us, we're probably going to be the easiest to educate but amongst the people out there. As somebody said earlier, they don't understand accounting anyway.

If there are decisions made to introduce Accrual Accounting, it will have to be done on a staged basis. It can't all be done at once, it will take three to five, three to ten years to get underway. And, I'd agree I think with all the earlier speakers that we are not going to throw the baby out with the bath water. Cash accounting has a very important function to serve and that will remain, serving those objectives that it's laid down to do. But let's not try and stretch it too far, let's perhaps consider its deficiencies and see if there's something better to answer

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some of the questions that resource users, resource providers are asking. I think that extra step of considering Accrual Accounting will provide those very positive answers.

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ACCRUAL ACCOUNTING SEMINAR

SUMMATION

BY

MR PADDY McGUINNESS
AUSTRALIAN FINANCIAL REVIEW

Summation delivered at New South Wales Public Accounts Committee's Accrual Accounting Seminar
Parliament House, Sydney
5th February, 1988.

'Public Accounts Committee

COMMENTARY

P.P. MCGUINNESS

AUSTRALIAN FINANCIAL REVIEW

The first thing I must tell you is that I'm not here officially. I'm on strike. But since we have made such careful distinctions today, perhaps you can say that, I'm not here on a cash basis but an accrual basis. I will not write today.

I have been fascinated by the discussion today. Not only because the subject itself is very interesting but also because of the climate of the discussion and the mix of people present.

I can remember when I first started to study Economics in this State some 30 years ago, reading the public accounts of New South Wales with growing horror, realising how much disinformation was being conveyed, how many useless figures were being presented and what a waste of time the whole effort was anyway, for most economic purposes and probably for most public accounting purposes.

And, of course, in those days and for quite a few years afterwards it was common for the discussion of the public accounts in the ordinary public debate to be conducted on a most elementary, political, slanging level and for the bureaucrats at the top and the politicians to have a kind of non-aggression pact between themselves such that nothing was ever reformed.

The accounts were conducted in a disgraceful fashion and the politicians and the bureaucrats traded off privileges between each other. An example of this was the way in which the heads of Statutory Authorities tended to be people who had become under-secretaries - permanent Heads of Departments - through serving Ministers and then ascended to heaven to become a head of

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a Statutory Authority, which was responsible to no-one, which was totally mismanaged in financial and economic terms but which was a lovely little empire to be on top of.

That has changed. We have here today a mixture of bureaucrats, politicians and some others who, for the most part, are concerned with discussing standards of good government and good public administration. That in itself is extraordinary, isn't it? We have politicians from both sides of the political fence and from all over Australia, as well as bureaucrats who are not concerned about making political points but who have been today, for the most part, discussing how to improve the standard of public administration and government in Australia. That in itself is a very real achievement.

And that, I think, is possibly the most important thing about what is happening in this whole debate about Accrual Accounting. Everybody knows that when you try to pin down accounting concepts, they get very difficult and elusive. Somebody referred earlier to the fact that even with all the people advocating the superiority of private sector standards, the private sector did give up on the question of current cost accounting, as too hard. Once you try to pin down such concepts, once you try to define income or capital, then you're in real difficulty - they're extremely elusive concepts. But we have been talking about the right thing - how to do better, in relative terms, rather than how to get absolute perfection.

I'm not going to try to go through what every speaker said, there has been a good deal of overlapping and repetition and the discussion of the concepts, so I'll just touch on a couple of themes which struck me as particularly important.

The first thing, of course, which Accrual Accounting, as it's emerged in the Australian discussion, is about - and this point has been made - is not about giving an overall accurate position

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necessarily of any specific accounting entity or of government as a whole. It's about telling people what they didn't know and what they've got a right to know.

The classic case is unfunded superannuation liabilities of particular entities. When the issue emerged some years ago in New South Wales, and indeed this was referred to by Bob Walker, one of the major offenders turned out to be the University of New South Wales. He pointed out that the UNSW has something like a quarter of a billion dollars of unfunded superannuation and long service liabilities.

This may or may not be acceptable. But the point is that the Federal Government as the major funding agency for that University, did not know it. The University was happily handing superannuation entitlements, long service entitlements, and other perks and other lurks to its staff, without telling the Parliaments of the State or the Commonwealth or even for that matter the Treasury, what it was doing. It was making commitments which the taxpayer would be expected to fund without telling any of the taxpayers' representatives. Now that was what was wrong with that particular policy. Many of the other tertiary education institutions and many of the other statutory authorities were up to the same trick.

It is an enormous improvement, and again I'm talking primarily about New South Wales, that the New South Wales Government had the guts to face up to it and started to do something about it, and of course, the Commonwealth has had the guts to face up to it with regard to their various authorities. And indeed, many of the authorities themselves, have faced up to it without having to be dragged kicking and screaming into the light of the public gaze have started to face up to the problem. As was said, this is not a question of how funding is actually going to take place in the future. There are different approaches to that. But at least we need to know that the funding is going to have to happen. It's not going to be presented to an unsuspecting Parliament 10 years hence. Parliament will not be told you can't spend money on,

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shall we say, building a new school or building a new old folk's home because we didn't tell you about this hundred million bucks you have got to come up with this year. That's what the essence of Accrual Accounting in the basic sense is, that the liabilities which are going to have to be funded, have to be stated.

The question of the educational problem was raised. When I hear a politician or indeed a senior bureaucrat talking about the need to educate the public, I get extremely suspicious. Because what they really mean is, persuading the public to agree with them. Education is what every propagandist calls convincing the public that he is right. Now this is not the issue at all. The issue is actually, in fact, educating people on a proper sense of making available knowledge about the issues and the concepts and the performance of governments and authorities.

This Seminar is doing a considerable amount in that respect because its papers will be disseminated. Various journalists, the tiny number of journalists who have the training or the interest or the background to approach these things, will in themselves disseminate some of that education and will receive that education in various forms.

I think Percy Allan has had a bit of a tough trot today because he has been criticised for things for which he should not have been criticised. I think as a good bureaucrat he has said exactly what a good bureaucrat ought to have said. He pointed out the difficulties of implementing various proposals which make sense in themselves.

Now one of those difficulties is the presentational difficulty. I know a bit about this, because I was involved in some of these presentational difficulties.

Some years ago, when I was running the Financial Review, the question of unfunded liabilities, superannuating bodies like the University of New South Wales, etc, came out and the Financial Review ran a front page story, which Mr Wran who was feeling

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rather paranoid about the Fairfax press in those days didn't quite interpret correctly. We said that if New South Wales were a commercial business it would be technically bankrupt, because of these unfunded liabilities. Now that was an arguable position but we were not saying that New South Wales was bankrupt which was the impression that was gained by the rather beleaguered Premier at the time.

Of course, one can argue that this is a presentational difficulty or it's a difficulty of public misunderstanding or whatever. But it's obviously a difficulty which can be got over because the very point of putting it hard like that was to bring out what an important issue it was and to lead onto further discussion. And I do think the Financial Review contributed to that and on several occasions the Financial Review said, and indeed I said it in the the Financial Review and other people said it, that the New South Wales Government deserved a considerable amount of praise for the enormous reforms, the extent and depth of the reforms that it had brought about in New South Wales Government finance. I think this ought not to be forgotten.

In that sense, the presentational difficulties were minor, although it is still true that there are a very large number of people in the community who have to have it pointed out to them, that good government is not just a matter of building or not building monorails, but is actually administering the finances of the community properly, which is an important issue neglected by most of the people who talk about trivialities like monorails.

Again another issue which came out today, and I think it was one of the central arguments, was the question of what David Shand referred to as the private sector cringe, the question of whether you should consolidate on Accrual principles, or simply apply Accrual Accounting to individual accounting entities, statutory authorities or government departments. And the meaning of the term deficit.

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Now I speak as somebody who has got Economics training rather than Accounting training. Although I have done a fair bit of study of accounting principles.

But the concept of the deficit is not just an accounting concept. It is an economic concept and of course it has various other connotations in various other fields. When a federal government, a central government, talks about a deficit, it is talking about a cash deficit. As was said the issue is, how does that Government finance the discrepancy between its cash receipts and its cash expenditures?

Now emerging liabilities in that context are irrelevant. We are talking about macroeconomic considerations, not microeconomic considerations, and that's an important distinction in this whole argument. The central government finances its deficit by raising taxes or by borrowing. The importance of that deficit and the method of financing it is in what it takes out of the community in terms of real resources in that accounting period. Or what it puts into that community in real resources in the accounting period, if you like to talk about the government borrowing overseas to finance its domestic deficit. That's the American problem now, essentially. That's got nothing to do with the question of Accrual Accounting, but with macroeconomic considerations year by year.

Accrual Accounting is really about the efficient allocation of resources within particular economic entities, within particular government departments and ultimately in the community as a whole, but not on an aggregate basis, in the sense that it is not meaningful to aggregate each-entity, to add them all together and say that is the whole.

The macroeconomic whole is not the same as the sum of the microeconomic entities. The essence of the whole development of Economics is in the last 50 or 60 years in that distinction. In that development and this is what's wrong with Keynesianism, in that development the microeconomic issues have often been

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overlooked. And this is what Accrual Accounting in a governmental sense is about rediscovering. That is, applying proper management and economic criteria to particular spending decisions and to the conduct of an economic entity. But it's not about the macro-economic issue of government deficits. And that's even apart from the question of how do you value things like parliament houses or opera houses or even the amenities of Sydney Harbour, which are real national assets but almost by definition cannot be reduced to monetary terms, which doesn't mean that proper management cannot be applied to them.

Now in a sense you could say, and this emerged a bit today, that every discipline tends to have its own form of imperialism. And some of the speakers today seem to be accounting imperialists. Accounting principles have to be applied to every aspect of life and to the whole of life and to the whole of the economy and to the whole of all welfare considerations. Now a moment's reflection makes that nonsense whether it be applied to Accounting as a discipline, or Economics as a discipline, or indeed Philosophy as a discipline.

Now I think the final issue which needs to be addressed, is that of performance indicators and another word which I don't think anybody mentioned today, incentives. Performance indicators for any economic entity or any governmental entity, whether it be economic or not, are very important. In education, for example, I'd like to see performance indicators which don't relate necessarily to Accrual Accounting for unfunded liabilities for superannuation, but do apply to the product of education, namely the children and the economy and the youth who are supposedly educated. I'd like to see performance indicators for teachers -primary, secondary and tertiary, for example. I'd like to see performance indicators for education expenditure and the point was made, that if you don't know your liabilities for superannuation, you don't even know what your educational expenditure, let alone what the performance of educational expenditure, is.

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But the question really is, how do you give people incentives to perform in such a way as to meet performance indicators or to even set up performance indicators or to consider they're important? How do you get people to run public administration properly, efficiently, and well and want to improve it? One way is very obvious from today. There is the professional ethos of competence as a very important element in this. It's important in the public sector, it's important in the private sector. People don't necessarily want to be rich, creative accountants. Quite often they want to be successful, good accountants and well respected in their profession. But the financial aspects can't be overlooked, we do have to look, even in the absence of profit considerations, to the kind of material incentives that operate on people in government, in the bureaucracy, in politics. And this I think has got to go far beyond Accrual Accounting. It's something which can't be ignored when you're talking about how to apply accounting principles in such a way as to use them as tools in the search for good performance in government or indeed good performance in the private sector. And in the long run that's going to boil down to economic and non economic incentives.

Thank You.

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