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**Parliament of New South Wales**

**Public Accounts Committee**

**of the**

**Fiftieth Parliament**

**Report on Progress of**

**Financial Reform in the**

**the New South Wales**

**Public Sector**

**Sixty-fourth Report**

**Inquiry pursuant to Section 57(1) of the Public Finance and Audit Act 1983,  
concerning the Progress of Financial Reform in the New South Wales Public  
Sector**

**June 1992**



**From left:**

***Geoff Irwin, Jim Longley (Chairman), Ray Chappell (Vice-Chairman), Terry Rumble, Michael Photios.***

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### **Mr Jim Longley, BEc, MEc, FCPA, ThC, MP, Chairman**

Jim Longley was elected Liberal Member for Pittwater in May 1986. Prior to entering Parliament he worked in the banking industry; he was a corporate analyst in Westpac's London office and group planning manager in the Sydney head office. He served as a member of the Regulation Review Committee and the New South Wales Parliamentary Library Committee, and has chaired three Government Committees, including the Treasury Advisory Committee.

### **Mr Ray Chappell, MP**

Ray Chappell was elected National Party Member for Northern Tablelands in May 1987. He has worked in university administration and in the building and retail industries, and he served four terms as an alderman on Armidale City Council. Ray Chappell was a member of the Regulation Review Committee and is the Legislative Assembly representative on the Board of Governors of the University of New England.

### **Mr Geoff Irwin, ProdEngCert, DipTech, DipEd, MP**

Geoff Irwin was elected as a Labor Member to Parliament in March 1984. He is currently the Member for Fairfield. Before entering Parliament he worked in industry as a planning and supply manager and taught business studies at TAFE. He served as a member of the Select Committee upon Small Business and as Opposition spokesperson on business and consumer affairs.

### **Mr Terry Rumble, AASA, MP**

Terry Rumble was elected Labor Member for Illawarra in March 1988. Before entering Parliament he qualified as an accountant and was employed in public practice and in the coal mining industry. He has served as a member of the Regulation Review Committee and as the Secretary of the Opposition Committee on Employment and Industry.

### **Mr Michael Photios, MP**

Michael Photios was elected as a Liberal Member to Parliament in March 1988. He is currently the Member for Ermington. Prior to entering Parliament he was marketing manager of an importing company. Michael Photios is a Trustee of the Ethnic Communities Council of NSW. He served as a member of the House Committee, is a member of four Government Committees, and chairs its Environment Committee.

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## CHAIRMAN'S FOREWORD

The Public Accounts Committee has a wide-ranging charter to examine and inquire into all aspects of public sector accountability in New South Wales. This report is a study of progress made to date on the package of financial reforms that were developed in the 1980s and are being implemented in the 1990s.

As part of the study, the Committee undertook a review of the development of the public sector's financial and reporting functions as they have developed since colonial days.

Throughout the 1980s a wide range of reforms were proposed involving, essentially, legislation to update the government accounting, auditing, reporting and external review functions. The range of public sector bodies responsible to the Parliament has increased substantially over the past decade, and unless the financial managers in the public sector continue to positively respond to the reform process, the Parliament will not be able to demonstrate that it can hold the executive and the whole public sector accountable.

If Parliament is to exercise effective control over government departments and authorities, and at the same time respond to the public's demand for a leaner and more cost-efficient public sector, managers must produce timely reports. These reports must contain not only reliable financial statements, but also other qualitative and quantitative data that fully disclose the size and complexity of the public sector in the 1990s.

To achieve this higher level of accountability, there must be a major upgrade in the financial skills and competencies of all managers in the public sector. The Committee strongly recommends that Treasury respond to this need by establishing a formal financial management improvement program to train and develop the skills of all staff.

The process of change must continue. Major reforms that will begin operating from July 1992 should be followed by a further package of reform measures that will ensure that New South Wales remains at the forefront of public sector financial reform.

The Committee wishes to express its appreciation to the many officers from government departments and authorities who assisted in the preparation of the case studies. The Committee acknowledges with gratitude the readiness of the panel of

experts who presented papers at the May 1992 seminar to share their professional experiences with their colleagues.

The Committee also wishes to acknowledge the dedicated work of the staff of its secretariat, particularly its consultant, Mr John Lynas, who so capably undertook the task of researching and preparing this report. The services of Mr Lynas were kindly made available to the Committee by the New South Wales Auditor-General, to whom the Committee wishes to express its gratitude. For invaluable secretarial assistance, the Committee wishes to thank Ms Robyn West, who worked above and beyond the call of duty.

A handwritten signature in cursive script that reads "Jim Longley". The signature is written in black ink and is positioned above the printed name.

Jim Longley, BEc, MEc, FCPA, ThC, MP  
Chairman

The health sector discussed in the fourth case study, is, in dollar terms, one of the largest areas of public sector outlays. The financial administration of the sector has to take into account the varying and at times apparently conflicting requirements of Commonwealth and State government financial reporting policies. The New South Wales Government requires statutory authorities to prepare their financial statements on an accrual accounting basis. The Commonwealth, on the other hand, funds health and other State grants on a cash basis. Compliance with Health Department budgets is a major financial control mechanism imposed upon the area health boards and individual hospital boards. This case study highlighted an instance where the Health Department made a retrospective adjustment to an area health service board's budget after the close of the financial year. The Health Department advised the Committee that this retrospective adjustment did not reflect adversely upon the administration of the board.

The training of staff and the development of a high level of competency in financial management can be seen as a requirement for the successful implementation of the package of financial reforms which include accrual accounting. The fifth case study on the Department of Corrective Services demonstrated how this issue had been addressed by introducing topics of financial administration in training courses to be conducted at the Corrective Services Academy.

Across the wider range of departments, statutory authorities and other reporting entities, there is a need to develop the skills and competencies of all managers in financial management. The Committee recommends that the Treasury sponsor and develop a financial management improvement program in co-operation with the professional bodies covering accounting and public administration. Completion of such a course should become a desirable attribute for promotion for otherwise qualified staff.

A key component in this review was a seminar held at Parliament House and hosted jointly by the Public Accounts Committee and the Treasury. At the seminar a panel of experts from Treasury and a user department and a retired senior Treasury official and a senior private sector accountant presented papers giving their views on progress to date in financial reform. All participants at the seminar had no doubt that the process of financial reform must continue if the public sector is to play its part in the well-being and development of Australia.

## SUMMARY OF RECOMMENDATIONS

1. The Committee recommends that the Treasury and Auditor-General develop guidelines to test the accuracy and appropriateness of reporting measures of efficiency, and that on a best practice basis, audits be undertaken of performance indicators included in annual reports. This audit task should be additional to the audit of financial statements and be regarded as part of the special audit functions under section 38B of the Public Finance and Audit Act (page 26 of this report).
2. The Committee recommends that on an annual basis Treasury publish a summary of the "good" and "bad" points disclosed from this review, the aim of this activity being to provide assistance in improving annual reports, not in identifying defaulters (page 27 of this report).
3. The Committee recommends that Treasury actively encourage participation by public sector reporting bodies in annual reporting competitions conducted by the Australian Institute of Management and similar bodies. The Royal Institute of Public Administration (Australia) and other professional bodies could be encouraged to promote this participation (page 27 of this report).
4. The Committee recommends that the valuation processes be reviewed to ensure that capital expenditure in earth works, ground improvements etc. be recorded at appropriate value to accurately reflect the State's equity in a project (page 38 of this report).
5. The Committee recommends that the basis for setting the fees payable to the Valuer-General's Department be reassessed in view of information disclosed by accrual accounting (page 45 of this report).
6. The Committee recommends that the Treasury, in collaboration with the Australian Accounting Research Foundation and the Public Sector Accounting Standards Board, expedite the issue of an Australian accounting standard for public sector infrastructure assets (page 52 of this report).
7. The Committee recommends that, if a controlling department finds it necessary to make adjustments to budget targets for controlled authorities, then the annual

report of the authority is to include a summary statement of the impact of the directions on the results for the year (page 58 of this report).

8. The Committee recommends that the Treasury strongly advocate the early promulgation of an Australian accounting standard for budget sector government departments and authorities (page 60 of this report).

## **INTRODUCTION**

This report is a study of the progress of financial reforms within the New South Wales public sector. In the 1990s the public - being taxpayers, electors, investors or users of public sector services - has an expectation that the highest level of probity and propriety will be maintained over public sector financial dealings.

To respond to this expectation a challenge is given to all public sector finance managers to ensure that accounting records and financial statements are prepared in a timely manner so as to ensure that full disclosure is made of all financial transactions and commitments.

## **ROLE OF THE PUBLIC ACCOUNTS COMMITTEE**

The Public Accounts Committee has been pivotal in the reform processes affecting the finances of the New South Wales public sector. In New South Wales the process of financial reform can be argued as being ahead of other States, the Territories, and indeed the Commonwealth. In one aspect at least New South Wales is a world leader, this being the presentation of consolidated financial statements covering the whole of government.

The Public Accounts Committee has always held a special interest in the reform of public sector finances. Since 1981 successive committees have shown a particular interest in reviewing the reform processes and, where necessary, in drawing attention to areas within the public sector where reforms or changes are necessary.<sup>1</sup>

## **TERMS OF REFERENCE**

The terms of reference adopted by the Committee for this inquiry were to inquire and report upon:

1. The Public Accounts of the State and the presentation by Treasury of "whole of government" consolidated financial statements.
2. The accounts of authorities of the State with particular reference to the adoption and implementation of accrual accounting.

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<sup>1</sup> For a summary of reports by the Public Accounts Committee since 1981 see *Annual Report of the Public Accounts Committee for 1990-91*.

3. The external reporting by authorities of the State with particular reference to the review processes over annual reports.
4. Any other matter that relates directly or indirectly to the reform of public sector finances in New South Wales.

## METHOD OF RESEARCH

The Committee's method of investigation included:

1. Jointly hosting with Treasury a seminar conducted at Parliament House on 1 May 1992. Papers were presented by:  
  
Mr Jim Longley, MP, Chairman of the Public Accounts Committee;  
Mr Percy Allan, Secretary, New South Wales Treasury;  
Mr Don Nicholls, retired Deputy Secretary of the NSW Treasury;  
Mr Michael Sharpe, Partner, Coopers and Lybrand, chartered accountants; and  
Mr Ken Barker, Director of Finance, New South Wales Department of Health.
2. A review of reports, published papers and other publicly available studies relevant to this topic.
3. Extensive informal and formal discussions with a number of senior officers of departments and statutory authorities and professional bodies in the areas of public sector accounting, auditing and financial reforms.

The Committee was pleased with the level of co-operation received during the review.

## WHAT ARE THESE REFORMS?

To assist the reader and introduce the topics of this study it is necessary to outline the highly complex and at times confusing world of public sector finance.

The Public Accounts Committee was pleased to note the publication in July 1991 of a major work on New South Wales State finances. In his book *Managing State Finance: The New South Wales Experience*, Don Nicholls, former Deputy Secretary of the New South Wales Treasury, wrote:

The broad approach adopted will encourage discussion by ... those interested in better financial management of the State.<sup>2</sup>

The Public Accounts Committee noted that Don Nicholls claimed that New South Wales was at the forefront of public sector financial reform and, in some areas of finance and accounting, at the leading edge.

There are a number of terms, however, that need to be defined:

### **What is accrual accounting?**

In his recent book, Don Nicholls gives the following definition:

Accrual accounting is the recognition of revenue and expenditure items as they are earned or incurred respectively (and not as money is received or paid) and included in the financial statements in the year to which they relate.<sup>3</sup>

For the public sector the introduction of accrual accounting means that non-cash transactions will be brought to account and reported in the year when the transaction occurs. By way of example:

**Income:** Licence fees due and unpaid are brought to account as debtors or accounts receivable when the debt is due to be paid. Under the cash based method of accounting unpaid income (fees etc.) was not brought to account.

**Expenditure:** Depreciation of plant and equipment and employees' long service leave entitlements due but not paid are items of expense that are incurred.

In addition to the recognition of income and expenditure, the adoption of accrual accounting by an authority involves the recognition and financial disclosure of the value of all assets and liabilities.

**Assets:** Assets used in the business are brought to account on the basis of cost or future economic benefits. The Committee notes that the methods of valuations of assets in both the private and public sectors are currently the subject of considerable debate.<sup>4</sup>

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<sup>2</sup> Don Nicholls, *Managing State Finances: The New South Wales Experience*. New South Wales Treasury, 1991, p. xiii.

<sup>3</sup> Nicholls, *op. cit.*, p. 311.

<sup>4</sup> See Case Study 1: Royal Botanic Gardens and Domain Trust, pp. 34-40 below.

**Liabilities:** Liabilities are brought to account when the expense is incurred and not when a cash payment is required. For example, employees' long service entitlements are brought to account as the employees accrue their leave and not as long service leave is taken.

**Cash accounting - shortcomings:** A shortcoming of cash accounting is that items of income and expenditure are not brought to account as they occur but when the physical transaction is processed.

Traditional cash accounting does not provide for the recording, accounting and disclosure of assets and liabilities held or controlled over one or more financial years.

In addition cash accounting does not provide an accounting mechanism to disclose the net worth of owners' investment in a business.

**Accrual accounting - advantages:** An advantage of accrual accounting is that financial statements and management reports can be prepared to disclose the value of assets employed, liabilities incurred and the owners' or investors' equity in the business for an accounting period.

Accrual accounting can provide financial information that discloses the cost of operations and the value of the organisation's assets, and assists in calculating the return on assets.

Accrual accounting will:

- Enable costs and revenue of activities or programs to be measured for the same period of time;
- Enable comparisons to be made between time periods without the financial data being distorted by variations in the timing differences of payments and receipts;
- Measure the performance of government-owned or -controlled assets on the basis of reliable financial data;
- Evaluate the opportunity cost of using and/or retaining public assets;
- Measure operating costs and/or revenue against industry standards.

## **Program budgeting**

This is a budgetary system in which spending is classified according to the purposes (objectives) to be accomplished.<sup>5</sup>

## **Global budgeting**

Global budgeting is a system allowing departments much greater freedom to alter spending patterns between expenditure categories and line items (e.g. salaries, maintenance) and programs, provided they live within their total budgets and staff ceilings. Moreover, greater flexibility in expenditure patterns will be allowed within the limits applying at the service delivery level, such as schools and health services. Ministers may seek to "borrow" from following years' allocations or "lend" forward to following years up to 2 per cent of their allocations.<sup>6</sup>

## **Annual reporting**

Annual reporting refers to that area of accounting work concerned with the design and operation of information and reporting systems which would be directed to agencies external to an organisation, and to the management of a functional area.

## **Whole of government financial reporting**

The adoption of accrual accounting across the New South Wales public sector for both the budget and non-budget segments has allowed the preparation and presentation of consolidated financial statements for the whole of the public sector. These statements can be likened to the consolidated financial statements prepared by any of the large holding companies in the private sector.

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<sup>5</sup> Nicholls, *op. cit.*, p. 322.

<sup>6</sup> Nicholls, *op. cit.*, p. 317.

## **COLONIAL DAYS TO 1980 - SLOW RATE OF REFORM**

### **1788: COLONIAL ERA**

The establishment of the Colony of New South Wales in 1788 brought with it all the trappings of the British Treasury system. Funds to support the Colony were supplied from London. The main expenses of the Civil Establishment of the Colony were the maintenance and supervision of transported convicts. Vouchers and accounts to support the payments from funds appropriated by the British Parliament were returned to London. The accountability mechanisms that existed were primitive by modern standards.

### **1819-1821: FIRST REFORMS**

By 1819 the colonial authorities in London had become concerned over the financial affairs of the far distant colony. Commissioner Bigge was appointed to conduct an inquiry into the affairs of the Colony including the administration of finances.

Resulting from Commissioner Bigge's report, the first round of reforms took place. William Balcombe<sup>7</sup> was appointed in 1824 to take charge of the local Treasury. Balcombe had previous experience in colonial administration on the island colony of Saint Helena where his main charge was the exiled Napoleon.

In the same year William Lithgow<sup>8</sup> was appointed to take charge of the stores of the colony as Commissary-General. In November 1824 Lithgow was given the additional function of Colonial Auditor.

### **1827: SEPARATION OF DUTIES AND INDEPENDENT AUDITOR**

In 1827 a further series of financial reforms took place due to the increase in government business. William Lithgow relinquished his duties as officer in charge of the Commissariat and continued as Colonial Auditor.

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<sup>7</sup> See Bob Scullion, Assistant Secretary, New South Wales Treasury, Paper on Accrual Accounting presented to National Accountants in Government Convention, Australian Society of CPAs, November 1991, p. 3.

<sup>8</sup> *Annual Report of the Auditor General's Office for 1989-90*, p. 75.

In retrospect, this was a significant reform, in that the responsibility for the control and custody of the State's assets, then mainly in the form of cash and stores, was separated from the role of audit.

This separation of duties between the custody and control of assets and the role of the independent auditor have continued to the present day. Under the *Public Finance and Audit Act 1983* the Auditor-General is appointed as a statutory office holder, independent of the government of the day, who cannot hold any other office under the Crown. In other jurisdictions the roles of Auditor and Controller of Public Assets have been combined into the statutory appointment of a Controller and Auditor-General.<sup>9</sup>

## **1856: RESPONSIBLE GOVERNMENT**

In 1856 the Colony of New South Wales achieved self government. The legislature, consisting of a popularly elected Lower House and an appointed Upper House, assumed full responsibility for the raising of taxes and other revenues and for the appropriation of revenue to fund the operations of government. The system of government inherited from the Imperial powers was based on the Westminster system and effectively forced the public sector to report on a cash basis to reflect the budgeting process on a cash (or funds) basis.

The cash basis of accounting continued indeed until the 1980s. The central accounts of government remained unchanged until the reforms of the 1980s, which will no doubt go down in history as the decade of change in the New South Wales public sector.

## **1870: STATUTORY APPOINTMENT OF AUDITOR-GENERAL**

A further reform occurred in 1870 when the tenure, powers, and duties of the office of Auditor-General were defined in statute.<sup>10</sup> Previously the position of colonial auditor had been filled by administrative action with the permission of the home authorities in London. This appointment can now be regarded as a major reform initiated by the New South Wales Legislature, as the Parliament assumed responsibility for appointing the Auditor-General and for determining his reporting requirements. This trend has continued into the 1990s. In 1992 the Parliament enacted the Statutory Appointments

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<sup>9</sup> For a discussion on the role of Controller and Auditor-General see Public Accounts Committee, *Report on the New South Wales Auditor-General's Office*, Report 49, Minutes of Evidence, Mr B H C Tyler, Controller and Auditor-General of New Zealand, p. 242.

<sup>10</sup> *Audit Act 1870*.

(Parliamentary Veto) legislation which included provision for the Public Accounts Committee of the Legislative Assembly to have the power to veto proposed appointments to the position of Auditor-General.

## **1902 AUDIT ACT: MAJOR REFORMS**

In 1902 major reforms occurred when the Audit Act was passed by the Parliament. This Act consolidated and amended the law relating to the collection and payment of public money, the audit of public accounts, and the protection of public property.

Under the 1902 Act the cash basis of accounting continued. However, the major reform under that Act was the establishment of a Public Accounts Committee consisting of members of the Legislative Assembly.

The pace of reform was slow and most probably any move for change was overshadowed by major events on the world stage.

## **1930: GREAT DEPRESSION**

In the 1930s New South Wales was in the grip of the Great Depression, and in the midst of the immense difficulties at that time, the State's public sector accounting and reporting requirements were subject to very little change.

## **1930: STANDARD FORMAT DISCLOSURE**

Two changes of note, however, did occur in the 1930s. A Committee chaired by the Auditor-General, John Spence, recommended to the Government that standard line items describing departmental budget items be introduced.<sup>11</sup> Although in itself not a significant change, the adoption of a standard format was possibly the start of a reform process leading to standardised annual reporting requirements in 1984 and 1985.

## **1932: NIEMEYER STATEMENT**

Another reform took place at this time. In response to the harsh economic conditions of that time, a special Premiers' Conference was held. Resulting from this conference, regular monthly reports called "Niemeyer Statements" were prepared.

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<sup>11</sup> See Scullion, *op. cit.*, p. 2, and Nicholls, *op. cit.*, p. 29.

These statements are prepared on a monthly basis and show functional operations on the Consolidated Fund and the balance of cash and securities held by the Treasurer.

For almost the next 50 years the process of change was exceedingly slow. The only changes of note were procedural amendments to the Audit Act to remove detailed prescriptions on the audit processes that applied to the Auditor-General.

## **THE 1980S - THE DECADE OF CHANGE**

In a review of New South Wales public sector financial management, the 1980s stand out as a decade of change. At the beginning of the decade the general public, taxpayers and their elected parliamentary representatives became aware that the financial reporting and disclosure practices of the public sector were in the "dark ages". To put it simply, the Government was not fully accountable.

The central accounts of government, the Public Accounts, based as they were on a system of funds accounting, were seen as fulfilling the traditional practice of showing legal compliance, but were unsuitable to meet the new demands.

In this review of public sector financial reform the functional areas of accounting, auditing, external reporting and review are discussed.

### **ACCOUNTING**

By the early 1980s there was a widely held concern that governments were not fully accountable for the ever-increasing financial demands of a growing public sector. This view was held not only in New South Wales but in other jurisdictions. In 1981 the then New South Wales Auditor-General, the late Jack O'Donnell, reported to the Parliament:

There was a great inconsistency across the range of statutory corporations in relation to that practice which, in the interests of comparing performances needed to be eliminated.<sup>12</sup>

It is of interest to note that Jack O'Donnell's concern was that the comparative performance of public sector bodies could not be readily ascertained based on the form and content of financial statements. The then Auditor-General was concerned more about the lack of information available to parliamentarians and taxpayers than about token compliance to accounting convention.

Parliamentarians themselves were concerned to ensure that in the organisation of State finances, government departments and statutory authorities would provide value for money. A parliamentary committee reported it had found:

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<sup>12</sup> 1980-81 Report of the Auditor-General: *The Public Accounts prepared by the Treasurer*, p. 16.

. . . great confusion resulting from the form in which information relating to public finance in New South Wales is presented.<sup>13</sup>

At a national level, the need had been recognised for improved standards of accounting and financial disclosure across the public sector. R G Humphry, now Director-General of the New South Wales Premier's Department, speaking at a national convention on government accounting, addressed the issue of public sector accounting standards:

The absence of accounting standards appropriate to the needs of the public sector has caused increasing concern to those accountable for the growing sophistication, complexity and size of government operations, including those elected by the public for safeguarding and promoting the interests of the electorate and society as a whole.<sup>14</sup>

On the world scene, the need to improve the standards of financial reporting by the public sector was acknowledged. Writing in the *Wall Street Journal*, Morton Egol, a partner with Arthur Anderson, gave this view:

There are no accounting and reporting systems in place to inform the public . . . They avoid accountability. Neither the executive branch nor Congress wants to bear the burden of being measured by sound financial reporting.<sup>15</sup>

It is against this background that it is appropriate to review the various reforms across budget and non-budget agencies in the New South Wales public sector.

## THE BUDGET SECTOR

The budget sector had developed in New South Wales from the colonial days when funds were appropriated from the Imperial Parliament in London and the accountability processes were defined by the British colonial administrators. With self-government in 1856, the accounting and reporting processes set up by the local authorities closely followed the colonial model.

By the end of the 1970s the system was antiquated. There was in place a rigid system of annual appropriations for detailed line items. This was a reflection of the accounting

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<sup>13</sup> New South Wales Parliament, *Progress Report from the Joint Committee of the Legislative Council and the Legislative Assembly upon Public Accounts and Financial Accounts of Statutory Authorities*, 27 March 1980, p. vi.

<sup>14</sup> R G Humphry, *The Public Sector Accounting Standards Board - the first year and the future*. Paper presented to National Government Accounting Convention, Australian Society of Accountants, University of Adelaide, February 1985.

<sup>15</sup> Morton Egol, Use Accounting to Make United States Leaders Accountable, *Wall Street Journal*, 10 March 1987.

practices at that time, which were concerned with clerical accuracy and compliance with very detailed Treasury instructions.<sup>16</sup>

In summary it can be said that up to the 1980s the emphasis on financial management in the public sector was on stewardship rather than on doing better with the funds available.

By way of example, the New South Wales Public Accounts for the 1980-81 financial year contain some 108 pages of very detailed dissection of payments. An extreme example of the minute detail recorded was the expenditure of \$505.18 for laundry expenses for the New South Wales government centres in North America.<sup>17</sup>

## **1980S CHANGES - A PATTERN FOR THE FUTURE**

It was now necessary to develop new systems and procedures that allowed greater flexibility and at the same time provide for improved accountability. The very structure of public sector financial management had to change.

## **NEW LEGISLATION**

The decision to introduce new legislation gave a legislative framework to the reform process. By the introduction of new legislation the parliament signalled the commencement of a new era, the discarding of many of the old outdated practices and the introduction of new accounting concepts that recognised internal accounting controls and management responsibilities.

The new *Public Finance and Audit Act 1983* included in the one statute new accounting, audit and review provisions. The decision to include these three functions in the one piece of legislation was in itself a major reform, in that the Parliament signalled that equal emphasis was to be placed on the Treasury function of accounting administration, the independent external audit function by the Auditor-General, and the parliamentary review process by the Public Accounts Committee.

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<sup>16</sup> For a detailed discussion on the historical development of the New South Wales public finance system see Nicholls, op. cit., pp. 17-35.

<sup>17</sup> *Public Accounts prepared by the Treasurer for the Financial Year Ended 30th June 1981*, p. 23, in *1980-81 Report of the Auditor-General: The Public Accounts prepared by the Treasurer*.

The new Public Finance and Audit Act asserted the Treasurer's role in determining accounting arrangements, maintained the separation of the audit function from the controllership function, and revamped the Public Accounts Committee as the investigative arm of the Legislative Assembly.

## **BUDGET SECTOR STRUCTURAL CHANGES**

A number of significant structural changes<sup>18</sup> were introduced to act as agents of financial reform. Many of these changes were included in legislation, while others were implemented by administrative action. That is, a policy decision of the government of the day can be subsequently amended by mere administrative action.

## **CAPITAL WORKS APPRAISAL**

A ministerial Capital Works Committee was established in 1983 to review both budget strategy and future issues in constructing capital works. In 1988 the Greiner Government introduced a requirement for economic appraisal on both a cost benefit and cost effectiveness basis for proposed capital works with a total cost in excess of \$0.5 million. To assist departments and authorities in the implementation of this policy, Treasury has issued detailed guidelines in the form of a technical paper.<sup>19</sup>

These two measures are in themselves major reforms, in that the allocation of scarce capital funds is made on the basis of economic evaluation applied in an accepted manner.

## **TREASURY CORPORATION - CENTRALISED PUBLIC SECTOR FINANCING**

In 1983 the Treasury Corporation was established as the State's centralised borrowing authority for raising funds on behalf of semi-government authorities and electricity supply county councils as well as providing short-term financing facilities.

This was another significant reform as the centralisation of the borrowing function for the Government's statutory authorities put a stop to the old practice of the various

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<sup>18</sup> Comment on this section has been adapted from Nicholls, *op. cit.*, and New South Wales Treasury, *New South Wales Public Sector Reform*, in *Budget Information*, Budget Paper No. 2, 1990-91, p. 407-412.

<sup>19</sup> New South Wales Treasury, *New South Wales Government Guidelines for Economic Appraisal*, Technical Paper, Revised Edition January 1990.

bodies actively competing against each other on the semi-government finance market. The benefits resulting from this initiative were improved efficiency and a better co-ordinated approach to loan raising with lower costs of borrowing and a more marketable security.

## **NATIONAL ACCOUNTS PRESENTATION - STATE BUDGET**

The State Budget was prepared on a cash basis up until 1988-89 when an alternative basis, the national accounts presentation, was adopted. The cash flow basis of preparing the budget detail was based on the accounting concepts of measuring stocks or holdings of assets and liabilities, and reporting and explaining the movements of these assets and liabilities as recorded on a balance sheet.

The national accounts presentation, on the other hand, was developed by economists and involves grouping total revenue, total outlays and a net financing requirement for government. This method of presentation is consistent with a standard Australian Bureau of Statistics format designed to prepare a standard report on Government Financial Statistics. It is favoured by the New South Wales Treasury because it enables an informed assessment to be made of the impact of the State public sector on the economy and on financial markets.<sup>20</sup>

This change in the method of budget presentation has not, however, received universal acceptance. Graeme Macmillan, a senior lecturer at the Public Sector Management Institute at Monash University, writing on "Accounting in Government" expressed the view that the "National Accounts" basis remains "a mystery to many . . . the accounting emphasis provides the greater clarity in reporting".<sup>21</sup>

The Committee holds the view, however, that the process of change must continue and that the presentation of whole of government financial statements on a conventional accounting basis should provide adequate external reporting.

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<sup>20</sup> New South Wales Treasury, *New South Wales Public Sector Reform*, in *Budget Information*, Budget Paper No. 2, 1990-91, p. 410.

<sup>21</sup> Graeme Macmillan, *Balance Sheet for a Brave New World in Accounting in Government*, *Government Officer Magazine*, April 1992, p. 10.

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## THE BUDGET PROCESS - CHANGES

The budget process itself has undergone major structural change. Some earlier Public Accounts Committee reports had noted shortcomings of the old style rigid budget process that had developed major accountability problems. Many agencies had been involved in year-end "spend-ups"<sup>22</sup> to ensure that budget appropriations were fully spent. Treasury had also made extensive use of the section 22 facility to make payments from the Consolidated Fund in excess of the amounts appropriated in the budget process.

There are two major financial reforms in this context:

### Target budgeting

Target budgeting provides budget sector agencies with a rolling three-year expenditure ceiling. This assists the government in keeping tighter control over growth in Budget expenditure and facilitates forward financial planning in agencies.

This is a significant reform and will go a long way towards overcoming the difficulties in planning and controlling major activities when funds are required for a period in excess of the annual budget cycle. For example the Public Accounts Committee noted<sup>23</sup> the problems encountered by the Treasury and the Public Works Department in planning and funding a long term program of maintenance on school buildings. At the same time payments were often made beyond amounts originally appropriated in the budget, as new programs and activities or extra costs of existing programs had not been anticipated.<sup>24</sup>

### Global budgeting

An additional major reform to the budget process is the introduction of global budgeting. Global budgeting provides greater flexibility to ministers and agencies to manage within their level of allocated resources. Under global budgeting a discretion is

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<sup>22</sup> See Public Accounts Committee, *Report on Year End Spending in government departments and authorities*, Report 20, March 1986.

<sup>23</sup> Public Accounts Committee, *Payments without parliamentary appropriation*, Report 43, February 1989, pp. 22-23.

<sup>24</sup> For a detailed discussion on supplementary funding allocations see Public Accounts Committee, *Report on year end spending in government departments and selected authorities*, Report 20, March 1986, p. 25.

given to move funds from a particular allocation to a different program and type of expenditure.

This reform should overcome most of the problems identified as year-end "spend-ups" which tried to fully use budget allocations before they lapsed on 30 June.

## **CONSOLIDATED FINANCIAL STATEMENTS FOR THE WHOLE OF GOVERNMENT**

In the past, governments have not adopted the practice of preparing and reporting on the finances of the whole of government. The cash budget gave cash movement details for the budget sector, and the various statutory authorities reported on an individual basis. The financial position of the whole of government was not known.

The private sector, on the other hand, has for many years been reporting on a consolidated basis in accordance with generally accepted accounting concepts. For organisations reporting under the Corporations Law, a legal requirement exists under approved accounting standard AASB1024 "Consolidated Accounts" to prepare financial reports on a consolidated basis for all subsidiaries controlled by the parent entity.<sup>25</sup>

In 1987 the New South Wales Auditor-General's Office undertook a review of public sector annual reporting, and suggested in a special report to the Treasurer that consolidated financial statements be prepared for both government departments and statutory bodies. The Auditor-General's report was reviewed and acknowledged by the 1988 Commission of Audit in its review over New South Wales finances. Included in the Commission's report was a consolidated statement for the year ended 30 June 1987. The Commission recommended that future consolidated financial statements for the whole of government be prepared by Treasury as the accountants for governments.

Since 1988, in accordance with government policy, Treasury has prepared consolidated financial statements for the whole of government on an annual basis. These statements show, over time, the movement in assets and liabilities. They also show income and expenditure, and the sources and application of all funds. They are thus seen as giving,

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<sup>25</sup> This comment reflects the requirement for consolidation that is current at the time this report was written. For periods prior to 1991 the test applying for the requirement to "consolidate" was based on ownership of share capital rather than control over the business.

at macro level, a more accurate picture of government performance in managing State finances.<sup>26</sup>

## PUBLIC SECTOR AUDITING

The role of the independent external auditor is an essential component in the accountability mechanisms that exist within the public sector in New South Wales. Indeed, the model adopted in New South Wales adheres very closely to the practice followed in the United Kingdom and in other jurisdictions adopting the Westminster system of government, that is, an independent auditor is appointed by the Parliament for a long term with the statutory duty of auditing the public accounts and the accounts of departments and statutory bodies.

With respect to the function of the Auditor-General, there is one major difference between the New South Wales model and that prevailing in the United Kingdom, the United States of America, Canada and New Zealand. In the latter jurisdictions the role of Auditor-General is combined with the role of Controller (or Comptroller) which involves custodial duties over the assets of the State. By way of example, in the United States, the New York State Comptroller has a much wider range of duties than his counterpart in the State of New South Wales.

The Comptroller is the State's chief fiscal officer and the auditor of its agencies and prescribes the State's method of accounting. The Comptroller supervises the accounts of local government, and is also the sole trustee of the State Common Retirement Fund's \$32 billion in assets and a trustee of the \$20 billion State Teachers Retirement System.<sup>27</sup>

The separation of duties in the New South Wales practice is important: it adds to the effectiveness of the role of Auditor-General and improves the independence of the external audit function.

By 1980 the scene had been set for a major overhaul of the accounting and auditing arrangements in the NSW public sector. There was widespread acceptance that the old 1902 Act had seen its day and after almost 80 years and many amendments did not provide a suitable vehicle on which to define the statutory framework for the audit

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<sup>26</sup> For a detailed study (140 pages) on financial management reforms see New South Wales Treasury, *Financial management for Inner Budget Sector agencies*, Technical Paper, March 1991.

<sup>27</sup> Edward V Regan, Comptroller for the State of New York, *Can accrual accounting work in government?* Address to Australian Society of Accountants, Sydney, November 1987.

charter for the public sector in the 1980s and beyond. A decision was made that a new Act was to be written to completely replace the old Act.

### **1983 Act - Auditor-General's audit independence maintained**

A major feature of the 1983 Act was to maintain the independence of the Auditor-General, who was appointed to:

. . . audit the Public Accounts and such other accounts as the Auditor-General is authorised or required to audit.<sup>28</sup>

This was a significant reform, in that the 1983 Act consolidated into one Act the audit requirements for all State government departments, statutory authorities and other bodies subject to audit. This effectively replaced the varying audit requirements under other enabling legislation that had developed over some 80 years. The Act also continued the separation of the role of audit from the role of custodian and controller of the State's assets.

### **Audit methodology**

A feature of the 1870 Audit Act and the 1902 Audit Act was the inclusion of very detailed prescription of the audit procedures to be followed by the Auditor-General. By 1980 the various amendments to the Act had removed most of this detailed prescription and had allowed the Auditor-General discretion in the procedures to be followed in conducting audits.

In the private sector the external auditor had for many years enjoyed a professional discretion to conduct his audit in accordance with generally accepted accounting and auditing principles. During the 1970s the professional accounting bodies, in recognition of the community's need and that of the profession to develop "best practice" concepts in accounting and auditing, began to issue standards and practice statements on specific issues relating to auditing and accounting.

For the public sector auditor there was no statutory obligation to follow the professional guidance given by the professional accounting bodies. The 1983 Act, however, required the Auditor-General to conduct his audit in line with professional standards

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<sup>28</sup> s. 34 *Public Finance and Audit Act 1983*.

and practices and in accordance with the "character and effectiveness of internal control".<sup>29</sup>

In order to recognise and maintain the balance between public and private sector audits, the professional accounting bodies have issued guidelines to external auditors on the application of standards to auditing in the public sector.<sup>30</sup>

The ongoing process of revising old standards and guidance releases to reflect public sector aspects of audit, and the development of new standards and practice statements, are both undertaken by the Australian Accounting Research Foundation. The Foundation has established an Auditing Standards Board which includes representatives from the public sector.<sup>31</sup>

## **INTERNAL CONTROL - STATUTORY RECOGNITION**

A major reform in public sector accountability was the inclusion in the 1983 Act of the statutory recognition of internal control as it applies to public sector bodies. This indeed was a significant reform, as the concept of internal control over accounting and related management controls had not previously been included in any statute.

This Act includes a detailed description of the scope and responsibilities of the internal control systems that are to be undertaken in all public sector bodies. It is indeed another major reform that the "financial and related operations of the authority"<sup>32</sup> are to be subject to the following internal control procedures:

- (a) management policies and requirements made by the provisions of this Act and the prescribed requirements;
- (b) sound practices for the efficient, effective and economical management of functions by each organisational branch or section within the authority;

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<sup>29</sup> s. 34 *Public Finance and Audit Act 1983*.

<sup>30</sup> Auditing Standards Board of the Australian Accounting Research Foundation, *Introductory statement on applicability of statements of auditing standards and statements of auditing practice to auditing in the public sector*. Australian Society of Accountants and Institute of Chartered Accountants in Australia, pp. 2003-10, March 1987.

<sup>31</sup> K J Robson, Auditor-General of New South Wales, was a member of the Auditing Standards Board for many years until his retirement in April 1992.

<sup>32</sup> See s. 11 *Public Finance and Audit Act 1983*, Internal Control and Audit

- (c) a system of authorisation and recording and procedures adequate to provide accounting control in relation to assets, liabilities, receipts and expenses;
- (d) proper segregation of functional responsibilities; and
- (e) procedures to review the adequacies of and compliance with the system of internal control.

## INTERNAL AUDIT - STATUTORY RECOGNITION

In conjunction with the statutory recognition of internal control, the 1983 Act also gave recognition to internal audit in the public sector. The Treasury issued specific written guidelines for internal control in public sector bodies. These were initially issued in 1984 and revised in 1990. In these guidelines, the following definition of internal audit is adopted:

. . . an independent appraisal function established within an organisation to examine and evaluate its activities as a service to the organisation. The objective of internal auditing is to assist members of the organisation in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analyses, appraisals, recommendations, counsel, and information concerning the activities reviewed.<sup>33</sup>

This statutory recognition of internal audit has placed New South Wales in the forefront of public sector administration across the developed world.

In a recent report Mr I Temby, QC, the Independent Commissioner Against Corruption, reviewed the internal function as it should work within a modern public sector organisation. Mr Temby noted:

. . . this statutory recognition of internal audit is unique within Australia, and perhaps in the world. It is encouraging that New South Wales should be in the forefront in this area.<sup>34</sup>

The Public Accounts Committee acknowledges the comments by Mr Temby and agrees that the statutory recognition of internal control and internal audit is indeed a major reform in public sector financial management.

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<sup>33</sup> *Standards for the professional practice of internal auditing*, Institute of Internal Auditors, Orlando, Florida, USA. Note that this definition of internal audit is adopted by the New South Wales Treasury in its guidelines on internal auditing in the public sector.

<sup>34</sup> Ian Temby, QC, *Report on investigation into driver licensing*. Independent Commission Against Corruption, December 1990, Vol.1, p. 211.

The Committee foreshadows its intention to further examine at some future point the role, function and effectiveness of internal audit in the public sector.

## EXTERNAL AUDIT - MAJOR REFORMS

The public sector external audit function is a major component of the accountability mechanisms in the public sector. In a recent study of public sector audit in Australia, the following statements describe the differences between external audit in the private and public sectors.

Over time, public sector audit has evolved from simply providing an independent and professional assurance that the resources of government have been managed properly in accordance with the law, and that no fraud has taken place. Today, public sector audit also includes forming opinions on a range of management matters, including value-for-money, efficiency and performance audits of various government organisational units. However, traditional compliance auditing still dominates public sector audit.

. . . In Australia there is no statutory requirement for private sector auditors to report on the propriety of transactions, nor on the efficiency or effectiveness with which the business is conducted.<sup>35</sup>

In New South Wales the Auditor-General has a wide mandate to undertake the external audit of the New South Wales public sector. At 30 November 1991 the Auditor-General's Office employed 189 staff and was responsible for auditing 454 organisations.<sup>36</sup>

The Public Accounts Committee conducted an inquiry into the Auditor-General's Office during 1989-90 and a report was tabled in the Legislative Assembly in July 1990.<sup>37</sup> The report contained some 40 recommendations, the majority of which were accepted by the Government and resulted in legislation in the form of the *Public Finance and Audit (Auditor-General) Amendment Act 1991*.

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<sup>35</sup> Linda English and James Guthrie, *Public sector auditing: private sector challenges to control and direction*. Public Sector Research Centre, University of New South Wales, Discussion Paper No. 11, November, 1990.

<sup>36</sup> *Annual Report of the Auditor-General's Office for 1990-91*, p. 2.

<sup>37</sup> Public Accounts Committee, *Report on the New South Wales Auditor-General's Office*, Report 49, July 1990.

## **EXTERNAL REPORTING**

An important component in the accountability processes that applies equally to the public and private sectors is disclosure and external reporting to the stakeholders in the business.

In an Australian study on external reporting practices, the following definition was proposed:

External reporting refers to that area of accounting work concerned with the design and operation of information and reporting systems directed to agencies external to an organisation, and to the management of the functional area.<sup>38</sup>

External reporting occurs in both the public and private sectors. To some extent the differences between these sectors lead to differences in the form of reporting used. There are movements throughout the world to co-ordinate the development of reporting standards in each sector.<sup>39</sup>

Companies operating in the private sector have for many years been under an obligation to provide timely, detailed annual reports. These obligations were imposed by legislation relating to the regulation of companies and stock exchange listing requirements.

In the early 1980s, the external reporting requirements for the public sector were less onerous. Government departments were not under any statutory requirement to prepare annual reports. Statutory bodies, on the other hand, prepared annual reports in accordance with variable and inconsistent requirements of numerous Acts of Parliament. What was needed was a major overhaul of the annual reporting process.

In his 1977 report, Peter Wilenski reported to the New South Wales Government:

The present system of . . . reporting about government activity is simply inadequate.<sup>40</sup>

In a 1981 report, the then Auditor-General reported to the Parliament on the results of a review into public sector accounting and reporting:

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<sup>38</sup> W P Birkett and M C Miller, External reporting, *Australian Accountant*, October 1986, p. 75.

<sup>39</sup> N Hepworth and P Vass, Accounting standards in the public sector, *Issues in Public Sector Accounting*, Oxford, 1984.

<sup>40</sup> Professor Peter Wilenski, *Directions for change*, Interim Report, November 1977, p. 40.

I commend to the Parliament and the Government the desirability of formalising the principles . . . [of] an Annual Reports Act . . . subject to control by the ultimate authority of the Parliament . . . the legislation could require . . . performance information and statistics which would permit assessment of the extent to which the corporation had, in fact, achieved its objectives . . . <sup>41</sup>

## Why annual reports?

In reviewing the various components of public sector financial reforms it is appropriate to consider firstly the purposes of annual reports and the review functions that give an assurance to the user of the integrity of the reports.

In a study on annual reporting in the various public sector jurisdictions across Australia, Stephen Rowe, a lecturer in accounting and finance at the University of New England, Northern Rivers concluded:

. . . annual reporting has the potential to be the ideal rostrum to show that accountability has been adequately discharged.<sup>42</sup>

As part of this study, Mr Rowe considered various compliance reviews that had been undertaken over annual reporting practices in the Commonwealth, State and Territories' administrations. Mr Rowe noted:

While generally satisfied the requirements are adequate, review bodies acknowledge that there is considerable room for improvement.<sup>43</sup>

In New South Wales, the statutory backing for public sector reporting reforms is in the form of two specific Acts of the Parliament that standardised the form and content of annual reports.

## Annual Reports (Statutory Bodies) Act 1984

This Act standardised the form and content of statutory bodies' annual reporting. Until then, most statutory bodies were under annual reporting obligations incorporated into their enabling legislation, and over time a great variety in requirements and practices had developed.

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<sup>41</sup> 1980-81 Report of the Auditor-General: The Public Accounts prepared by the Treasurer, p. 16.

<sup>42</sup> Stephen Rowe, *Public sector annual reporting*, Unpublished research paper, University of New England, Northern Rivers, 1991, p. 83.

<sup>43</sup> Rowe, *op. cit.*, p. 84.

## **Annual Reports (Departments) Act 1985**

This Act required government departments to prepare annual reports to a standard format that includes:

- annual financial statements
- auditor's opinion on the statements
- report of operations

### **Performance measures**

Common inclusions in annual reports for reporting entities in both the public and private sectors are non-financial performance measures used as indicators as to how the organisation had achieved its objectives.

For public sector bodies the Regulations to the annual reporting legislation require appropriate performance measures described in the following terms:

. . . where practical, qualitative and quantitative measures and indicators of performance showing the level of efficiency and effectiveness.<sup>44</sup>

The inclusion of this clause into the Regulation is in line with Public Accounts Committee Report No. 23 on a proposed Regulation accompanying the *Annual Reports (Departments) Act 1985*, published in May 1986.

The inclusion into annual reports of appropriate performance indicators is a major improvement in external reporting. The question then arises as to whether the performance measures are appropriate, and the basis used to calculate the performance measures is consistent with the underlying records and transactions.

By comparison, financial statements included in reports are prepared in accordance with accounting standards, and are independently audited in accordance with auditing standards and practices. Non-financial performance measures, on the other hand, are not subject to audit or to management's assertion as to their appropriateness and correctness. For the public sector, non-financial performance measures are on many occasions better and more appropriate indicators of an organisation's performance in achieving its objects than financial reports which indicate income earned and expenses

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<sup>44</sup> Annual Reports (Departments) Regulation 1986, clause 3(h)(ii).

incurred. These are measures of inputs generally and outputs, while the true measure of a non-commercial organisation's performance is the relationship between inputs and outputs (efficiency) and the ability to achieve objectives (effectiveness).

### **RECOMMENDATION 1**

The Committee recommends that the Treasury and Auditor-General develop guidelines to test the accuracy and appropriateness of reporting measures of efficiency, and that on a best practice basis, audits be undertaken of performance indicators included in annual reports. This audit task should be additional to the audit of financial statements and be regarded as part of the special audit functions under section 38B of the Public Finance and Audit Act.

### **Annual reporting - Treasury review**

The Treasurer has ministerial responsibility for the annual reporting legislation. The Treasury, being the department providing administrative support to the Treasurer, is under an obligation to provide administrative and regulatory services to ensure compliance with the Acts.

In a previous report,<sup>45</sup> the Committee noted that the Treasury was not actively monitoring compliance and non-compliance with the legislation.

In a more recent report,<sup>46</sup> the Committee noted the initiative by Treasury in appointing the Auditor-General's Office as agent to undertake a detailed examination of annual reports to check compliance with legislation.

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<sup>45</sup> Public Accounts Committee, *The challenge of accountability*, Report 47, November 1989, p.54.

<sup>46</sup> Public Accounts Committee, *Follow-up report on financial accountability*, Report 61, June 1992, p. 68.

## RECOMMENDATION 2

The Committee recommends that on an annual basis Treasury publish a summary of the "good" and "bad" points disclosed from this review, the aim of this activity being to provide assistance in improving annual reports, not in identifying defaulters.

### **Rewards and sanctions**

In an earlier report<sup>47</sup> the Committee noted the various sanctions that exist for non-achievement of obligations under accounting and reporting legislation.

The Committee holds the view, however, that reinforcement of rewards might be more successful than sanctions in encouraging an improvement in accounting and annual reporting disclosure. It is noted that the Australian Institute of Management undertakes an annual reports competition which includes a section dealing with public sector bodies. Increasing the participation by public sector bodies in this or similar competitions is seen as an aid in improving annual reporting.

## RECOMMENDATION 3

The Committee recommends that Treasury actively encourage participation by public sector reporting bodies in annual reporting competitions conducted by the Australian Institute of Management and similar bodies. The Royal Institute of Public Administration (Australia) and other professional bodies could be encouraged to promote this participation.

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<sup>47</sup> Public Accounts Committee, *The challenge of accountability*, Report 47, November 1989, p. 57.

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## PUBLIC SECTOR REVIEW MECHANISMS

In New South Wales, the accountability mechanisms in the public sector are based on the Westminster system. Within this system, a Public Accounts Committee of the Parliament is at the pinnacle of the system of checks and balances and review processes.

In a study on the levels of government and responsibilities within the public sector in Australia, the Auditing Standards Board of the Australian Accounting Research Foundation prepared the following statement:

Most Parliaments have established standing committees to monitor the Public Accounts and to oversee accountability in administration of these resources.<sup>48</sup>

In New South Wales, the Audit Act of 1902 established a Public Accounts Committee whose principal role was to examine payments made without parliamentary appropriation. For almost 80 years the Public Accounts Committee, under the 1902 Act, performed a non-controversial role and in the words of a Select Committee of the Parliament:

In New South Wales it is beyond question that there has been a less than energetic response throughout the machinery of government to the potential role the Public Accounts Committee could play . . .<sup>49</sup>

The Parliament responded to this report in 1982 by enacting amendments to the old 1902 Act to expand the powers of the Committee to respond to the expectations of Parliament for a more active parliamentary review process. The revamped Public Accounts Committee completed some nine reports up until December 1983 covering a wide range of public sector accountability issues.

The statutory backing for an independent parliamentary review process was continued in the Public Finance and Audit Act of 1983. Under this Act, the accounting, auditing and parliamentary review processes were specified and brought up to date to address the accountability challenges of the 1980s.

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<sup>48</sup> Auditing Standards Board of the Australian Accounting Research Foundation, *Introductory statement on applicability of statements of auditing standards and statements of auditing practice to auditing in the public sector*, Australian Society of Accountants and Institute of Chartered Accountants in Australia, p. 2005, March 1987.

<sup>49</sup> New South Wales Parliament, *Progress Report from the Joint Committee of the Legislative Council and the Legislative Assembly upon Public Accounts and Financial Accounts of Statutory Authorities*, 27 March 1980, p. xxviii.

Up to June 1992 a total of 62 reports have been prepared by the Public Accounts Committees of the Forty-seventh, Forty-eighth, Forty-ninth and Fiftieth Parliaments.

This active role of top level review over the public sector can be seen as a major reform over public sector finances.

It is pleasing to note that in New South Wales these reviews by a Public Accounts Committee are in line with public sector accountability reforms around the world.

Following the May 1985 Tokyo Declaration of "Guidelines on Public Accountability", a study was undertaken of various public accountability models in 21 countries in the Asia-Pacific region. This study led to the following comment on the role of Public Accounts Committees:

The process adopted by most legislatures is for SAI [Supreme Audit Institution] reports to be reviewed by a committee such as a Public Accounts Committee. Depending on practices followed as between the government and the legislature which vary as between countries, action is taken to correct deficiencies and weaknesses raised by the SAI.<sup>50</sup>

## **THE FUTURE**

The view of the Public Accounts Committee is, however, that this reform process is ongoing, and the Public Accounts Committee records its continuing interest in the development of further reforms. Major changes to the basic structure of public sector accounting practices and financial systems will occur resulting from the *Public Finance and Audit (Amendment) Act 1982*.

This Act will result in another round of major reforms that will commence with the 1992-93 financial year.

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<sup>50</sup> Asian Organisation of Supreme Audit Institutions, *Accountability and Control of Public Enterprises*, Kuala Lumpur, Malaysia, ISBN 983-99503, 1989, p. 8.

## THE 1990S - THE ERA OF IMPLEMENTATION

### INTRODUCTION

In undertaking this review the Public Accounts Committee notes that whilst the 1980s represented the decade of change, the full impact of the implementation of those changes is being felt by the finance and accounting staff in departments and authorities in the 1990s.

1992 is a significant year in the reform agenda for public sector changes. Early in the year, legislation was introduced into the Parliament to give the force of law to the Government's financial reforms.<sup>51</sup> The legislation formally introduces the major financial reforms that have been actively promoted by the major players in the review process.

To complete this study of progress on financial reform, the Committee decided to undertake a series of case studies based on individual departments and authorities.

The case studies were selected on the basis of issues that are well known as being typical of many of the problems and challenges faced by organisations undergoing rapid financial reform.

A profile of the case studies selected and a rationale for the selection for the study subjects are detailed below.

#### **"Heritage" asset**

The introduction of accrual accounting to the public sector involves the recognition, accounting and financial disclosure of assets and liabilities. There are many organisations operating within the public sector that provide an essential service to the public by the use and continued operation of what are termed "heritage" assets.

The nature of these assets is such that there is no practicable alternative commercial use. There are very few examples of this type of activity in the private sector, as the organisations or the service they provide rely on government funded subsidies.

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<sup>51</sup> *Public Finance and Audit (Amendment) Act 1992.*

The Royal Botanic Gardens was selected as a case study for this topic. The "Gardens" are well known and provide a widely used service to city workers and tourists alike as high quality green space close to the central business district. The Gardens include two satellite gardens operating in the Western suburbs of Sydney (Mount Annan) and the Blue Mountains (Mount Tomah).

This case study concluded that the current Treasury policy of giving a \$1 value to the land controlled by the Gardens Trust results in a substantial understatement on the balance sheet, in that earthworks and other improvements are not recorded.

### **"User pays"**

As part of the package of financial reforms, public sector organisations that provide a service to other agencies of government have changed and upgraded their internal accounting processes. Following the introduction of accrual accounting, these organisations can report their total costs, and fees can be set on a cost recovery basis.

The Valuer-General's Department was selected for this case study. The Department has been operating under accrual accounting for a number of years. The clients of the Department are the New South Wales Government and local council authorities that need reliable information on land valuations across the State. The Department's fee basis was set some years ago before accrual accounting identified all the costs incurred in providing valuation services.

This case study showed that the historic basis used to set the fees charged by the Department was insufficient to cover the costs incurred identified under accrual accounting.

### **Road infrastructure**

A safe and efficient road network is an essential component in the economic development of Australia. For many years the State Government and Commonwealth Government have allocated large sums of money for improving and extending the road network in New South Wales.

The road infrastructure network is one of the major assets controlled by the State. The valuation and recording of this asset represent a major task undertaken in the process of preparing financial statements on a consolidated basis for the whole of government.

The Roads and Traffic Authority (RTA) case study clearly demonstrated that major reforms in financial disclosure have been achieved by the RTA. The case study also showed, however, that there are inconsistencies in accounting practices among some statutory authorities. Whereas the RTA values the land across the State under roads and bridges at some \$21 billion, the Maritime Services Board values land under wharves, roads, channels and ports that it controls at a nominal \$1.

### **Health infrastructure**

The provision of health services in the form of hospital and other functions is a major social responsibility provided by State governments and the Commonwealth Government.

The health sector receives substantial funding from the Commonwealth under the Medicare arrangements. The health system is regulated under State law and administered by appointed boards of directors responsible for area health services in the major metropolitan centres and individual hospitals in country areas.

For almost a decade, the ability of hospital administrations to achieve budget targets has been a major issue. The Public Accounts Committee in the early 1980s conducted several inquiries into this very sensitive area.

The introduction of accrual accounting to the health sector has improved the level of financial disclosure, as the total costs are known previously. That is, under cash accounting, cash income and cash expenditure budgets were the accounting mechanisms used.

This case study showed that notwithstanding the overall improvement in accounting systems and financial reporting practices, an improvement could be made in the timing of notification of budget targets and any subsequent variations.

### **Corrective services**

Many of the traditional services conducted by the various government departments require staff with special skills and competencies that have been developed over many years. With many of the management services provided by other government bodies on a "no-charge" basis, and under the old cash accounting systems, staff were not required to develop financial management skills.

Accrual accounting and the other financial reforms now being implemented have brought about a fundamental change in the skills and competencies required by public sector managers at all levels.

The Department of Corrective Services was selected as a case study to gain an understanding of how financial management skills have been developed and utilised as the Department implemented accrual accounting.

## **CASE STUDY 1: THE ROYAL BOTANIC GARDENS AND DOMAIN TRUST**

### **Introduction**

The Sydney Gardens are among the city's major tourist attractions and receive over three million visits each year. As the major area of open space to the city centre, the Sydney Gardens provide an important recreational facility that adds to the quality of life of the inner city area.

The Sydney Gardens include the site of the first farm established in 1788 by Governor Phillip. Botanic gardens were formally established on the site by Governor Macquarie in 1816. In 1817, a Colonial Botanist was appointed, and from that time scientific and botanical research have been undertaken. The Royal Botanic Gardens have international recognition as a significant scientific institution.

The Royal Botanic Gardens and Domain Trust controls over 500 hectares of land, being some 65 hectares in Sydney and 444 hectares at Mount Annan and Mount Tomah Gardens. The Sydney Gardens and Domain have a high public profile and are frequently quoted as an example of a heritage or cultural asset that has no realistic alternative commercial use.

In financial terms, the operations of the Trust are substantial. Revenue in the 1990-91 financial year was \$16.4 million (table 1), and total expenses were \$16.5 million.

The Trust employs some 275 staff involved in scientific and horticultural research, horticultural and gardens management, and corporate services.

TABLE 1

**ROYAL BOTANIC GARDENS AND DOMAIN TRUST  
SUMMARY OF REVENUE IN 1990-91**

	<b>\$000</b>
<b>CONSOLIDATED FUND</b>	
Recurrent	12,336
Capital	<u>1,263</u>
Total government funding	13,599
<b>OPERATING REVENUE</b>	
Garden shops	486
Publications	19
Fees	341
Admission charges	410
Rent	459
Other	<u>54</u>
Total operating revenue	1,769
<b>DONATIONS AND CONTRIBUTIONS</b>	
Corporate and private benefactors	591
Research grants	271
Apprentice training grants	<u>42</u>
Total donations and contributions	904
<b>OTHER REVENUE</b>	
Interest	130
<b>TOTAL REVENUE</b>	<u><u>16,402</u></u>

Source: Royal Botanic Gardens and Domain Trust  
Annual Report for 1990-91

### **Expenses**

With the introduction of accrual accounting, the Trust brings to account all expenses at the time they are incurred. Under the old system of cash accounting, expenses were brought to account when the payments were made. Non-cash expenses such as depreciation, long service leave accruals, and deferred superannuation expenses were

not previously recorded. Table 2 illustrates the recent increased level of public disclosure.

TABLE 2

**ROYAL BOTANIC GARDENS AND DOMAIN TRUST  
SUMMARY OF OPERATING EXPENSES IN 1990-91**

	\$000
<b>EMPLOYEE RELATED EXPENSES</b>	
Salaries and wages	7,538
Superannuation entitlements	415
Payroll tax and fringe benefits tax	578
Long service leave and recreation leave	222
Workers compensation insurance	82
Other	18
Total employee related expenses	<u>8,853</u>
<b>MAINTENANCE AND WORKING EXPENSES</b>	6,336
<b>TOTAL OPERATING EXPENSES</b>	<u><u>15,189</u></u>

Source: Royal Botanic Gardens and Domain Trust Annual Report for 1990-91

**Assets**

The process of identification, valuation, recording and accounting for public sector assets constitutes one of the major tasks in the process of implementing accrual accounting. For the Royal Botanic Gardens and Domain Trust this was indeed a major task, as the Sydney Gardens have been used for special horticultural purposes since 1788. The buildings, ground improvements, and items of plant located at the Gardens are used for a wide range of scientific and horticultural research, garden management, recreational and historical purposes.

The task of compiling the inventory of buildings and improvements (that is, earth works and sea walls) was undertaken by the Public Works Department's Quantity Surveyors Services. Some 135 buildings were valued at a replacement cost of \$65.7 million with accumulated depreciation of \$28.0 million.

Property improvements - seawalls, roads, boundary, fences etc. - were valued at a replacement cost of \$33.7 million (accumulated depreciation \$19.4 million).

Plant and equipment were identified and recorded by Gardens staff and valued at replacement cost as at 30 June 1991. This process identified over 1700 items of plant with a replacement cost valued at \$11.7 million.

The Committee is of the view that the financial reforms discussed earlier in recording, valuing and disclosing the assets in the Royal Botanic Gardens represent a major improvement in public sector accountability and allow for a higher level of disclosure.

### **Bicentennial expenditure**

Additional information, however, has come to the notice of the Committee which indicates that the State Government's investment in the Royal Botanical Gardens may be substantially understated. The Committee in an earlier report<sup>52</sup> noted that some \$25 million were allocated to the State Bicentennial Program in 1986-87 under s. 22 of the *Public Finance and Audit Act 1983* as a payment without parliamentary appropriation. The Committee also noted that the Auditor-General in a report to Parliament in 1989<sup>53</sup> reviewed Bicentennial expenditure, including some \$14.2 million expended on behalf of the Royal Botanical Gardens (table 3).

TABLE 3

#### **ROYAL BOTANIC GARDENS AND DOMAIN TRUST SUMMARY OF BICENTENNIAL FUNDING**

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	\$m
Mount Tomah Botanic Gardens	3.8
Mount Annan Botanic Gardens	<u>10.4</u>
TOTAL	<u><u>14.2</u></u>

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Source: Auditor-General's Report to Parliament 1989, Vol. 2, p. 85

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<sup>52</sup> Public Accounts Committee, *Report on payments without parliamentary appropriation*, Report 43, February 1989, p. 47.

<sup>53</sup> *New South Wales Auditor General's Report to Parliament for 1989*, Vol. 2, p. 89.

In addition to the \$14.2 million readily identified as construction payments at various botanic gardens, the Premier's Department was responsible for expenditure of some \$99 million on Bicentennial projects. Of this amount some \$69 million were spent on miscellaneous projects as summarised in table 4.

**TABLE 4**  
**BICENTENNIAL PROJECTS**

	\$m
Commonwealth projects	48.6
Departmental projects	9.3
Special events	<u>11.1</u>
<b>TOTAL</b>	<b><u>69.0</u></b>

Source: Auditor-General's Report to Parliament 1989, Vol. 2, p. 86

The site of the Sydney Botanic Gardens could be described as the centre stage of the Bicentennial celebrations. However, it is unknown if any of the expenditure detailed in table 4 was in the nature of capital expenditure and therefore should be brought to account as part of the State's investment.

The Committee is concerned to note that the State's substantial allocation of Bicentennial funds for capital works at the Royal Botanic Gardens in Sydney, Mount Annan and Mount Tomah is not reflected in the record shown for the State's equity in the Trust.

**RECOMMENDATION 4**

The Committee recommends that the valuation processes be reviewed to ensure that capital expenditure in earth works, ground improvements etc. be recorded at appropriate value to accurately reflect the State's equity in a project.

## **Private sector funding**

Until very recent times, the Royal Botanic Gardens were dependent on government funding. The improved quality of financial information has enabled the Gardens' administration to address issues of financial management and to focus on funding opportunities from non-government sources.

The Committee was pleased to note a most fruitful benefit coming from the introduction of accrual accounting and from other reforms. The Committee noted that the Trust is actively seeking funds from other sources to supplement Consolidated Fund appropriations. The Committee was advised that the Trust is seeking to provide expert consultancy services to a wide range of clients in both the private and public sectors.

The advantages of accrual accounting have allowed the administration to identify costs more clearly, so that the Gardens can move towards a commercial basis for scientific and botanical consultancy engagements. In 1990-91 research grants and consultancies raised \$271,000 in revenue.

The Gardens Trust has also been successful in obtaining private sector funding to finance the construction of two new facilities at the Sydney Gardens. Table 5 lists the projects funded by private sector donations.

**TABLE 5**

**ROYAL BOTANIC GARDENS  
NEW PROJECTS PRIVATELY FUNDED**

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		<b>\$000</b>
Fern garden	Sydney	175
Herb garden	Sydney	<u>320</u>
<b>TOTAL</b>		<u><u>495</u></u>

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**Source:** Personal communication, Royal Botanic Gardens and Domain Trust, 1992

## Conclusion

In concluding this case study the Committee noted the improved quality of financial information produced and the improved level of disclosure. The Committee, however, holds strongly to the view that the Government's equity in the Gardens should be recorded so as to include the investment of \$14.2 million in Bicentennial funds.

## CASE STUDY 2: VALUER-GENERAL'S DEPARTMENT

### Introduction

The Valuer-General's Department was established by statute in 1916 to make all valuations in any part of the State required for levying rates, taxes or duties on the value of land. The Valuer-General was also made responsible for valuations for the purposes of resumption and determining security for mortgages advanced by the Crown.

The rationale behind a separate organisation undertaking valuations on behalf of the public sector was expressed in the second reading speech for the *Valuation of Land Act 1916*.

I do not consider that a Taxing Authority or a resuming authority ought to have anything to do with the fixing of value.

They ought to be fixed by an independent body after independent review.<sup>54</sup>

The principal function of the Department is the preparation and maintenance of the central Valuation Roll for all land holdings in New South Wales.

The Valuation Roll is used by local councils, water boards, and the Commissioner of Land Tax as the basis of assessing and levying rates and taxes based on land values. The Valuer-General's valuation role is also used for valuations and assessments under the *National Parks and Wildlife Act 1974*, *Heritage Act 1977*, *Coal Acquisition Act 1981* and *Mine Subsidence Compensation Act 1961*.

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<sup>54</sup> New South Wales Parliament, *Hansard*, 19 August 1915, p.1239.

The workload of the Department is complex, with the Valuation Roll currently holding some two million records. Table 6 shows the transactions processed in the 1990-91 financial year.

It can be seen that the Department has a most important role in the development of the State Land Information Network. The Valuer-General's role is to provide up-to-date property and valuation data. These have a significant impact on the revenue of the Government and the revenue and functions of a number of government authorities.

The Department operates on a user pays basis and since 1 July 1988 has been accounting for its operations using accrual accounting. The functions of the Department are labour intensive; the use of computers, together with productivity savings, have resulted in a considerable reduction in staff, with direct savings in payroll costs. Table 7 shows the movement in staff numbers between 1982 and 1991.

**TABLE 6**

**VALUER-GENERAL'S DEPARTMENT  
VALUATION ROLL - CHANGES BY TYPE**

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Changes to owners' name and address	200,000
Valuations on a planned program basis	500,000
New valuations on subdivisions etc.	200,000

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**Source:** Briefing note supplied to the Committee by the Valuer-General's Department, 1992

**TABLE 7**

**VALUER-GENERAL'S DEPARTMENT  
STAFF NUMBERS 1982 TO 1991**

---

	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991
Executive staff	11	11	11	11	10	10	10	10	8	8
Valuers	258	249	246	240	237	232	209	205	203	198
Clerical	253	229	210	215	211	211	201	216	199	195

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**Source:** Briefing note supplied to the Committee by the Valuer-General's Department, 1992

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## Finances

As mentioned earlier, the Department operates on a full accrual accounting basis. Table 8 shows the operating loss incurred by the Department in the three years since the introduction of accrual accounting, and table 9 summarises revenues over the same period.

The Committee noted with interest the comments by the Valuer-General in a review of finances included in the 1990-91 Annual Report. The Annual Report noted<sup>55</sup> that no increase was permitted in the Department's statutory fees, and revenue had not matched expenditure.

The Committee was advised that the major source of income to the Department was fees charged to councils and water boards. The fee is based on the number of properties listed on the Valuation Role for the particular rating authority. Table 10 shows the history of the "fee per entry" for the past ten years.

In comments made to the Committee it was explained that the workload and expense incurred in maintaining and updating the Valuation Roll related more directly to the type of property valued rather than the number of properties valued.

TABLE 8

**VALUER-GENERAL'S DEPARTMENT  
OPERATING DEFICIT AFTER ABNORMAL ITEMS**

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	\$
1990-91	1,435,611
1989-90	1,932,637
1988-89	174,621

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Source: Annual reports of the Valuer-General's Department

Note: Accrual accounting adopted from 1 July 1988. Previous years' financial statements prepared on a cash basis and meaningful comparisons not possible.

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<sup>55</sup> *Annual Report of the Valuer General's Department for 1990-91*, p. 5.

TABLE 9

**VALUER-GENERAL'S DEPARTMENT  
SUMMARY OF REVENUE**

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	1988-89	1989-90	1990-91
	\$000	\$000	\$000
Fees for valuation data supplied to rating and taxing authorities	12,422	12,095	11,908
Fees for valuation reports	2,936	3,618	3,955
Fees for certificates of valuation	1,556	1,052	978
Other income	423	111	879
<b>TOTAL REVENUE</b>	<b>17,337</b>	<b>16,876</b>	<b>17,720</b>

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Source: Annual reports of the Valuer-General's Department

Note: Accrual accounting adopted from 1 July 1988. Previous years' financial statements prepared on a cash basis and meaningful comparisons not possible.

TABLE 10

**VALUER-GENERAL'S DEPARTMENT  
FEES FOR VALUATION LISTS 1982-1991**

---

Year	Fee for entry (\$)
1982	3.50
1983	2.50
1984	2.70
1985	2.70
1986	2.70
1987	2.70
1988	1.85
1989	2.40
1990	2.55
1991	2.55

---

Source: Briefing note supplied to the Committee by the Valuer-General's Department, 1992

By way of example, the Valuation Rolls for the Shire of Blayney and the City of Sydney contained approximately the same number of property entries, yet produced vastly different amounts of rate revenues to the councils. **The costs incurred in the valuation process do not relate to the fee recovered from council.** The Committee noted that the current method of charging fees for valuation services relates directly to the number of physical records maintained rather than the amount of work necessary to maintain the Valuation Roll. This is illustrated in table 11 which shows that the valuation fees for the City of Sydney and the Shire of Blayney are approximately the same. That is, the Department receives the same \$2.55 fee to maintain one entry for the City of Sydney roll as for the Blayney Shire roll.

On this basis, the complexities of central business district valuation objections and appeals to the Land and Environment Court are not reflected in the basis on which fees are set. The Committee understands that to defend a valuation through the legal processes up to court action can involve significant internal time and therefore costs. Legal fees in the range of \$40,000 - \$50,000 can be incurred by the Valuer-General in responding to a court appeal, but the fee payable to the Valuer-General remains at \$2.55 per entry on the Valuation Roll, notwithstanding other costs incurred.

The reduction in fees from \$2.70 to \$1.85 per entry between 1987 and 1988 (table 10) occurred as a result of a decision to charge fees to the Commissioner for Land Tax for access to the Valuation Roll. Previously, the Land Tax Office did not pay fees for services obtained from the Department. Table 12 shows the ten year trends in revenue for valuation fees.

This case study gives a good example of the improved financial information that is available when financial statements are prepared on a full accrual accounting basis. The Valuer-General's Department is receiving revenue based on historic figures which were approved when the records showing the financial operations of the Department were not prepared on an accrual basis.

The latest statements show that the Government is, effectively, subsidising the operations of the Department.

TABLE 11

COMPARISON BETWEEN SELECTED LOCAL AUTHORITIES

Authority	No. of entries on Roll	A	B	B:A
		Rate revenue (\$)	Valuation fees (\$)	
Sydney City	3,354	92.3m	8,552	0.009
Blacktown	66,888	40.3m	170,564	0.42
Blayney Shire	3,109	1.7m	7,927	0.48

Source: Briefing note supplied to the Committee by the Valuer-General's Department, 1992

TABLE 12

VALUER-GENERAL'S DEPARTMENT  
TRENDS IN REVENUE (\$000)

	Reports	Certificates	General valuation			Total	
			Councils	Water Board	Land tax		Other
1980-81	588	2,617	2,407	1,716	-	129	7,457
1981-82	655	2,468	2,687	1,891	-	136	7,837
1982-83	624	1,867	4,630	3,239	-	102	10,462
1983-84	671	2,097	4,963	3,483	-	38	11,252
1984-85	600	2,349	4,719	3,477	-	67	11,212
1985-86	709	2,211	5,154	3,857	-	244	12,175
1986-87	850	2,239	5,176	3,770	-	121	12,156
1987-88	887	2,061	3,593	3,449	-	700	10,690
1988-89	2,936	1,556	4,716	2,365	5,341	423	17,337
1989-90	3,618	1,051	5,016	1,355	5,724	113	16,877

Source: Annual reports of the Valuer-General's Department

**RECOMMENDATION 5**

The Committee recommends that the basis for setting the fees payable to the Valuer-General's Department be reassessed in view of information disclosed by accrual accounting.

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## CASE STUDY 3: ROADS AND TRAFFIC AUTHORITY

### Introduction

The Roads and Traffic Authority (RTA) was formed in 1989 to manage the road and traffic system in New South Wales. The Authority effectively took over the functions of the Department of Main Roads and the Department of Motor Transport.

The Authority plays a most important place in the economic activity of the State. It is responsible for the construction and maintenance of the State's main road network including bridges, for the registration of vehicles, and for the licensing of drivers. Table 13, quoting figures from the Authority's 1990-91 Annual Report, illustrates the extent of the Authority's operations.

In terms of finance, the operations of the RTA are substantial. Table 14 shows the consolidated results for the RTA for the 1990-91 financial year.

TABLE 13

### ROADS AND TRAFFIC AUTHORITY SCALE OF OPERATIONS 1990-91

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Drivers licensed	3.6 million
Vehicles registered	3.2 million
Cars	2.4 million
Motor cycles	80,000
Commercial vehicles	700,000
Roads managed	39,100 km
Road kilometres travelled per annum	33 million

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Source: Roads and Traffic Authority Annual Report for 1990-91

TABLE 14

**ROADS AND TRAFFIC AUTHORITY  
SUMMARY OF FINANCIAL OPERATIONS 1990-91**

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	<b>\$m</b>
Income from all sources	966
Expenditure from all sources	<u>1,467</u>
Operating deficit	501
Total assets	44,354
Total liabilities	1,905

---

Source: Roads and Traffic Authority Annual Report for 1990-91

## **Revenue**

The RTA receives revenue from State and Commonwealth government grants, from fuel taxes and user charges, and from special purpose funding. Table 15 shows the income of the Authority for the 1990-91 financial year. In the same light the Balance Sheet of the Roads and Traffic Authority, prepared on an accrual basis, shows a high level of financial disclosure (table 16), and highlights the high dollar value placed on the Authority's holdings of land used for road infrastructure, works and residences, and land and buildings acquired for future roadworks.

Table 17 details the land, buildings and improvements reported by the Authority, and clearly shows the enhanced disclosure brought about by the accounting and reporting reforms over the past decade. Under the old reporting regime, one of the antecedent bodies to the Roads and Traffic Authority, the Department of Main Roads, did not report on an accrual accounting basis. This resulted in the Department of Main Roads not reporting in financial terms on the value of its road transport infrastructure.

A review of the Department of Main Roads Annual Report for the year ended 30 June 1984, the first full year of reporting under the 1983 Public Finance and Audit Act, shows a reduced level of financial disclosure. By way of example, the 1984 financial statements include a statement of balances rather than a balance sheet (a balance sheet, prepared on a full accrual accounting basis, shows all assets and liabilities and discloses the proprietor's or owner's equity in the business; a statement of balances was the term used to describe a statement disclosing debts, assets and liabilities of a reporting

business that did not have complete financial records). Table 18 shows the 1992 value of the significant items not reported in the 1984 financial statements of the Department of Main Roads.

TABLE 15

**ROADS AND TRAFFIC AUTHORITY  
SUMMARY OF INCOME IN 1990-91**

	\$m
<b>COMMONWEALTH FUNDS</b>	
Land transport development	205
Interstate road transport	6
Badgerys Creek airport access	8
Total Commonwealth funds	<u>219</u>
<b>STATE FUNDS</b>	
Motor vehicle taxation	384
Consolidated Fund	63
State fuel taxes	47
Natural disaster—flood restoration	57
Total State funds	<u>551</u>
<b>OTHER INCOME</b>	
Sale of properties	45
Sale of other assets	14
Road toll revenue	50
Contributions	20
Rent from properties	17
Interest	5
Other sources	45
Total other income	<u>196</u>
<b>TOTAL INCOME FROM ALL SOURCES</b>	<u><u>966</u></u>

Source: Roads and Traffic Authority Annual Report for 1990-91

TABLE 16

**ROADS AND TRAFFIC AUTHORITY  
SUMMARY OF ASSETS AND LIABILITIES**

30 June 1990 \$000		30 June 1991 \$000
	<b>CURRENT ASSETS</b>	
130,180	Cash, receivables, investments	71,947
64,734	Inventories and other current assets	68,012
194,914	Total current assets	139,959
	<b>NON-CURRENT ASSETS</b>	
112,211	Loan to Sydney Harbour Tunnel Company	160,381
2,4554	Investments	2,064
852,279	Property, plant, equipment etc.	986,795
42,419,962	Roads, bridges, and traffic control network	43,064,957
43,386,906	Total non-current assets	44,214,197
43,581,820	<b>TOTAL ASSETS</b>	44,354,156
378,926	<b>CURRENT LIABILITIES</b>	215,005
	<b>NON-CURRENT LIABILITIES</b>	
978,687	Creditors and borrowers	1,195,302
447,884	Provisions	495,021
1,426,571	Total non-current liabilities	1,690,323
1,805,497	<b>TOTAL LIABILITIES</b>	1,905
41,776,323	<b>NET ASSETS</b>	42,449
	<b>FUNDS EMPLOYED</b>	
61,917	Reserves	68,964
640,676	Capital grants	1,459,349
41,073,730	Accumulated funds	40,920,515
41,776,323	<b>NET EQUITY</b>	42,448,828

Source: Roads and Traffic Authority Annual Report for 1990-91

TABLE 17

**ROADS AND TRAFFIC AUTHORITY  
LAND, BUILDINGS, BRIDGES AND ROAD INFRASTRUCTURE  
NET OF DEPRECIATION**

30 June 1990		30 June 1991
\$m		\$m
164.5	Land and buildings in service for works administration	179.8
24.3	Officers' residences	17.5
480.8	Land and buildings acquired for future road works	597.2
42,419.9	Road infrastructure	43,065.0
<u>43,089.5</u>	<b>TOTAL</b>	<u>43,859.5</u>

Source: Roads and Traffic Authority Annual Report for 1990-91

TABLE 18

**1992 VALUES OF ITEMS NOT DISCLOSED IN THE  
1984 FINANCIAL STATEMENTS OF  
THE DEPARTMENT OF MAIN ROADS**

	\$m
Road infrastructure: roads, bridges, traffic control network	43,065.0
Superannuation liability fully provided	450.3

Source: Roads and Traffic Authority Annual Report for 1990-91

The adoption of full accrual accounting and the presentation of a balance sheet have afforded many advantages in financial reporting. Michael Churchill, in a recent study on the implementation of accrual accounting in the public sector, listed the advantages as being:

One gains an understanding of the total asset base managed by the organisation.

It aids evaluation of the organisation's level of funding and its mix of debt versus equity.

One can evaluate working capital management.

One can allocate accountability for specific assets and liabilities.<sup>56</sup>

### **Road infrastructure: recording, accounting and financial disclosure**

The adoption of accrual accounting as a component of public sector financial reform has a high level of acceptance across the whole community. The valuation of infrastructure assets on a current cost basis does not have the same level of acceptance. The lack of a definitive accounting standard that offers specific guidance on the accounting issues for public sector infrastructure accounting is a matter of concern. This issue has been addressed by the RTA in consultation with the Australian Accounting Research Foundation, the Auditor-General's Office, and major accounting firms.

The RTA's accounting policy is that the concept of depreciation is generally accepted when accounting for operational assets (e.g. plant and equipment), but is not entirely appropriate when calculating values and accounting for infrastructure assets.

The RTA has developed a policy for infrastructure accounting which involves calculating a Provision for Asset Restoration (the amount required to bring the road network to an acceptable standard) and a Provision for Asset Renewal (the amount required to bring the road network from an acceptable standard to near new condition). The RTA reports that it:

. . . considers that the aggregation of the elements providing for Asset Restoration and Asset Renewal will satisfy the requirements of Australian Accounting Standard AAS4 -Depreciation of Non-current Assets, in respect of infrastructure assets. It is anticipated that these methods of valuation and depreciation of the road infrastructure will be adopted by other Australian State Road Authorities.<sup>57</sup>

The Committee commends the RTA for its initiative in developing and implementing its policy of accounting for the capital cost and restoration and renewal of infrastructure assets. The Committee notes, however, that there may be reservations and non-

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<sup>56</sup> Michael Churchill, Accrual accounting in the public sector. *Australian Accountant*, June 1992, pp. 39-42.

<sup>57</sup> *Annual Report of the Roads and Traffic Authority for 1990-91*, p. 79.

acceptance in some quarters as to the validity of this policy even though the financial statements have the unqualified audit opinion of the Auditor-General.

### **Maritime Services Board: a different policy - land and property**

The Committee notes by way of comparison that the Annual Report of the Maritime Services Board discloses a different policy for the reporting of land and infrastructure assets.

The MSB policy<sup>58</sup> for the valuation of land used for infrastructure purposes<sup>59</sup> is that it should be valued at a nominal \$1 per site based on the Valuer-General's advice.

The Committee notes that in regard to the accounting for infrastructure assets the MSB's policy is at variance with the RTA's policy. In the interest of meaningful comparisons between public sector bodies and also between private and public sector reporting entities a consistent basis of valuation is essential.

#### **RECOMMENDATION 6**

The Committee recommends that the Treasury, in collaboration with the Australian Accounting Research Foundation and the Public Sector Accounting Standards Board, expedite the issue of an Australian accounting standard for public sector infrastructure assets.

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<sup>58</sup> *Annual Report of the Maritime Services Board for 1990-91*, p. 55.

<sup>59</sup> That is, wetlands associated with wharves, pipeline corridors, and land used as roads and reserves but not occupied for commercial purposes.

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## CASE STUDY 4: NORTHERN SYDNEY AREA HEALTH SERVICE

### Introduction

The health sector comprises a significant proportion of the State's total Budget outlays. For the 1990-91 financial year, total public sector spending on a functional basis showed that 16.4 per cent of total budget outlays, or \$4.6 billion, were related to health services. Table 19 shows consolidated public sector income and expenditure details for the health sector in 1990-91. The Commonwealth contributed \$1.4 billion, or 63 per cent, towards the total revenue of \$2.3 billion for the health sector that year.

TABLE 19

### HEALTH SECTOR OUTLAYS FOR 1990-91

---

	\$000
<b>REVENUE</b>	
Operating revenue	561,545
Investment revenue	54,475
Commonwealth grants/subsidies	1,448,223
Other	239,433
Total revenue	<u>2,303,676</u>
<b>EXPENSES</b>	
Employee related	2,480,728
Maintenance and working	83,936
Depreciation	68,752
Superannuation	71,932
Leave entitlements	306,607
Interest and loan charges	107,504
Other	1,551,906
Total expenses	<u>4,671,365</u>
<b>DEFICIT</b>	<u><u>2,367,689</u></u>

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Source: NSW State Public Sector Consolidated Financial Statements 1990-91,  
NSW Treasury, December 1991

The health sector holds substantial assets and liabilities: table 20 shows the State's net assets (or net investment) in the sector at \$1.4 billion.

**TABLE 20**  
**HEALTH SECTOR SUMMARY OF ASSETS, LIABILITIES**  
**AND EQUITY**

	<b>\$000</b>
Current assets	571,063
Non-current assets	<u>6,799,862</u>
Total assets	7,370,925
Current liabilities	704,893
Non-current liabilities	<u>5,292,857</u>
Total liabilities	5,997,750
Net assets (equity)	<u><u>1,373,175</u></u>

Source: NSW State Public Sector Consolidated Financial Statements 1990-91,  
NSW Treasury, December 1991

### **Area health services - accountability mechanisms**

Health is a complicated area with a range of accounting and reporting requirements imposed by the Commonwealth and the State.

The Commonwealth is the major provider of funds for the health sector, as detailed in table 19, some 63 per cent of funding in the health sector coming from Commonwealth sources. The Commonwealth requirements relate primarily to grants to the states under the Medicare agreement.

The New South Wales Government imposes a different set of accountability mechanisms over the health sector. The area health services in the Sydney, Hunter and Illawarra areas and the hospital boards for the rest of the State are not classified as Departments or Statutory authorities under the Public Finance and Audit Act and the annual reporting legislation. Area health services and hospital boards are subject to the Accounts and Audit Determination of the Department of Health.

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## **Previous reports of the Public Accounts Committee regarding the health sector**

Since 1981 the Public Accounts Committee has undertaken a number of inquiries into accounting and accountability issues in the health sector that reflect general concern for the budgetary impact and the importance of public health to the general public (table 21).

**TABLE 21**

### **PUBLIC ACCOUNTS COMMITTEE REPORTS ON INQUIRIES INTO HEALTH-RELATED ISSUES**

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<b>Report no.</b>	<b>Date tabled</b>	<b>Topic</b>
2	February 1982	Over-expenditure in health funding to hospitals
3	April 1982	Public accountability in public and other subsidised hospitals
32	July 1987	Home Care Service of New South Wales
44	February 1989	New South Wales Ambulance Service
45	June 1989	Payments to visiting medical officers

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### **Case study selection**

In selecting a suitable case study to show the accounting and reporting reforms of the health sector, the Committee decided on an area health service. The Northern Sydney Area Health Service was selected as it services a large geographic area, and also as initial inquiries indicated that the issues of accrual accounting and financial reform were in the process of being implemented.

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## Northern Sydney Area Health Service

The Incorporated General Fund Special Purpose and Trust Fund Balance Sheet at 30 June 1991 for the Northern Sydney Area Health Service discloses the assets and liabilities for a net State equity of \$874.2 million (table 22).

The Income and Expenditure Statement for 1990-91 shows that only about 14 per cent of operating costs are recovered from patient fees and other income (table 23). Like all other areas within the health sector, the Service is heavily dependent on subsidies and grants provided from State and Commonwealth government sources.

Table 23 shows the "net cost of services" basis to be used by budget sector authorities when reporting on an accrual accounting basis. This method of presenting the accounts shows the total cost of operations less revenue raised by the body, with the shortfall of revenue matched against the government subsidy. The figures in Table 23 clearly show that the Area Health Service was dependent on cash subsidies of \$417.5 million from Commonwealth and State subsidies. It is clear from these figures that budgetary controls and achievement of budget targets are a major accountability mechanism for the health sector.

TABLE 22

### NORTHERN SYDNEY AREA HEALTH SERVICE SUMMARY OF ASSETS AND LIABILITIES

	\$m
<b>ASSETS</b>	
Cash, investments etc.	53.7
Plant, property and equipment	<u>931.1</u>
Total assets	984.8
<b>LIABILITIES</b>	
Creditors, borrowings and other current liabilities	84.9
Borrowings and other non-current liabilities	<u>25.7</u>
Total liabilities	110.6
<b>NET ASSETS (EQUITY)</b>	<u><u>874.2</u></u>

Source: Northern Sydney Area Health Service Annual Report for 1990-91

TABLE 23

**NORTHERN SYDNEY AREA HEALTH SERVICE  
OPERATING STATEMENT FOR 1990-91**

	<b>\$000</b>
<b>OPERATING EXPENSES</b>	
Employee related	
Salaries and wages	274,310
Awards	13,107
Superannuation	<u>14,700</u>
Total employee related	302,117
Maintenance and working	
Visiting medical officers	18,484
Goods and services	91,247
Repairs, maintenance, and minor item replacements	<u>12,369</u>
Total maintenance and working	122,100
Depreciation	20,894
Total operating expenses	<u>445,111</u>
<b>OPERATING REVENUE</b>	
User charges	60,882
Other	<u>1,582</u>
Total operating revenue	62,464
Loss on sale of property, plant and equipment	(66)
<b>NET COST OF SERVICES</b>	<u>(382,713)</u>
Payments from Dept of Health	417,491
Add: Revenue not remitted to Dept of Health in prior years	<u>115</u>
	417,606
Less: Revenue remitted to Dept of Health	(61,419)
Revenue not remitted to Dept of Health for current year	<u>240</u>
<b>DEFICIT FOR THE YEAR</b>	<u>26,766</u>

Source: Northern Sydney Area Health Service Annual Report for 1990-91

Note: 1990-91 was the first year that financial statements were prepared on an accrual accounting basis.

## Public hospitals - budgetary control

The Committee has a long history of interest in the budgetary control processes of public hospitals. As mentioned earlier in this case study, two of the first three reports by the Committee in 1981-82 were related to this topic. The Committee notes that the budgetary control mechanisms are still a matter of concern and public comment.

### Retrospective adjustment - budget

The annual report of the Northern Sydney Area Health Service includes comment indicating that for the 1990-91 financial year all targets were reached, with the exception of the revenue target. This

. . . was not reached due to a retrospective increase in the revenue budget after the financial year had concluded.<sup>60</sup>

The Committee views with concern any practice of making retrospective adjustments, particularly after the financial year had concluded. Inquiries by the Committee indicate that retrospective budget adjustments are not a common occurrence; however the concept of effective budgetary control is lost if the controlling department is able to change budget targets after the close of the financial year. The Committee has been advised by the Department of Health that the retrospective adjustment to the Area's revenue budget and the resultant "unfavourable variance" in no way reflect on the Area's management.<sup>61</sup> The Committee accepts this explanation and regards the expressed concern by the Area's board as a most positive and commendable indication of the Area's acceptance of its responsibility for achieving budget targets.

### RECOMMENDATION 7

The Committee recommends that if a controlling department finds it necessary to make adjustments to budget targets for controlled authorities, then the annual report of the authority is to include a summary statement of the impact of the directions on the results for the year.

<sup>60</sup> *Annual Report of the Northern Sydney Area Health Service for 1990-91*, p. 6.

<sup>61</sup> Letter to the Public Accounts Committee from the Director General, Department of Health, dated 16 June 1992.

## **Hospital assets - recognition, accounting and reporting**

The implementation of accrual accounting across the public sector has resulted in the recognition, accounting, disclosure and reporting of assets. To assist departments and authorities to address these issues as part of the implementation process, the New South Wales Treasury has issued specific guidelines<sup>62</sup> on the valuation of assets.

For the health sector, the accounting for assets on an accrual basis has a significant impact on the financial result for the year, due to the inclusion of depreciation charges which are not included in government funding. This issue was addressed by the Northern Sydney Area Health Service in the following terms:

The policies and procedures applied . . . for accrual accounting result in a reported operating loss of \$26.8m.

. . . The deficit recorded is, therefore, directly attributable to the Government subsidy excluding the funding for depreciation, employee entitlements incurred during the year . . . Accrual accounting results, calculated on this basis, will continue to record deficits, so long as funding is not provided for these expenses.<sup>63</sup>

Some proponents of public sector accounting reform object to the wholesale adoption of private sector practices, on the grounds that organisations that conduct community service operations do not have the generation of profit as their primary objective. According to Michael Churchill<sup>64</sup>, their aim is to provide the best service they can, and service is something which cannot be measured in terms of dollars alone.

This case study has clearly demonstrated that the financial reporting by an organisation like the Northern Sydney Area Health Service can result in a misleading interpretation if the operating profit or loss is taken as the sole indicator of efficiency.

The Committee recognises that the New South Wales public sector is at the leading edge of public sector financial reform, and the lack of a definitive Australian accounting standard for budget sector departments and authorities can result in New South Wales departments reporting their financial results on a basis that is not directly comparable to reporting entities in either other jurisdictions or the private sector.

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<sup>62</sup> New South Wales Treasury, *Policy guidelines for evaluation of physical non-current assets in NSW public sector*. Technical Paper, September 1990.

<sup>63</sup> *Annual Report of the Northern Sydney Area Health Service for 1990-91*, p. 49.

<sup>64</sup> Michael Churchill, Accrual accounting in the public sector. *Australian Accountant*, June 1992, pp. 39-42.

The Public Sector Accounting Standards Board of the Australian Accounting Research Foundation has issued an exposure draft for such a standard.<sup>65</sup> The exposure draft is open to public comment until 30 June 1992. Due process in the development and implementation of accounting standards requires exposure drafts to be open for public comment from any interested parties. The Committee has been informed that the finalisation of the project and the issue of the standard cannot be expected before 1993.

### **RECOMMENDATION 8**

The Committee recommends that the Treasury strongly advocate the early promulgation of an Australian accounting standard for budget sector government departments and authorities.

## **CASE STUDY 5: DEPARTMENT OF CORRECTIVE SERVICES**

### **Introduction**

The Department of Corrective Services occupies a crucial place in the criminal justice system with its role of managing the State's prison and community based service penalties. The scope of the Department's activities includes prison operations and the community corrections service.

In New South Wales the forerunner of the Department of Corrective Services was the colonial era convict administration which, with the government stores, commenced public sector activities at Sydney in 1788.

The Department is a suitable case study on financial reform having been in operation continuously in one form or another for over 200 years and therefore having been involved in all the financial reforms in that time.

For the 1991 financial year the Department reported on its financial results for both an accrual and non-accrual basis.

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<sup>65</sup> Public Sector Accounting Standards Board of the Australian Accounting Research Foundation, *ED 55 - Financial reporting by government departments*, Melbourne, 1992.

On an accrual accounting basis of reporting, the Department showed in unaudited financial statements an operating loss of \$4.3 million (after bringing to account capital allocation of \$90 million). The audited financial statements, prepared on cash appropriation basis, showed an excess of payments over receipts (both capital and recurrent) of \$314.5 million.

This case study clearly demonstrates, and indeed highlights, the differences in reporting financial operations on an accrual basis as compared to full accrual accounting. Table 24 illustrates, in summary form, the different level of financial disclosure between financial statements prepared on a cash budget appropriation basis and when prepared on a full accrual accounting basis.

**TABLE 24  
DEPARTMENT OF CORRECTIVE SERVICES  
COMPARISON OF FINANCIAL RESULTS AS REPORTED ON  
CASH BASIS VERSUS ACCRUAL ACCOUNTING BASIS**

CASH	\$000	ACCRUAL	\$000
<b>CASH RECEIPTS</b>		<b>OPERATING REVENUE</b>	
Services rendered	7,352	User charges	19,343
Prison industries	11,704	Other	3,405
Other	11,005		
<b>Total receipts</b>	<b>30,061</b>	<b>Total operating revenue</b>	<b>22,748</b>
<b>CASH PAYMENTS</b>		<b>OPERATING EXPENSES</b>	
Salary related	176,159	Employee related	209,900
Maintenance	59,905	Maintenance	55,121
Capital construction	90,297	Other	27,496
Other	18,547		
<b>Total payments</b>	<b>344,908</b>	<b>Total operating expenses</b>	<b>292,517</b>
		Net cost of services	264,013
		Net government contribution to operations	259,722
		<b>OPERATING RESULT</b>	<b>(4,291)</b>
		Net Consolidated Fund capital allocation	87,750
		<b>OPERATING RESULT AFTER CAPITAL ALLOCATION</b>	<b>83,459</b>
<b>EXCESS OF PAYMENTS OVER RECEIPTS</b>	<b>314,847</b>		

Source: Department of Corrective Services Annual Report for 1990-91

## **Accrual accounting- implementation and training**

Information supplied to the Public Accounts Committee indicates that the process of implementation was indeed a significant undertaking involving a major challenge in training staff in the skills and competencies necessary to implement accrual accounting and the other financial reforms.

This case study demonstrated the size and complexity of the task. For accounting and reporting purposes the Department's activities are divided into 80 cost centres across the State. To successfully implement the package of reforms an education and training program has had to be introduced. The Public Accounts Committee understands that formal, in-house training on financial management is being carried out at courses offered at the Corrective Services Academy.

The Public Accounts Committee commends the Department for the introduction of formal training on financial management for non-accounting staff.

### **Balance sheet - accrual accounting**

The implementation of accrual accounting involves the recognition and accounting of all items of revenue and expenses, and the disclosure of all assets and liabilities. Government departments, when reporting financial operations on a full accrual basis, can prepare a balance sheet which discloses all assets under the control of the department and all liabilities incurred, and which highlights the Crown's equity in the department.

When a traditional government department reports on a cash basis, a conventional balance sheet cannot be prepared because non-cash assets and liabilities and non-cash revenue and expenses are either not recorded, or are recorded and reported as notes and/or as supplementary statements.

### **Accrual accounting - recognition of assets and financial disclosure**

The recognition, accounting and disclosure of assets represent one of the major changes that occurs when an organisation previously reporting on a cash basis converts to accrual accounting. Michael Churchill, a corporate adviser writing on a study on accrual accounting in the public sector across Australia, made the following observation:

In the past, many public sector organisations saw the recognition and recording of assets as a necessary evil.<sup>66</sup>

In New South Wales, the implementation of accrual accounting has resulted in the accounting and financial disclosure of assets within auditable financial statements. By comparison, under the old regime of cash accounting, details of property holdings were shown without financial values in the non-audited section of the annual report. In the case of the Department of Corrective Services, accrual accounting will result in the balance sheet disclosing a net figure of \$807.7 million for property, plant and equipment. Table 25 summarises the increased level of financial disclosure.

**TABLE 25**

**DEPARTMENT OF CORRECTIVE SERVICES  
PROPERTY, PLANT AND EQUIPMENT  
BROUGHT TO ACCOUNT (NET OF DEPRECIATION)  
AT 30 JUNE 1991**

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	\$000
Land	101,837
Buildings	695,021
General plant and equipment	10,129
Computer equipment	753
<b>TOTAL</b>	<u><u>807,740</u></u>

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Source: Department of Corrective Services Annual Report for 1990-91

**Balance Sheet at 30 June 1991 - accruals basis**

For the 1991 financial year the Department of Corrective Services prepared an unaudited balance sheet on a full accrual accounting basis disclosing a net equity held by the Crown of \$807.1 million (table 26).

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<sup>66</sup> Michael Churchill, The winds of change. *Australian Accountant*, March 1992, p. 20.

financial disclosure, and is one of the major achievements in public sector financial reform.