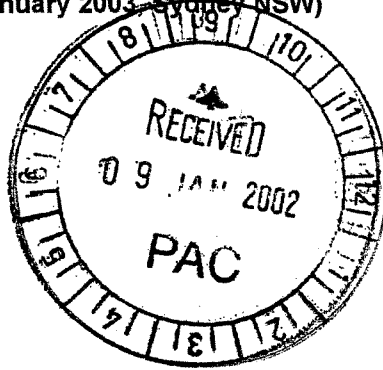


Sub 1

**Submission - Financial Reporting Requirements for Small Public Sector Agencies
(January 2003 - Sydney NSW)**

The Manager
Public Accounts Committee
Parliament House
Macquarie Street
SYDNEY NSW 2000



January 8, 2003

Dear Sir / Madam,

**INQUIRY INTO FINANCIAL REPORTING
REVIEW OF REPORTING REQUIREMENTS FOR SMALL AGENCIES**

I refer to your invitation for submissions from interested parties in relation to the above matter. I am an interested person and wish to make the following comments to assist the Public Accounts Committee in its inquiry into the financial reporting requirements for Small Public Sector Agencies.

If there is a case for changing the present statutory requirement for the audit of Small Public Sector Agencies were to be accepted there would appear to be two basic alternatives available¹, either:

- (a) a statutory requirement for an examination differing from an audit in its purpose and therefore in its methods: or
- (b) no legal requirement for an external examination of the financial statements.

In either case standards to be observed by the accountants / public servants associating their name with unaudited financial statements of the Small Public Sector Agencies would need to be laid down by the Audit Office. If there were no statutory requirement for an external examination of the financial statements, such standards would not necessarily be observed if the financial statements were prepared by an unqualified accountant or an officer with little experience in financial accounting.

The Public Accounts Committee, which acts as watchdog on expenditure by Government bodies, considers the purpose of preparing financial reports is to ensure both financial transparency and accountability by informing the public, through the Parliament, about the performance of agencies in the State Sector so that appropriate decisions can be made about the State Sector.

I do not accept that a small agency should be exempt from annual audit because it has been classified as *small*. A Small Public Sector Agency will have a

¹ ~~Subject to~~ certain restrictions and safeguards would need to be provided if the law is amended to allow Small Public Sector Agencies to opt out of the present statutory audit requirement.

**Submission - Financial Reporting Requirements for Small Public Sector Agencies
(January 2003, Sydney NSW)**

taxpayer funded budget of planned expenditures for the year ahead and must be accountable to the taxpayers of New South Wales. A Small Public Sector Agency must satisfy the external auditor that internal controls are adequate and that dependable periodic financial statements can be produced to correctly reflect the agency's financial position and financial performance for the period of planned expenditure.

The Discussion Paper tabled by the Public Accounts Committee on 20 November 2002 refers to the strength of an agency's internal control systems and makes it clear that small agencies may lack the financial expertise and knowledge depth to comply with all the requirements of financial reporting and accounting processes while larger agencies may have strong internal controls.

Internal Control is meant not only internal check and internal audit but the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the agency in an orderly manner, safeguard the agency's assets and secure as far as possible the accuracy and reliability of the agency's records.

The object of internal control is to provide a safeguard against errors and fraud and to ensure that the accounting and financial records include –

1. all income which should be received by the agency
2. all expenditure properly incurred and authorised by the agency
3. all the assets of the agency
4. all liabilities outstanding including provision for employee entitlements and the ascertainment or exposure to potential losses

It thus follows that all the records must provide a dependable basis for preparation of periodical financial statements for use by management and to assure Parliament that the business activities of the Public Sector Agency has been conducted in a proper and transparent manner and that taxpayers money has been spent for the purpose that it was intended for.

The concept of a small proprietary company as described in the Discussion Paper may be useful for the private sector where capital raising and the maximisation of shareholder wealth is fundamentally the driving force behind our capital system; but it would be improper to apply the same concept to classify a public sector agency as small for the purpose of granting it audit exemption. The entire state, through Parliament, is interested in the audited financial information of Public Sector Agencies which need to be accountable for public money and fixed assets deployed for the enduring benefit of the community irrespective of the agency's size, complexity, risk profile and structure. The public interest far outweighs any possible efficiency gains by reducing the number of agencies required to prepare reports and be audited.

**Submission - Financial Reporting Requirements for Small Public Sector Agencies
(January 2003, Sydney NSW)**

The issue of who should review agency classifications under a system of differential reporting is not critical because I do not propose any exemptions for Small Public Sector Agencies. Instead I propose that the Public Accounts Committee, in consultation with NSW Treasury, be the responsible body to undertake a reclassification of all Public Sector Agencies into Small, Medium or Large by using relevant classification criteria with a view to reforming the Public Sector through consolidation rather than granting exemption status for Small Public Sector Agencies. For example, the criteria² introduced in the *First Corporate Law Simplification Act 1995* can be applied to classify an agency as *small* with a view to “*subsidiarising*”³ it to a larger entity that already has strong internal controls, division of duties and the economies of scale to ensure both financial transparency and accountability.

What criteria is used to classify an agency as a *small* agency for the purposes of this discussion paper? Is it based on budgeted expenditure, the number of employees and its organisational structure, its low risk activities or a combination of any of these criteria.

Even if any one or all of the features of the agency were present, the agency would still need the level of internal controls I have described above and risk management in order to provide a safeguard against errors and fraud and to ensure that the accounting and financial records include –

- all income which should be received by the agency
- all expenditure properly incurred and authorised by the agency
- all the assets of the agency
- all liabilities outstanding including provision for employee entitlements⁴ and the ascertainment or exposure to potential losses

The cost of compliance for Small Public Sector Agencies engaged in low risk activities or have small budgets should not be a reason for relaxing the audit

² A proprietary company is small if it meets two of the three following criteria:

- Less than \$10 million in consolidated gross operating revenue.
- \$5 million in consolidated gross assets or less.
- Less than 50 equivalent full-time employees in the company and the entities it controls.

³ Subsidiarise – to make a subsidiary of a large agency or to transfer the function/s of the small agency to a large agency.

⁴ The recent collapse of Ansett Airlines highlights the need to identify and verify that all Employee Entitlements are fully provided for in the Statement of Financial Position of the Economic Entity and that the Economic Entity has sufficient assets to meet these entitlements as and when they fall due.

**Submission - Financial Reporting Requirements for Small Public Sector Agencies
(January 2003, Sydney NSW)**

requirements of Small Public Sector Agencies. There should be no trade off for agencies with small budgets engaged in low risk activities against the cost of report preparation⁵ and audit services. Assume there are 20 Small Public Sector Agencies with budgets of \$4 million dollars each engaged in low risk activities. Individually, this amount is small compared to a large public sector agency but collectively this would represent \$80 million of taxpayer's money allocated to these agencies to deliver services for the benefit of the community. A community which demands full accountability.

To exempt the Small Public Sector Agency from annual audit is to create a new class of entity that will not provide the same level of independent assurance to Parliament about its activities as does an agency with an accompanying Auditor's Report to its Annual Report.

Thankyou,

ÆB

Sydney, 8 January 2003

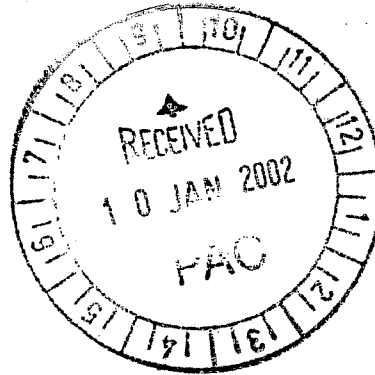
⁵ It should also be noted that there are other costs such as printing, photographic, artwork design and distribution costs which add significantly to the final cost of financial reporting for a small public sector agency.



PRIVACY

NEW SOUTH WALES

Enquiries: John Gaudin
Tel: (02) 9268 5581
Our ref: IR02/575
Your ref:



The Manager
Public Accounts Committee
Parliament House
Macquarie Street
Sydney NSW 2000

9 January, 2003

Dear Mr Monk

I refer to the Public Accounts Committee's Discussion Paper; Review of Reporting Requirements for Small Agencies. I do not wish to respond specifically to the questions posed by the Discussion Paper. However I would like to alert the Committee to a possible unintended consequence to the Privacy and Personal Information Protection Act (PIIP Act) which could follow from varying the audit requirements for small agencies.

The PIIP Act covers public sector agencies, which are defined in section 3 of the Act in a way which refers to the audit requirements of the Public Finance and Audit Act, as follows.

public sector agency means any of the following:

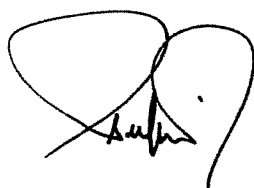
- (a) a government department or the Education Teaching Service,
- (b) a statutory body representing the Crown,
- (c) a declared authority under the Public Sector Management Act 1988,
- (d) a person or body in relation to whom, or to whose functions, an account is kept of administration or working expenses, if the account:
 - (i) is part of the accounts prepared under the Public Finance and Audit Act 1983, or
 - (ii) is required by or under any Act to be audited by the Auditor General, or
 - (iii) is an account with respect to which the Auditor General has powers under any law, or
 - (iv) is an account with respect to which the Auditor General may exercise powers under a law relating to the audit of accounts if requested to do so by a Minister of the Crown,
- (e) the Police Service,
- (f) a local government authority,
- (g) a person or body that:
 - (i) provides data services (being services relating to the collection, processing, disclosure or use of personal information or that provide for access to such information) for or on behalf of a body referred to in paragraph (a)–(f) of this definition, or that receives funding from any such body in connection with providing data services, and
 - (ii) is prescribed by the regulations for the purposes of this definition,

but does not include a State owned corporation.

Office of the Privacy Commissioner
PO Box A2122
Sydney South NSW 1235
Level 17, 201 Elizabeth Street
Sydney NSW 2000
Telephone 02 9268 5588
Facsimile 02 9268 5501
privacy_nsw@agd.nsw.gov.au
www.lawlink.nsw.gov.au/pc

When it came to establishing the scope of the Act's coverage, my Office found that a significant number of agencies were only covered by the Act by virtue of the audit requirements in clause (d) of the definition. I would be concerned if the Audit requirements of State agencies were removed from the legislation in a way which significantly diminished the coverage of the PPIP Act. I recommend that any recommendations made by your Committee recognise this possibility and record the need for consequential amendment to the PPIP Act to avoid such an effect.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Chris Puplick', enclosed within a large, loopy, hand-drawn outline that resembles a stylized heart or a large 'C'.

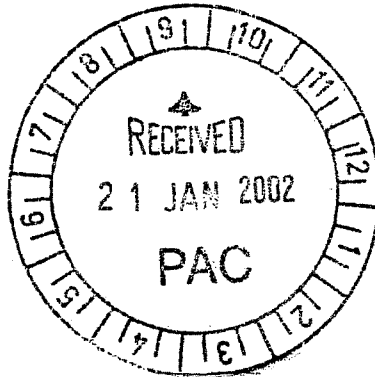
Chris Puplick
PRIVACY COMMISSIONER



NEW SOUTH WALES

Minister for Education and Training

Mr Joseph Tripodi MP
Chairman
Public Accounts Committee
Parliament House
Macquarie Street
SYDNEY NSW 2000



RML 02/9329

Dear Mr Tripodi,

I refer to your letter, received by me on 28 November 2002, inviting submissions to an inquiry of the Public Accounts Committee on the Discussion Paper, *Review of Reporting Requirements for Small Agencies*.

The Department of Education and Training prepares annual reports and financial statements for two small agencies. These agencies are the Technical Education Trust Funds (TETF), which has net assets of \$400,000 and annual revenue of \$24,000; and the Art Education Foundation Trust which has net assets of \$163,000 and annual revenue of \$7,600.

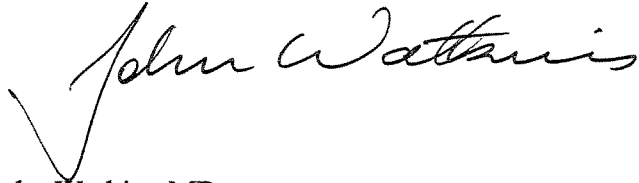
These agencies are subject to the same reporting requirements as the Department. The TETF was created by the *Technical Education Trust Funds Act 1967* which refers to the requirements of the *Public Finance and Audit Act 1983*. Any changes to reporting requirements will therefore require changes to other related legislation. A trust instrument created the Arts Education Foundation Trust.

Public money should always receive a strong level of protection against the possibility of inappropriate use. Audit office reviews are one way in which an independent assessment of that protection can be obtained. However, the cost of auditing a small agency may be disproportionate to the costs incurred by a larger organisation and the level of fees for small agencies might be considered for inclusion in the review.

I agree with the range of factors outlined on page 8 of the Discussion Paper which are listed for consideration when deciding whether an agency should be audited. In particular, the factor concerning external and internal risks as determined by the Audit Office would appear to be integral to the decision. Regardless of the audit regimen determined, the requirement for the agency to produce annual and financial reports should remain consistent with current accounting standards and legislation.

Should you have any further enquiries regarding this issue, please contact Mr Ian Gillespie, Relieving General Manager of Finance by telephone 9561 8922.

Yours sincerely,

A handwritten signature in black ink that reads "John Watkins". The signature is written in a cursive style with a large, sweeping initial 'J'.

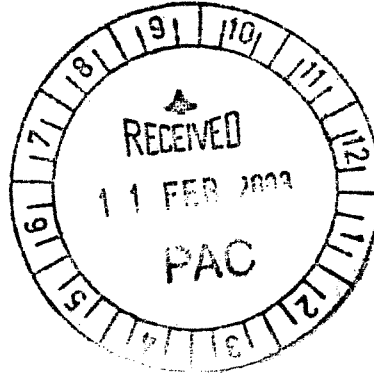
John Watkins MP
Minister for Education and Training

16 JAN 2003



New South Wales
TREASURY

Mr J.Tripodi MP
Chairman
Public Accounts Committee
Parliament House
Macquarie Street
SYDNEY NSW 2000



Contact: M.Smith
Telephone: (02) 9228 5158
Our Reference: E19096
Your Reference: Report 138 [No 20/52]

- 7 FEB 2003

Dear Mr Tripodi

Review of Reporting Requirements for Small Agencies

Thank you for providing NSW Treasury with the opportunity to comment on the Public Accounts Committee's Discussion Paper *Review of Reporting Requirements for Small Agencies*. Treasury shares the Committee's concerns regarding the level of reporting required by these agencies.

Treasury believes that differential reporting could expose the public sector to additional risks (appendix 1). The Public Bodies Review Committee, the Clerk of the Legislative Assembly, the Audit Office and two other agencies have indicated that they do not support differential reporting (appendix 2). Treasury's current review of annual reporting will focus on agencies' objectives, and their performance in achieving these objectives. The review will consider moving less relevant compliance reporting to an all-agency data base. If implemented, this will result in fewer annual reporting requirements for all agencies as well as improve the standard and usefulness of reports. This is considered preferable to imposing a differential regime on existing requirements (appendix 3).

Treasury has also responded to each of the questions raised in the Discussion Paper (appendix 4).

Please contact me (tel: 9228 3308) if you require further information.

Yours faithfully

Ian Neale
for Secretary

INDEX

- Appendix 1 Differential reporting - observations
- Appendix 2 Differential reporting - surveyed comments
- Appendix 3 Reduce number of annual reporting requirements
- Appendix 4 Response to questions raised in PAC discussion paper

DIFFERENTIAL REPORTING - OBSERVATIONS

The Parliament/Government has established the NSW public sector reporting regime. Currently, no exemption on the basis of size is available. The premise is that if the Parliament/Government believes an agency should be established separately, then the agency should be subject to all Parliament/Government reporting requirements. This is a logical premise.

One option for making small agency reporting more efficient and effective is to establish a differential reporting regime. Under such a regime, small entities are exempted from some of the reporting or auditing requirements. There are several problems in moving to a differential regime:

1. **Differences of opinion as to status:** An agency, the Treasury, the Auditor-General, the Government, the Parliament and the public may have different views on whether an agency is "large" or "small". Differential reporting may create unnecessary confusion.
2. **Determination of large/small status:** Some agencies have low dollar value assets, liabilities, expenses and revenues yet have high dollar value commitments and contingent liabilities. Users of financial statements should not be deprived of information (or audit) because the main financial statements detail low financial activity.
3. **Timing of determination:** An agency's status could change from "small" to "large" due to a single transaction on the last day of the agency's financial year. Agencies, the Treasury and the Auditor-General may not become aware of the change until well after the end of the financial year. This may delay preparation and audit of the Total State Sector Accounts.
4. **More and less important criteria (risk to transparency, integrity and comparability of reports):** "More important" requirements would apply to all agencies. "Less important" requirements would only apply to large agencies. Large agencies would become aware of what the Parliament/Government considers "less important". This knowledge could result in a reduced standard of reporting of these items by large agencies and jeopardise the transparency, integrity and comparability of reports.
5. **Reporting entity under Australian Accounting Standards:** Australian Accounting Standards require that all "reporting entities" prepare general purpose financial statements. According to Statement of Accounting Concepts SAC 1 *Definition of the Reporting Entity* "most government departments and statutory authorities will be reporting entities". NSW legislation could be amended to remove the requirement on particular agencies to prepare financial statements. However, Australian Accounting Standards may still require that these agencies prepare financial statements. The Auditor-General audits in accordance with Australian Accounting Standards. If financial statements for a reporting entity were not prepared, the Auditor-General would still be required to issue a qualified independent audit report.
6. **Transactions structured through small agencies:** Incentives could be created for agencies to structure transactions through "small" controlled entities principally to avoid reporting and auditing. This would be a poor outcome for public accountability.

DIFFERENTIAL REPORTING – SURVEYED COMMENTS

Treasury's 1998 working paper *Fundamental Review of NSW Financial and Annual Reporting Legislation* (the Consultative Document) proposed a new framework for reporting by NSW public sector agencies. The Consultative Document was circulated to Members of Parliament, agencies, the Auditor-General, Australian Accounting Bodies, accounting firms, private sector bodies and other interested parties.

One of the issues raised in the Consultative Document was a proposal to introduce differential reporting. The Public Bodies Review Committee, the Clerk of the Legislative Assembly, the Audit Office and two other agencies indicated in their submissions that they did not support differentiation as proposed in the Consultative Document.

Treasury reported this to the Fundamental Review Working Party (consisting of the Auditor-General and various senior chief finance officers) and Reference Panel (consisting of agency finance officers, accountants and other interested people). Treasury recommended that no further extension to the current degree of differential reporting be undertaken. The Working Party and Reference Panel both accepted Treasury's recommendation.

REDUCE NUMBER OF ANNUAL REPORTING REQUIREMENTS

NSW public sector agencies must comply with various Parliament and Government imposed reporting requirements including:

- *Public Finance and Audit Act 1983*
- *Annual Reports (Statutory Bodies) Act 1984*
- *Annual Reports (Departments) Act 1985*
- *Annual Reports (Statutory Bodies) Regulation 2000*
- *Annual Reports (Departments) Regulation 2000*
- Treasurer's Directions
- Premier's Memoranda

Some recent annual reporting requirements do not provide information which directly assist in assessing agency performance. For example, agencies are required to include a certification on the use of credit card use and report in detail on freedom of information requests. The number of requirements continues to increase. As a result, the time and costs required to prepare annual reports also increases.

Differential reporting has been suggested as a means to reduce this problem for small agencies. A better solution may be to remove unnecessary reporting requirements, or publish the information in other reports compiled by the appropriate central agencies.

The Consultative Document page 49 states:

"At present, some of the detailed information included in the annual reports of agencies is also required to be submitted to central agencies in another form (eg equal employment opportunity and freedom of information statistics). It has been suggested that such information could perhaps be deleted from the annual reports and instead be published centrally by an appropriate agency. This proposal is worthy of further consideration. If adopted, it has the potential to ameliorate the problem of information overload as well as reducing the cost of production of annual reports.

In selecting materials for centralised publication, the criterion should be that the information is not directly related to the management process and it is not essential for the assessment of an agency's performance."

Treasury's current review of annual reporting will focus on agencies' objectives and their performance in achieving these objectives. The review will consider moving less relevant compliance reporting to an all-agency data base. If implemented, this will result in fewer annual reporting requirements for all agencies and will improve the usefulness of reports. This is considered preferable to imposing differential reporting on an already cumbersome reporting regime.

Concerns regarding the number of requirements imposed on small agencies may also be managed by considering, from time to time, the continued appropriateness of structural arrangements for service delivery. This includes assessing the most efficient and effective structures for delivering services, taking into account any changes in function, economic environment and interrelationships with other agencies.

RESPONSE TO QUESTIONS RAISED IN PAC DISCUSSION PAPER

1. Who are the users of financial and annual reports? The Parliament? The Government? The public?

The Parliament, the Government and the public may all use financial and annual reports to hold the management of agencies accountable for the use of public moneys.

Australian Accounting Standards require all “reporting entities” to prepare general purpose financial statements. According to Statement of Accounting Concepts SAC 1 *Definition of the Reporting Entity* “most government departments and statutory authorities will be reporting entities”.

2. Do the Parliament and the public need to know the detailed financial circumstances of very small entities?

As noted above, Australian Accounting Standards presume that most government agencies are reporting entities. These agencies must prepare financial statements in accordance with Australian Accounting Standards irrespective of any exemptions provided by NSW legislation or Treasury.

3. Does the need for accountability for public money and assets outweigh any possible efficiency gains by reducing the number of agencies required to prepare reports and be audited?

The current level of accountability can be retained but the number of reporting requirements can be reduced by removing those requirements that do not directly assist in helping the reader to evaluate agency performance (appendix 3). In addition, the number of agency reports may be managed by considering, from time to time, the continued appropriateness of structural arrangements for service delivery, taking into account any changes in function, economic environment and interrelationships with other agencies (appendix 3).

4. Would there be any benefit in reducing the level of scrutiny for small agencies? If so, what criteria would be appropriate?

The benefits in reducing scrutiny for small entities include:

1. Reduction in staff time required to prepare financial statements and annual reports. This time could be used for other purposes.
2. Reduction in time required to audit financial statements. This would result in reduced audit fees.
3. Reduced printing and distribution costs.

There are, however, disadvantages in moving to a system of differential reporting – refer question 6 below.

5. Is it essential to maintain a link between financial reporting requirements and the need to prepare an annual report?

Under existing legislation, not all public sector agencies that prepare financial statements are required to prepare annual reports.

All agencies listed in Schedules 2 and 3 to the *Public Finance and Audit Act 1983* are required to prepare financial statements, which must be audited by the Auditor-General. These agencies are also required to prepare annual reports.

Controlled entities of agencies listed in Schedules 2 and 3 are required to prepare financial statements, but are not required to prepare annual reports. Information on these agencies must be included in the annual report of the controlling entity.

Agencies that are audited at the invitation of a Minister or the Treasurer are required to prepare financial statements, but are not required to prepare annual reports.

6. Would the State's financial reporting be subjected to any additional risks by creating differential levels of reporting?

Yes. These risks are discussed in Appendix 1 under the headings:

1. Differences of opinion as to status
2. Determination of large/small status
3. Timing of determination
4. More and less important criteria (risk to transparency, integrity and comparability of reports)
5. Reporting entity under Australian Accounting Standards
6. Transaction structured through small agencies

7. Who should review classifications under a system of differential reporting? How often? Should these reviews be subject to Parliamentary scrutiny?

As noted in Appendix 1 under the heading "Differences of opinion as to status" an agency, the Treasury, the Auditor-General, the Government, the Parliament and the public may have different views on whether an agency is "large" or "small". A system of differential reporting, which is subject to review may create confusion and instability for agencies.

In practice, classifications would need to be determined annually, by the Treasury in consultation with the Auditor-General. Parliament and the Government would not need to be involved in this detailed process.

Treasury and the Auditor-General could disagree on classification. Presumably, the Auditor-General would advise of any disagreement in his reports to Parliament.

8. What level of resources are required to prepare annual and financial reports? Is this onerous for small agencies?

This question is best answered by agencies.

9. Would it be appropriate to enable smaller, low risk agencies to prepare less comprehensive financial reports?

Risk is probably harder to define than size. Not all “small” agencies are “low-risk”. Conversely, not all “large” agencies are “high-risk”. Treasury does not consider that “smaller”, or “low” risk agencies (however defined) should be subject to a less comprehensive reporting regime. Reasons are discussed in Appendix 1.

10. If so, what criteria would provide the right balance between risk and accountability?

Treasury does not consider that the cost saving achieved by differential reporting justifies the additional risks.

If however, a differential model were adopted, criteria for determining risk would need to include:

1. Consolidated Fund appropriation \$
2. revenue \$
3. expenditure \$
4. assets \$
5. liabilities \$
6. commitments \$
7. contingent liabilities \$
8. legal status (eg all SOCs irrespective of dollar value)
9. public interest in agency (irrespective of dollar value)

One of the risks associated with differential reporting is that parent entities could structure transactions to occur through controlled entities for the purpose of avoiding scrutiny. If the criteria for determining the distinction between “small” and “large” were publicly known, some agencies could structure transactions to avoid scrutiny. To avoid this, it may be better not to document criteria for the “small” and “large” test, although this would not be a desirable outcome for transparency reasons. However, if this option was pursued, Treasury and the Auditor-General could agree on which agencies are “small”. The presumption could be that an agency is classified as “large” for reporting purposes unless both Treasury and the Auditor-General agree that the agency should be classified as “small”.

11. What should be included in a concise financial report?

As previously noted, Australian Accounting Standards generally assume that public sector agencies are reporting entities irrespective of size. As a minimum, a concise financial report would need to comply with Australian Accounting Standards. Other disclosures currently required by NSW legislation could be dispensed with.

“More important” NSW requirements would apply to all agencies. “Less important” requirements would only apply to large agencies. Large agencies would become aware of what the Parliament/Government considers “less important”. This knowledge could result in a reduced standard of reporting of these items by large agencies.

12. How often should decisions be made about an agency’s reporting requirements?

Assessment would have to be made at least annually.

13. What are the risks if the level of audit for small entities is reduced?

The risks associated with reducing the level of audit for small entities are discussed in Appendix 1.

14. Has the Audit Office added any benefit by performing reviews of very small agencies included in the PFA Regulations by identifying accounting control problems or other financial management issues?

The Audit Office’s role is to detect and report on material non-compliance with NSW financial legislation, Treasurer’s Directions and legislation and Australian Accounting Standards. The Auditor-General could advise the Public Accounts Committee as to the level of non-compliance by small agencies, which has been detected and adjusted prior to finalisation of financial statements.

The Audit Office also has a role in the prevention of non-compliance. Agencies are more likely to take care with their financial affairs simply because they will be subject to audit by the Auditor-General. The value of this role in respect of small agencies is unquantifiable.

15. Who should decide whether organisations are subject to this level of scrutiny? The Government? The Treasury? The Parliament?

In practice, classifications would need to be determined annually, by the Treasury in consultation with the Auditor-General. Parliament and the Government would not need to be involved in this detailed process.

Treasury and the Auditor-General could disagree on classification. Presumably, the Auditor-General would advise of any disagreement in his reports to Parliament.

16. What should be the criteria for deciding the reporting requirements for agencies? For instance, should it be the size of the budget, assets or whether their activities are commercially focussed?

Factors could include:

1. Consolidated Fund appropriation \$
2. revenue \$
3. expenditure \$
4. assets \$
5. liabilities \$
6. commitments \$
7. contingent liabilities \$
8. legal status (eg all SOCs irrespective of dollar value)
9. public interest in agency (irrespective of dollar value)

As noted previously (refer question 10), one of the risks associated with differential reporting is that parent entities could structure transactions to occur through controlled entities for the purpose of avoiding scrutiny.

17. Should there be a regular revision of organisations included in the invited audits list?

Invited audits are audits undertaken by the Auditor-General pursuant to a request by a Minister or the Treasurer under sections 44 and 45 of the *Public Finance and Audit Act 1983*.

The agency and the Auditor-General would be best placed to know whether there is a continued need for audit. Where appropriate, the agency or the Auditor-General could suggest to the responsible Minister that the invitation be withdrawn. The responsible Minister could then request that a particular agency be removed from the list of invited audits.



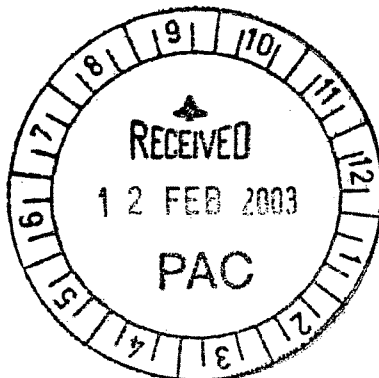
Office of the
Auditor-General of Queensland

Your ref:

Our ref: 00-3173

7 February 2003

Mr D Monk
The Manager
Public Accounts Committee
Parliament House
Macquarie Street
SYDNEY NSW 2000



Dear Mr Monk

I refer to the Committee's Discussion Paper entitled *Review of Reporting Requirements for Small Agencies*, which seeks comment on a range of issues related to the efficiency and effectiveness of accountability arrangements for small agencies.

It is clear that there are a number of competing issues relevant to the consideration of auditing and reporting requirements for small and very small public sector entities. It is my opinion that the public has a right to be assured that entities funded by the public purse or controlled by Government are financially sound and that expected standards of probity, propriety and compliance are being met. Within this context, Government also has to balance its responsibility for ensuring that the services are delivered in an efficient and effective manner.

The attachment to this letter provides commentary on the relevant questions included in the discussion paper. Please do not hesitate to contact Mr Len Scanlan, Auditor-General, on (07) 3405 1103 should you wish to discuss this letter in more detail. Alternatively your officers may contact Mr John Findlay, Director – Audit Policy and Reporting on (07) 3405 1115 (e-mail john.findlay@gao.qld.gov.au).

Yours sincerely

V P MANERA
Acting Auditor-General of Queensland



Attachment – Responses to Questions included in the Discussion Paper

1) Who are the users of financial and annual reports? The Parliament? The Government? The public?

All stakeholders noted are users of financial statements and annual reports. Audited financial statements and annual reports facilitate accountability and transparency and allow stakeholders to review the financial and operational performance of the entities concerned.

2) Do the Parliament and the public need to know the detailed financial circumstances of very small entities?

There are a range of views on whether the Parliament and public need to know the detailed financial circumstances of very small entities. While there are arguments that the audit of very small entities (which are generally insignificant in materiality terms as opposed to the wider public sector) may be considered inefficient, I contend that public interest considerations need to be taken into account. For example, credible 'safety nets' should be in place to provide independent scrutiny on behalf of Parliament and the public. This has been recognised in amendments to the *Financial Administration and Audit Act 1977* in 2001 whereby the Queensland Parliament expanded the Auditor-General's mandate to audit controlled entities (mostly small entities). In small organisations where there are often weak internal controls, external audit and reporting deter opportunities for fraud, misappropriation or corruption, and act to detect going concern issues, all of which attract considerable attention from a public interest point of view. In this respect, materiality levels are not relevant.

External audit also provides business improvement opportunities and facilitates good governance practices as knowledge is shared with entity staff.

With specific reference to annual reporting, consideration could be given to achieving efficiencies through streamlined reporting arrangements. Some examples for consideration include the use of summary or short form annual reports (see for example s. 46KL of the *Financial Administration and Audit Act* and s. 95 of the *Financial Management Standard 1997 (Qld)* respectively.¹ One drawback however in the use of summary reports in Queensland's experience is that the size of the entities and the lack of sophistication of accounting systems and records have a major impact on the uniformity of data that can be collected.

3) Does the need for accountability for public money and assets outweigh any possible efficiency gains by reducing the number of agencies required to prepare reports and be audited?

As outlined in Question 2, accountability, although a central issue, is not the only argument for the retention of the preparation of financial statements for certification by external audit and the preparation of financial reports. The provision of knowledge sharing and potential business improvement opportunities, detection of going concern issues, pressure to establish good governance systems, and mitigation of control weaknesses are all associated with the preparation of financial statements for external audit and reporting.

Consideration could be given to other alternatives for achieving efficiencies rather than removing fundamental accountability arrangements such as financial statements and annual reporting. For example, amalgamation of small entities where appropriate and feasible, streamlined financial reporting requirements, use of special purpose rather than general purpose financial statements (where appropriate) or the use of summary or short form reports as discussed in Question 2 above.

4) Would there be any benefit in reducing the level of scrutiny for small agencies? If so, what criteria would be appropriate?

Benefits in reducing the dollar cost of accountability measures (such as audit fees and annual reporting) are offset by costs of reduced accountability and assurance to Parliament and the public. The creation of a streamlined financial reporting processes and use of short-form or summary reports could reduce the dollar cost of accountability measures, while still retaining independent scrutiny and assurance over public sector entity operations.

¹ Refer www.legislation.qld.gov.au for copies of this legislation.

5) Is it essential to maintain a link between financial reporting requirements and the need to prepare an annual report?

Yes. Financial reporting is only one aspect of accountability – stakeholders are also entitled to know about the operational performance of entities. Poor operational performance of an entity can manifest itself in both inefficiency and ineffectiveness. Annual reports traditionally provide both financial and operational reporting.

6) Would the State's financial reporting be subjected to any additional risks by creating differential levels of reporting?

In Queensland, differential reporting already occurs, for example, some small entities such as Aboriginal Councils produce cash-based statements and are not required to produce annual reports. Issues would arise in situations where entities are required to be consolidated into parent entities, or where whole of Government information is required.

7) Who should review classifications under a system of differential reporting? How often? Should these reviews be subject to Parliamentary scrutiny?

This is fundamentally a Government policy decision, however, where the reporting regimes are established by legislation, amendments to these regimes need to be subject to Parliamentary scrutiny.

8) What level of resources are required to prepare annual and financial reports? Is this onerous for small agencies?

The preparation of general purpose financial statements for small entities consumes significant resources. The use of special purpose financial statements is less resource intensive. The issue with a number of the smaller entities, for example statutory bodies and local Governments in Queensland, is that they find it difficult to attract and retain qualified accounting staff. Many engage financial consultants to prepare their annual financial statements which can be expensive. However, a number of smaller councils are relying on accounting software packages which have been designed to comply with their reporting requirements and are generally working satisfactorily.

9) Would it be appropriate to enable smaller, low risk agencies to prepare less comprehensive financial reports?

See responses to Questions 2 to 4.

10) If so, what criteria would provide for the right balance between risk and accountability?

A range of criteria could be considered, including –

- Sensitivity
- Level of public funding
- Materiality of operations
- Revenue / asset budgets
- Financial soundness of organisation
- Size of budget
- Number of staff
- Number of operational locations

11) What should be included in a concise financial report?

Section 95 of the Financial Management Standard refers to AASB 1039 Concise Financial Reports so far as is relevant. This is regarded as an acceptable benchmark.



12) How often should decisions be made about an agency's reporting requirements?

Although fundamentally a policy issue for Government, circumstances including changes in the public sector financial management environment or issues facing individual entities would influence this timeframe.

13) What are the risks if the level of audit for small entities is reduced?

Although it is not clear to what extent the committee envisages that audit would be 'reduced' (eg auditing with parent entity or no audit at all for small entities as noted in the discussion paper) there will always be risks associated with a decrease in independent external scrutiny such as that afforded by audit. Obvious risks include –

- Weakening of governance systems and internal controls resulting in the failure to detect fraud, misuse of funds, waste and extravagance;
- Failure to detect significant errors or going concern issues;
- Quality of reports to Boards / parent entities may decrease;
- Less reliance being able to be placed on small entities by granting and other funding bodies in the absence of assurance from independent external audit; and
- Parent entities may attempt to limit scrutiny, for example by placing liability or asset balances in small subsidiaries not subject to audit, thereby effectively removing inappropriate transactions from view.

Although the level of materiality involved in small and very small audits is generally low, in a public sector context consideration must always be given to probity, propriety and compliance.

14) Has the Audit Office added any benefit by performing reviews of very small agencies (audit time less than 50 hours) by identifying accounting control problems or other financial management issues?

As noted in Question 2, in a general sense external audits facilitate business improvement opportunities as knowledge is shared with entity staff. The act of preparing financial statements for certification and annual reports also facilitates transparency and good governance practices.

15) Who should decide whether organisations are subject to this level of scrutiny? The Government? The Treasury? The Parliament?

A policy decision by Government which should be debated by Parliament in instances where entities are subject to audit and reporting regimes imposed by legislation. As noted in Question 2, recent legislative amendments to the Financial Administration and Audit Act increased the number of controlled entities (mostly small entities) subject to audit by the Auditor-General.

16) What should be the criteria for deciding the reporting requirements for agencies? For instance, should it be the size of the budget, assets or whether their activities are commercially focussed?

Refer Question 10. Also need to consider consolidation issues, potential users of the information, whole of Government reporting, and whether reliance is placed on the information for the acquittal of grant or other funding. Consideration could also be given to reporting requirements under the *Corporations Act 2001* for different sized entities.

17) Should there be regular revision of the organisations included in the invited audits list?

Not applicable.