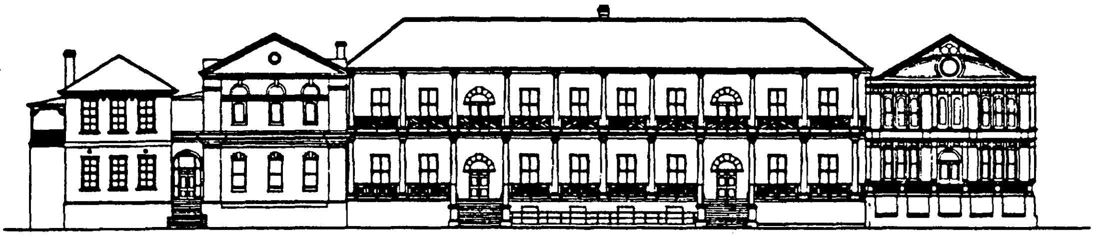
PUBLIC ACCOUNTS COMMITTEE

Proceedings of the Seminar on Accrual Accounting — The Scorecard to Date

13 December 1994



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Public Accounts Committee Secretariat

Patricia Azarias, MPA *Princeton*, BA(Hons) Oxon., BA(Hons);
Director

David Blunt BA(Hons), M Phil *Sydney*
Senior Project Officer

Jozef Imrich, BA *Deakin*;
Clerk to the Committee

Caterina Sciara
Assistant Committee Officer

Kendy McLean, BA
Assistant Committee Officer

John Lynas, FCPA,
Accounting and Auditing Advisor
Auditor-General's Office

Public Accounts Committee
Parliament House
Macquarie Street
Sydney NSW 2000

Telephone (02) 230 2631
Facsimile (02) 230 2831

MEMBERS OF THE PUBLIC ACCOUNTS COMMITTEE

Mr Ian Glachan, MP Chairman

The Liberal Member for Albury since 1988, Ian Glachan has had a varied background. He served five years at sea as a marine engineer, was a farmer for ten years, and operated a newsagency in Albury for 18 years. Mr Glachan is also a past president of the Albury-Hume Rotary Club and a Paul Harris Fellow, an active member of the Anglican Church, and the Legislative Assembly member on the Board of Governors of Charles Sturt University. Other parliamentary responsibilities include Chairmanship of the Minister's Advisory Committee on Health, and vice-chairmanship of the Minister's Advisory Committee on Roads and Transport. Mr Glachan was elected Chairman of the Committee on 15 September, 1994.

Mr Peter Cochran, MP, Vice-Chairman

Following a background in farming, the Army, the Commonwealth Police, ASIO, and the Cooma-Monaro Shire Council, Peter Cochran won the seat of Monaro for the National Party in 1988. His other parliamentary responsibilities include the chairmanship of the Minister's Advisory Committee on Land and Water Conservation, deputy chairmanship of the Committee for Police and Emergency Services, and membership of the committee for the Environment and the Select Committee on Public Sector Superannuation. He is also the Premier's representative on the Anzac House Trust and the Anzac Memorial Trust.

Mr Geoff Irwin, MBA, ProdEngCert, DipTech, DipEd, MP

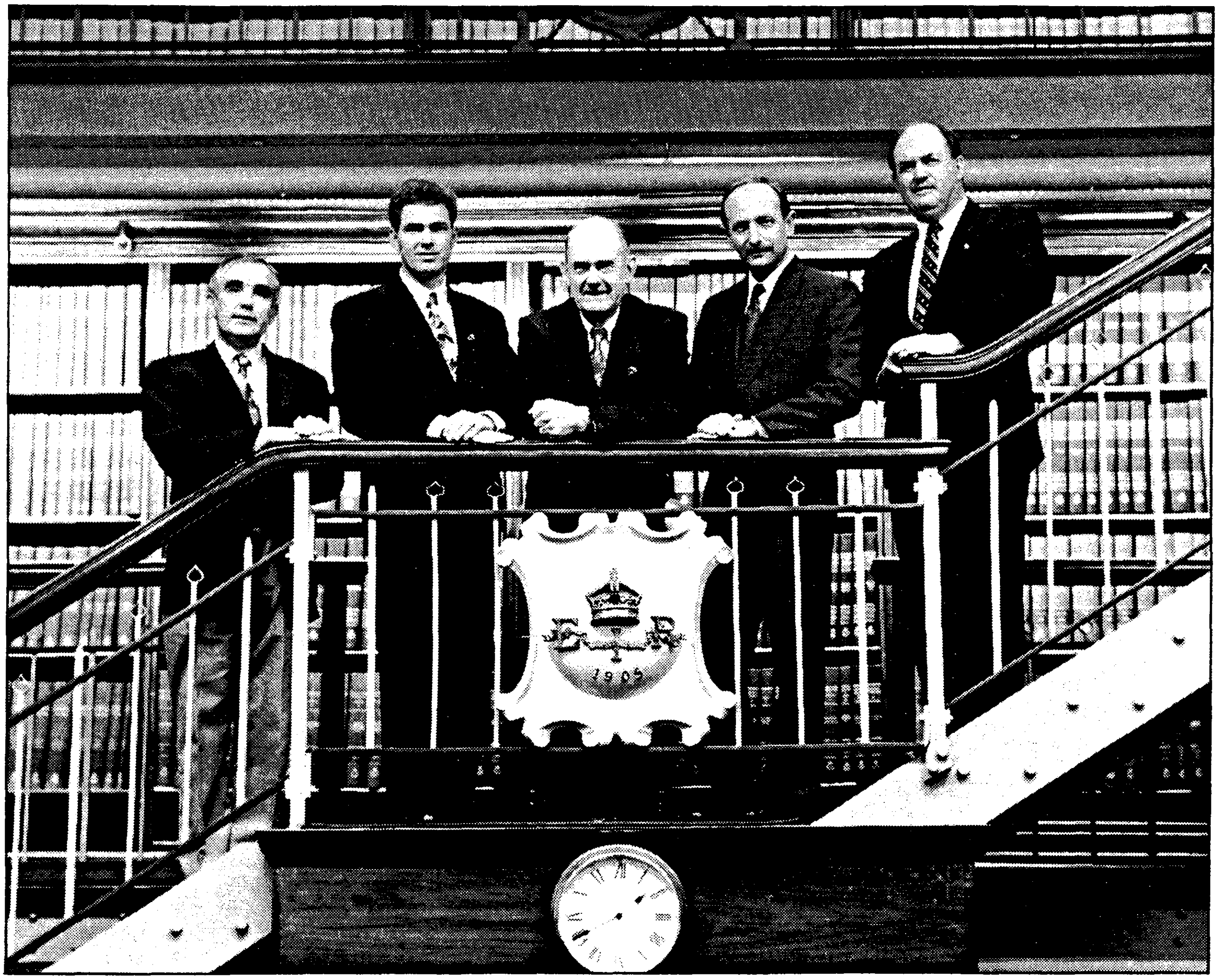
Geoff Irwin was elected to Parliament in March, 1984 as the Labor Member for Merrylands, and he has been the Member for Fairfield since March 1988. Before entering Parliament he worked in industry as a planning and supply manager and taught business studies at TAFE. He served as a member of the Select Committee upon Small Business and as Opposition Spokesperson on Business and Consumer Affairs. *Resigned from Parliament on 24 January 1995.*

Mr Terry Rumble, FCPA, 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 is the Chairman of the Leader of the Opposition's Backbench Committee which involves Treasury, arts and ethnic affairs.

Mr Andrew Humpherson, MP

The Liberal member for Davidson since May 1992 Andrew Humpherson was Deputy Shire President of Warringah Shire Council having served several terms on the Council. Mr Humpherson was an Area Manager for Shell. He has also worked as an Engineer for Repco and Shell. He holds a degree in Chemical Engineering from the University of New South Wales. His other parliamentary responsibilities have included the Chairmanship of the Select Committee on Motor Vehicle Emissions and Legislation Committee upon the Endangered Species Bill. He has served as a Member of Select Committee into Water Board, State Owned Coal Mines, Bushfires and the Joint Committee on the Office of the Ombudsman.



The Public Accounts Committee

From left: Terry Rumble, Andrew Humpherson, Ian Glachan **(Chairman)**, Geoff Irwin (*Resigned from Parliament on 24.1.1995*), Peter Cochran (Vice-Chairman)

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CHAIRMAN'S FOREWORD

The aim of this report is to present an account of the progress made to date in the Committee's inquiry into the implementation of accrual accounting in the New South Wales public sector.

Over many years the Public Accounts Committee has taken a keen interest in the reform of Public Sector financial management and has actively supported the implementation of accrual accounting throughout the public sector. This most important and fundamental financial reform has not been a politically divisive issue in New South Wales; indeed successive governments have adopted and then promoted accrual accounting with increasing enthusiasm.

New South Wales can be seen to be at the forefront of reforms in financial management of the public sector, notwithstanding some criticism from some quarters. However, there are still several outstanding issues that need to be addressed if the implementation of accrual accounting is to be brought to a successful conclusion. Two of these stand out. These are

- the need for some specific accounting standards for particular accounting issues and
- the need to improve the skills and training for accounting and finance officers.

During the inquiry, the Committee will be closely examining these issues.

This Seminar was the starting point for this inquiry. Our thanks and appreciation are due to the many officers in departments and authorities who came along and participated. By sharing our views and experiences we can all gain from the collective experience over a wide range of departments and authorities.

To our panel of speakers, a special acknowledgment for the time and effort taken to prepare their papers and to prepare for the open forum session. The Committee is pleased that such a high level of expertise can be readily found from within the public sector.

To my fellow members I acknowledge the usual bi-partisan approach to the work of the Committee. This is the strength behind the success of our work and is of special importance at this time as we approach the forthcoming state election. To the staff of the Committee, a special note of appreciation for organising the seminar in addition to their normal duties. We specially appreciate the contribution of John Lynas, Adviser from the Auditor-General's Office, who identified the topics and organised the speakers; Debbie Isted and Caterina Sciara handled the booking and registration of delegates in their usual efficient manner; to Kendy McLean for editing and compiling the transcript of the proceedings we owe a special vote of thanks; and, as usual, Patricia Azarias, the Director, supervised the operation.

Ian Glachan MP
Chairman
February 1994

SUMMARY OF SIGNIFICANT ISSUES

The implementation of Accrual Accounting across the New South Wales public sector is one of the most significant and far reaching reforms in financial management to have occurred in Australia in the past 50 years.

The New South Wales public sector is ranked among the leaders in the world in reform of financial management in the public sector. However, notwithstanding the progress achieved to date, there are a number of outstanding matters that still need to be resolved. The first of these issues relates to accounting standards and the second relates to the accounting and reporting requirements for the Public Trustee.

In relation to accounting standards, there are two issues that remain unresolved which have been the subject of comment by the Public Accounts Committee in previous reports. The first relates to accounting standards for infrastructure and the second relates to the external reporting requirements for public trustee operations.

In several earlier reports, particularly numbers 73 and 80, the Committee inquired into and reported on the private sectors involvement in public sector infrastructure. The Committee noted that one of the barriers to increased involvement by the private sector was the degree of uncertainty as to the appropriate accounting treatment to report on the business arrangements. The Committee noted that in several instances (for example, the Roads and Traffic Authority's involvement in the Sydney Harbour tunnel and the private sector tollways), the RTA, the Auditor-General, the NSW Treasury and several Big Six accounting firms were not able to agree on the appropriate accounting treatment.

The Committee is firmly of the view that this matter needs to be quickly resolved. In this regard the Committee was pleased to note that the Australian Accounting Research Foundation is in the process of preparing an issues paper on this topic and that a project advisory panel is to be established to support this project.

The second matter still outstanding and of continuing concern to the Committee is the accounting and external reporting requirements for publicly owned and conducted trustee operations. In report No. 82 the Committee undertook follow-up action on a number of matters previously reported to Parliament by the Auditor-General. In these reports the Auditor-General had indicated his concern at the high level of earnings that are retained by the Public Trustee. The Committee recommended a number of changes to the reporting and review requirements imposed upon the Public Trustee and recommended that a new Accounting Standard be developed for public trustee operations.

Mr Ian Glachan, MP

Chairman of the Public Accounts Committee

CHAIRMAN'S ADDRESS

Introduction by Ian Glachan, MP, Chairman of the Public Accounts Committee

Good morning ladies and gentlemen. My name is Ian Glachan and I am Chairman of the New South Wales Public Accounts Committee. It is my great pleasure to be able to welcome you here this morning on behalf of the Public Accounts Committee and to the New South Wales Parliament House for our seminar on accrual accounting, which we have entitled "The Scorecard to Date".

I want to extend a very special welcome to my colleagues from other parliaments, and I believe it is quite fitting that today in the oldest parliament in Australia we should be hosting this seminar.

I am pleased to note that New South Wales is seen as a leader in the process of reform of financial management in the public sector and that the parliament itself, through the Public Accounts Committee, is a major player in the reform process.

Let me introduce to you, firstly, two of my colleagues on the New South Wales Public Accounts Committee, Mr Andrew Humpherson, Member for Davidson, and Mr Terry Rumble, Member for Illawarra.

Our first speaker today is the former Chairman of the Public Accounts Committee, now Parliamentary Secretary to the Premier, Mr Andrew Tink, Member for Eastwood.

I would also like to just offer a very special welcome to our colleagues from Victoria, first of all to Mr Ross Smith MP and Mr Tony Plowman, my neighbour whose seat of Benambra faces my seat of Albury across the Murray River.

I would also like to welcome Mr Fenwell MLA, a member of the Queensland Public Accounts Committee, and a very special welcome to Mr Bill Warne, the Financial Controller of the Albury City Council, the man who makes sure that the rates I pay are put to good use.

We also have Treasury officers from the Commonwealth and other States and Territories here today, and I extend a very warm welcome to them.

I am pleased to acknowledge Thuy Mellor, who is here standing in today for the Secretary to the New South Wales Treasury, Mr Mike Lambert. Thuy was last week nominated for a special honour as Government Accountant of the year - a very special honour indeed. That is an award sponsored and promoted by the professional accounting bodies and the "New Accountant" magazine. Mrs Mellor's achievements in public sector financial reform are at the heart of the topic we are discussing today, and I might add that although the final of the award went to Sydney Tax Commissioner Dennis Cortese, it is no shame at all to be pipped on the post by the taxman. That happens to a lot of us. I do extend my congratulations to you on your nomination.

The importance of our seminar today is demonstrated by the wide range of organisations represented, Public Accounts Committees from the Commonwealth and other States, staff from Auditors-General's Offices across Australia and professional accountants from private sector firms offering their expertise to the public sector. You are all welcome and I am confident that you will add your collective wisdom and knowledge to the seminar proceedings.

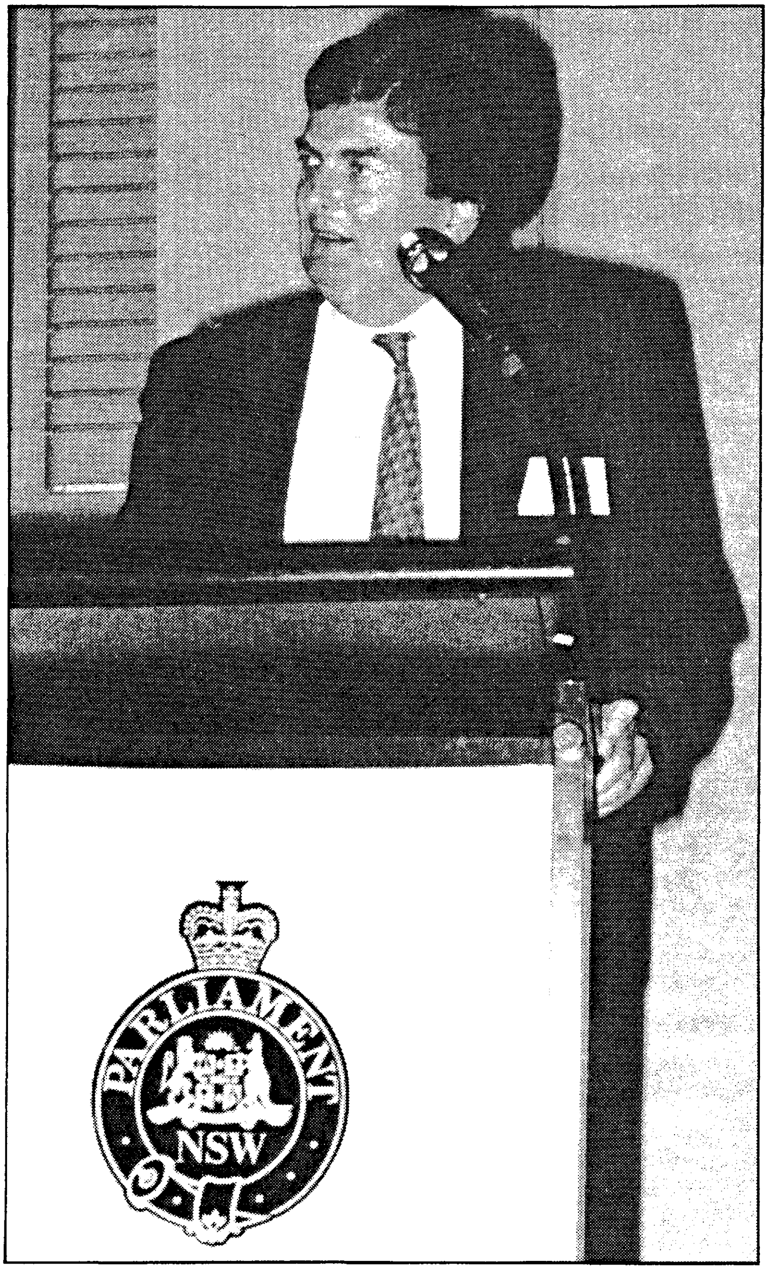
Last, but not least, I welcome accounting and financial professionals from the three tiers of government - Federal, State and local. You have all carried the brunt of the hard work that is needed in implementing these changes in reforms and you are all very welcome; and I acknowledge your consideration to the topics we will discuss today.

My personal thanks go to my parliamentary colleagues and to the distinguished speakers that we have today, all of whom are very highly regarded in their own fields.

Now, as Chairman of the Public Accounts Committee, it is my great pleasure to introduce to you our first speaker who will open the conference, and that is my colleague Andrew Tink, Member for Eastwood, formerly Chairman of the Committee, and now Parliamentary Secretary to the Premier. Andrew was elected first in 1988 as the Member for Eastwood and before entering parliament he practiced as a barrister in equity, commercial and shipping law.

Andrew's career in Parliament has included membership of a wide variety of parliamentary and government committees as well as being Chairman of the Joint Parliamentary Committee on the Office of the Ombudsman. He has served as a temporary Chairman of Committees and Deputy Speaker of the Legislative Assembly, and is the representative of the Parliament on the Council of Macquarie University.

While Chairman of the Public Accounts Committee he was a dynamic leader. Those who served with him always admired his analytical mind, his dedication and particularly his dedication to public accountability and efficiency. Ladies and gentlemen, will you please welcome Mr Andrew Tink.



Mr Andrew Tink, MP
Parliamentary Secretary to the Premier

"The State of the Art in Public Sector Financial Management"

MR TINK: Thanks very, much Ian. I firstly would like to congratulate Ian Glachan and the Committee for continuing what has now become a tradition of seminars in Parliament House relating to public accountability issues. We keep a record of what is said here and it is good to look back on it from time to time and see what people have said in the past.

I was looking at a seminar that the Public Accounts Committee hosted in this room back in February 1988. It was a seminar on accrual accounting, and the then Treasury Secretary, Percy Allan, addressed the gathering and his topic was "Accrual Accounting, To Be Or Not To Be". He started out by saying that he didn't think accrual accounting in government departments was a clear cut issue in terms of whether or not it should proceed and he expressed I think fairly strong personal reservations and strong reservations of the government of the day about whether or not accrual accounting was a good idea. He certainly thought that it would be a formidable administrative task and not something that could be done without a lot of cost.

He identified a number of other areas where he thought the priority lay and he also took the view that accrual accounting was something that ought to take a lower priority than any of those issues. So that was the position at a seminar in 1988 in this room on the same topic.

Interestingly, he made a particular comment about interpretations by journalists, and said this:

"The New South Wales Treasury has a good media profile, so I don't want to be critical of the Press. But there have been instances where incorrect interpretation of the State's accounts by journalists have led to considerable confusion and considerable work in explaining misunderstandings".

I think he was probably a little bit worried about too much information being something that perhaps the press couldn't handle. I guess we have come a long way and, by 1990, at another seminar, the Assistant Secretary of the New South Wales Treasury, Bob Scullion, was able to say that, and I will quote him:

"Let me say very clearly and very publicly that not only does Treasury believe the programs are achievable but we strongly believe the process can be shortened, certainly by one year and possibly two".

There was a very significant sea change over a very short period of time. For somebody who is a non-accountant like myself, he also made some interesting comments on cash versus accrual accounting, and said this:

Under cash accounting the budget result has no meaning from a modern accounting viewpoint and is little more than the difference between cheques drawn from the bank during the year and cash deposited into the bank. This has been called "tennis-club" accounting and has been the form of accounting since State Treasury *was established in 1824".*

I suppose in that spiel I can understand or think I can understand a little bit of what "tennis-club" accounting is like and so I have some understanding what he was trying to convey.

What has now happened is that legislation has been passed, the Public Finance and Audit Amendment Act, and one of the key planks in that Act is to require departments to prepare their annual financial statements on an accrual accounting basis. This hasn't been without quite a bit of pain and the Committee had some first hand experience during the time that I was Chairman of the sort of problems that can arise.

In relation to a particular problem that arose with the Water Resources annual report a few years ago, we heard some evidence of what the problems were. The Committee heard of some of the incredible difficulties in introducing accrual accounting in that department, given the particular nature of the job it did and the very diverse charter it had, if you like, in a sort of geographic sense around the State. We heard of some assets that needed to be valued and some of the complexities about those valuations. The issues included cross-border issues, irrigation issues relating to other States, equipment that relates to joint Commonwealth-State arrangements in relation to irrigation, all that sort of thing. It became clear to us listening to the evidence just how hard it can be for some departments to come to grips with accrual accounting.

The evidence on that front was really very illuminating and gave the Committee a much more realistic appreciation of just what was involved.

We then looked at some issues relating to local government and, I guess for me personally, it is in the local government area where the politics of accrual accounting, if I can put it that way, have become most significant. As a local member of parliament I guess I am as aware and sensitive about local issues in my area as any other member of parliament anywhere else - and we were very pleased in the PAC with the regime that came in with the new Local Government Act where there is now a requirement to have comprehensive accrual accounting in the local government area.

It is interesting to see the way that comes out in the annual reporting provisions where councils are now required to report on the condition of public works, including public buildings, public roads and water, sewerage and drainage works under the control of the council, at the end of that year, together with an estimate of current values, the amount of money required to bring the works up to a satisfactory standard and an estimate of current values of the annual expense of maintaining the works at that standard and council programs for maintenance for that year in respect of the works.

From a Public Accounts Committee point of view, that is all terrific stuff and we were very supportive of it in general, but the rubber hit the road, so to speak, in my electorate with Ryde Council, where the council was faced with complying with this legislation. As I suspect is the case with many other councils around New South Wales, particularly in Sydney, Ryde

Council has a tremendous problem with its drainage, and it has been a case I think that out of sight is out of mind, so where

you have a road, you have a road full of potholes, a footpath which is being pushed up by a tree, then council tends to get in, like any government body - I am not down on councils - and tends to do something about it because it is advisable and people complained about it.

But where something is under the ground, there is no sense that people are in any way accountable for it, there is no great complaint about it, people do not really understand it, and it is out of sight out of mind. I did in my electorate, however, have some serious flooding a few years ago and so drainage became a big issue. What these provisions required council to do was actively get out there and publicly disclose what the state of its drainage infrastructure was.

With current technology you can get a little camera on the end of a plastic probe, the sort of thing they use in surgery, and you can actually go down tunnels and have a look at tunnels with remote photography that nobody has ever looked down since those tunnels were built, and some of what Ryde Council found was just a disgrace. We had major drainage works which unbeknowns to the council had other utilities drop drains in at right angles to the first drain, so the camera would see a drain disappearing and all of a sudden some huge drain at right angles which cuts out about 50 per cent of the capacity of the first drain, and it was not on any council map; somebody else had just put it in there.

That sort of thing was quite common. Obviously in an overflow situation you hardly have to imagine what the impact of that would be.

Anyway, Ryde Council came to the three local members - and I am one - and said, *"Listen, thanks to you fellows we have a big problem. We have to go public with this. We have to go and explain to the public that the drains are a mess, and we basically are looking at putting on a special levy."* Now, I jumped as high and as long as any of my other colleagues when as a State member I was being verballed, pulled in, whatever you like, to some type of local government levy to be imposed on ratepayers. We were extremely uptight about it and had some fairly touchy meetings with the Council.

The point I am trying to make, perhaps a bit laboriously, is that when the Council actually explained to the public what was going on, when the council did the presentations to the public - they did a fantastic job I must say - there was, in fact, very significant support for a drainage levy on the basis that the levy be directed specifically to the drainage problems and no other issue.

So to get back to a fundamental point, I guess, at the end of the day there is really nothing to be feared and there is even nothing to be feared politically by being transparent about problems and laying them out for the public and saying, *"Look, there is the problem and this is what we have to try to do to fix it."*

The point I am trying to make is that accrual accounting is a very important tool in achieving that public outcome.

At the end of the day what it is all about is just explaining to the public what is going on, being a lot more open about things. The experience we have had is that when you are open in that way, people will come along with you. I think that is a very important lesson I learned about that exercise and from that exercise. So I have come back full circle. Initially whilst I was supportive in principle of accrual accounting, I was extremely uptight about coming clean at the local parish pump political level.

I think, being honest, that is probably the initial reaction of most politicians. Then, when pushed through the exercise by legislation, when actually forced by law to do it, they see the outcome made it all worth while. So I think there is a very beneficial public interest outcome there at the end of the day which makes this whole exercise worth persevering with.

I was interested to see, Ian, that you have Bob Walker coming along to speak at lunch time, and I could not let the occasion pass without saying a few things about accrual accounting and Bob Walker. Because I am not the host today, I will speak my mind. One thing - I do not speak for the Public Accounts Committee here - that personally irritates me a bit is that I think Bob could be a bit more charitable about the work that has been achieved in New South Wales in terms of accountability.

I hasten to add that I am very pleased that Terry Rumble is here. In my time and since, he has made a great contribution to the PAC as one of the ALP members who has always tried to have a bipartisan approach. Not only on the PAC, but also in New South Wales we have had a bipartisan approach to financial reform. Whilst accrual accounting perhaps has moved in recent years, it would be remiss of me not to say that the reform process in New South Wales started with Ken Booth and the Labor Government and it has proceeded that way very much on a bipartisan basis on the issues that matter. So it is, I think, also with accrual accounting.

One of the paradoxes is that I think it is fair to say that New South Wales is in the lead here, certainly in terms of the types of consolidated financial statements that I think Thuy Mellor amongst others is required to sign off on. New South Wales really does lead Australia in terms of the nature of the statement of compliance and the sort of statement that can be made, such as, for example, that they are in compliance with accounting concepts and all applicable Australian accounting standards.

So I think we get to a position here where we are able to identify what is on the balance sheet, what is off the balance sheet, to have a much clearer picture of what is going on. I regret to say, though, that as far as Bob Walker is concerned, we do not seem to get any thanks for it.

There was an article in the "New Accountant" of 13 October 1994, which was headed up "Accountability: What state are you in?" New South Wales, I think, ironically came out of that fairly badly. I have asked myself why. It seemed to me - this is perhaps not a very good analogy but do I my best - it is like the difference between an actor with make-up on and an actor who has not got make-up on. New South Wales has got to the point where we have the make-up off and people can see what is really going on, and in some way it is less attractive than the person with the make-up on, but the make-up in a sense is not real; it just presents a picture. The real picture is perhaps the person with make-up off.

I think New South Wales, in terms of its accountability, has its make-up off, and if Professor Walker is finding more fault here, it is because we have actually got a better basis for setting out the real position in the consolidated financial statements and so there is more transparency there to get a better picture of the problem issues.

The position is also illustrated with some of the other States and the Commonwealth. For example, in the Commonwealth there was an audit report of the Auditor-General 1993-94, *"Efficiency Audit Accrual Accounting, Are Agencies Ready"*. I think we have answered that question in New South Wales and moved on. I think that Bob Walker, if he was fair dinkum about things, would give New South Wales a bit more credit than it has had in that area.

I would also say the same about the Public Accounts Committee. As some of you probably know, we have done a fair bit of work in the infrastructure financing area and Bob has strongly criticised our work in the "Financial Review". However I am pleased to say that some of our key recommendations on accounting standards are being up by the Australian Accounting Research Foundation, an area of keen professional interest for Bob Walker but one he has given the PAC no credit for.

It is an outcome of accrual accounting in NSW that Bob Walker has been able to identify issues relating to infrastructure. As you probably know, we have a number of so called Build Own Operate Transfer programs - BOOT programs. We have the tunnel, the M4, the M5, the M2 and so on, but, in the context of that debate, one thing that accrual accounting has done is to actually identify better than anywhere else just where those projects start and where the public sector financing of them stops.

We have a long way to go in that area but I think that accrual accounting is one of a number of tools that helps to identify what is what and to cauterise off these BOOT projects to determine just what issues are there for accounting purposes.

I think that notwithstanding Bob's criticism of the work the Committee did on infrastructure, the Auditor-General's latest report indicates that we have done some good work in trying to advance the public debate in the context of contract summaries and just generally getting out into the public even a lot more information about these projects.

The important work that needs to be done to build on accrual accounting infrastructure is to look at the relevant accounting standards. And this is something that the Foundation is moving towards and I think it is something that people like Bob Walker need to spend more time on. I am talking particularly about Accounting Standards 17 and 19. We really need to move towards a new Accounting Standard, which is something that Treasury is doing already, looking at this concept of an emerging right to infrastructure, and that is something that is being built at, if you like, from the accrual accounting concepts now in place.

In conclusion, I think that some important

In conclusion, I think that some important work has been done. It is not easy. We have had evidence that accrual accounting for particular agencies can be exceptionally tough. I guess I have had some personal experience that accrual accounting can at times appear tough for politicians, but at the end of the day the name of the game in all this for all of us, from infrastructure projects right back to local drains, is to be open about what is going on, to lay it on the table, to, in effect, trust the public, and to make trusting the public the key element of public policy.

As a local Member I have yet to be disappointed with laying things out on the table for the public in my electorate. If you do that, if you tell people what is going on, then you are going to have a much better basis for ultimate decision-making.

It is where people do not know what is going on, where decisions are made without telling people what is going on, that you run into trouble. Having been to a fairly big and lively airport meeting last night, I was reminded of that pretty forcefully.

Ian, congratulations on this Conference. You are following a very significant tradition of Public Accounts Committees spanning conferences over the last 10 to 15 years and I wish you all the best; and thanks for allowing me to open the Conference.

MR GLACHAN: Thank you very much, Andrew. Andrew has to leave us shortly. He has a meeting soon representing the Premier in a meeting with the Premier of Transvaal. We thank you for your time.

establish a Treasury Help Desk. At this stage I would like to acknowledge the contribution from the "big six" accounting firms, the assistance that the firms have provided to Treasury and to a number of departments in the process. The firms provided eight people, two to Treasury and six to departments, at cost, to assist in the implementation.

It was expected, and I think it is now realised, that such skill transfer and such exchange is beneficial to New South Wales agencies as much as it is to the firms themselves.

In addition to the contribution from the firms, Treasury has also taken a more active role in the development of accounting policy and its application in particular situations. This has been necessary and essential, given the need to have consistent policies and a uniform presentation of financial accounts for the preparation of the State's consolidated financial statements.

Treasury sees itself as having the role of a head office accountant of a large corporation, that it should provide a policy framework within which all "subsidiaries" will report, and that we should follow Accounting Standards. But, if there is any need for any departure, or where there is no existing standard, we certainly would talk to the agency concerned - and certainly the Audit Office, I should not forget to mention that - and come up with some accounting treatment that we all believe is appropriate.

As I mentioned before, sometimes we do not agree with the Audit Office, but that is reasonable so long as we put on the table our reasons for disagreement with the Audit Office. Treasury certainly does not subscribe to the view that accounting treatment, that is, whether it is on or off balance sheet, should determine whether a transaction project is to be undertaken.

Treasury believes that the transaction, or the project, particularly when we talk about transaction infrastructure projects, that those projects should be considered, accepted or rejected on the basis of an economic analysis of benefits and risks to the State and should be accounted for accordingly.

The other role that Treasury also adopts is providing the training impetus for departments. We do not get involved in the delivery of the training. But in conjunction with the Management Development Section of the Office of Public Management, and with the assistance of Coopers and Lybrand, Treasury about two years ago developed the content of a package used to conduct basic accounting training for financial and non- financial staff. We have not really got involved with the delivery of it. OPM and Coopers and Lybrand conducted them. I believe they have been quite successful. The package, because of copyright, really belongs to Treasury so the package, with some amendments, has been used by a number of large departments for in-house training.

The second issue that I would like to touch on today is what lessons Treasury has learned in that process. As with any major change, there are always problems, particularly in the early stage of implementation. Some are technical, for example, the identification and valuation of assets, the weaknesses or deficiency in internal control systems, and the documentation of procedures. The other thing Treasury has been told by a number of departments is the maintenance of ledgers under accrual accounting and cash. One part of Treasury asked departments to maintain ledgers on an accrual basis, while another part of Treasury still required departments to report on a cash basis.

The Auditor-General reported on these technical problems in his Volume 1 Report to Parliament in 1993. I noted that in his latest report, Volume 2 of 1994, there were fewer qualifications on accounting systems. The one major area relates to fixed asset identification, particularly for agencies with large asset holdings spread across the State.

As I said before, with a few hundred years of cash accounting and with little or no record of what was purchased, what was used and what had been scrapped, it is obvious that four or five years is not sufficient as a transitional period to identify and value all public sector assets.

However, these technical problems will be solved by the agencies concerned. Of more concern to Treasury is the "people" issue. Treasury undertook a post-implementation review of a number of departments in 1992. We were told in that review, or it appeared to us, that there was a lack of understanding of the usefulness of information on accrual basis and hence a lack of commitment to accrual accounting by senior management.

The introduction of accrual accounting was seen as something imposed by Treasury, that it was a technical exercise to be carried out by the accountants, and that it had nothing to do with the day-to-day management process. I should acknowledge that Treasury has been partly responsible for this view because we have not articulated very well the linkage between accrual accounting/budgeting and the cash budget appropriation process.

In addition, we were also given to understand that there has been lack of staff with appropriate skills to provide support to operational managers in interpreting the more comprehensive data which is now available and to assist managers to understand how to use such information in their day-to-day operations and decision-making.

So Treasury has learnt four lessons, and in the next section I intend to go through those to see what we have to do to respond to those four lessons.

If we had the opportunity to do it all over again, I believe Treasury would start by spending more time articulating the purpose of the financial management reform program, the importance of accounting reform in the overall management process, and explaining how the more comprehensive information can be used by managers in their day-to-day operations.

In addition, we would spend more time very early in the process, I mean, we do it now, but we believe we should have done it three or four years ago, that we should spend more time developing and explaining the linkage between accounting and budgeting and the budget appropriation process. As the Budget appropriation remains on a cash basis, the perception that "cash is king" is reinforced.

We also need to clearly explain the parliamentary control mechanisms under the accrual budgeting regime. We should explain whether parliament controls only cash or whether the parliament also controls the net cost of services, and exactly what is meant by "parliamentary control of the net cost of services".

The other lesson that we are doing something about at the moment is that Treasury needs to define clearly the role of Treasury's budget officers in this environment of accrual budgeting and accrual accounting. It is a difficult area, as there is no corporate finance model for organisations lacking the profit motive as a measure of performance. It is doubly difficult where the Parliament, via the Government and the Minister, is both the purchaser of services and the owner of the department.

In our contact with New Zealand Treasury, this difficulty has also been experienced by New Zealand, even though the financial management reform program in New Zealand adopts contractual budgeting principles which distinguish the ownership and the purchaser interests of the government, but even then we were given to understand by the New Zealand Treasury that they have difficulty in trying to articulate how the whole monitoring process hangs together.

Another lesson that Treasury has learned about which we are also trying to do something about at this stage is the lack of benchmarks which may be used by agencies as targets for financial management in program activities. There has been no practical advice to agencies, particularly for small and medium agencies, on how the new information can be used by operational staff in meeting their day-to-day responsibilities.

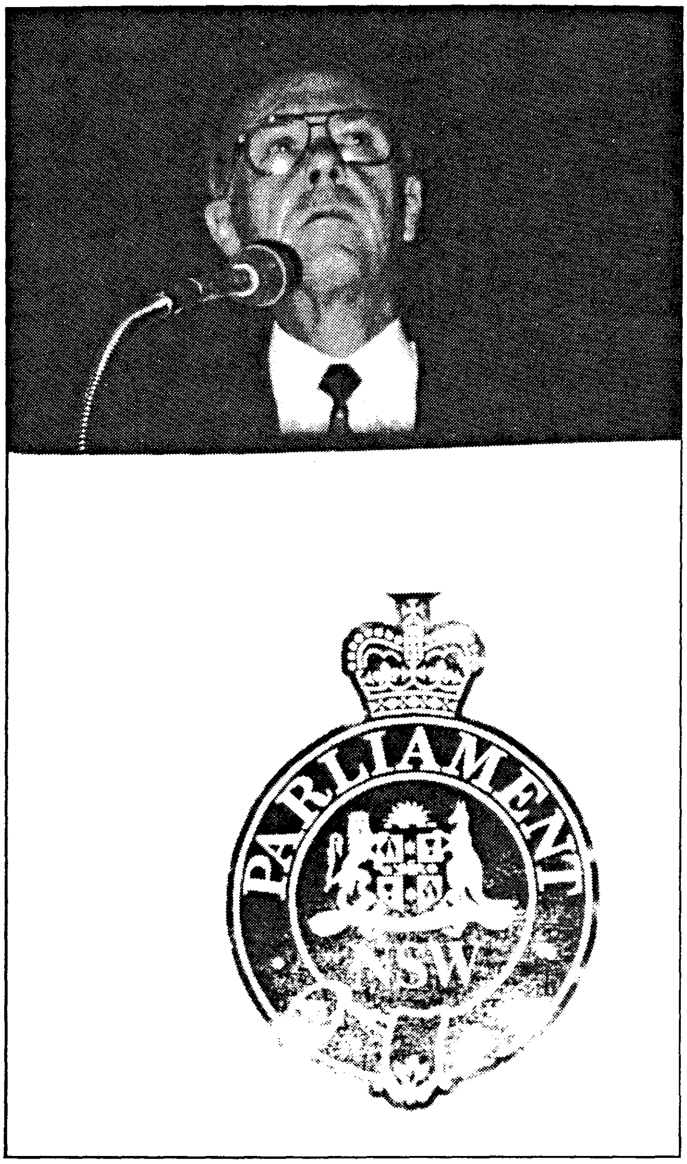
As I indicated, Treasury has now put these priorities firmly in its corporate plan for the next 12 months. We have started the process already, but we think that it will take longer than a few months. We will develop a framework for accrual accounting and budgeting. This framework will touch on issues such as how should the accrual budget be presented; is there an appropriate debt-equity structure for the budget sector; should there be some forms of financial targets for the budget sector and the departments; how should departmental financial performance be monitored by Treasury; should there be any incentive for agencies with improved performance; and, last but not least, and this is more difficult, how is performance to be measured given the lack of profit motive.

For anyone who is interested in more details on the progress and experience of the accrual accounting implementation in New South Wales, Treasury is making a very detailed submission to the PAC in its inquiry on accrual accounting.

So, we certainly will spend more time on looking at those issues. As I said before, we should have done this three or four years ago, but better late than never. And I just hope that perhaps the other States and Territories, and the Commonwealth, can learn from our lessons and perhaps start from where we should have started four or five years ago.

To sum up to date, Treasury budget sector reform has focused on improving financial allocations, management and accountability. This has involved initiatives to improve budgetary accounting and reporting systems. Whilst these are important, they have tended to concentrate on inputs and processes, rather than outputs and outcomes. Or, put another way, they have been about better management rather than necessarily better service. Of course, better service is not possible without better management. Therefore, Treasury in the near future will be trying to translate these improved systems and processes into better service to the taxpayers of New South Wales. Thank you.

MR RUMBLE: Thank you, Thuy, for that informative talk that you gave us from the Treasury's perspective.



Mr Ken Brown
Director,
Department of Sport and Recreation and Racing

"Views from a Smaller Agency"

MR RUMBLE: Mr Chairman and distinguished guests, it is my pleasure this morning to introduce to you Mr Ken Brown, who is the director of the Department of Sport, Recreation and Racing. Mr Brown joined the New South Wales Public Service in 1960 and prior to his appointment as departmental head in July 1982, he held various positions in the Auditor-General's Department, the Chief Secretary's Department and the Department of Leisure Sport and Tourism.

He is a fellow of the Australian Society of Certified Practising Accountants, having been admitted to membership of the Society in 1966. Mr Brown has served on numerous board trusts and committees, including the Totalizator Agency Board of New South Wales, the Australian Tourism Commission and the New South Wales Government Olympic Management Executive Committee.

It has been said that Ken has been a great survivor in the New South Wales Public Service. He has worked with governments of both political persuasions. I understand that he is the longest serving Chief Executive Officer in New South Wales within a Government agency within the New South Wales Public Service, which is no mean feat these days. Ken will be speaking with us today on his views from a smaller agency and I would ask everyone to welcome Ken in the usual manner, thank you.

MR BROWN: Mr Ian Glachan, MP, Chairman of the Public Accounts Committee, Mr Terry Rumble, Members of the Committee, Ladies and Gentlemen, in the context of what I might term the wagering industry of this State, I once saw the "Sport of Kings" - racing - described as *"a primitive form of transport engaged to facilitate the exchange of unnecessary money"*.

To a few, indeed quite a few I think these days, such a definition might well sit comfortably and be acceptable. As opposed to that however, only recently, indeed I think some six weeks ago, when entering Randwick Racecourse, I could not help but overhear one of our better known turf accountants, who was immediately in front of me, making his way to his stand say to his clerk who accompanied him, *"Jock, I hope to hell I break even today, I need the money."*

Now, while I certainly derived a smile from that statement at the time, it was not until after I received a call from Mr John Lynas, inviting me on behalf of the Public Accounts Committee to speak at this seminar today on my personal observations on the introduction of accrual accounting in the New South Wales budget sector, that I actually recounted the occasion.

In certain respects, I saw an analogy in the words of that particular gentleman and the views expressed by certain employees of government when confronted by the decision, the initiative to introduce accrual accounting into the budget sector. For reasons best known to that bookmaker, he had to be at Randwick on that day to ply his calling. Contractual obligations, condition of licence, need, want, or just out of habit, he was there; and yet, he was not there in a positive sense. He was not there to gain or derive profit from the experience. He was not there to win. Rather, at best, he was there not to lose, or as he put it, to break even.

In that regard quite a few employees in the budget sector, I believe, approached the introduction of accrual accounting in a similar vein. Certainly in the organisation I represent, there were individuals who saw the exercise as but another imposition on their operations by the Treasury. Being comfortable with the established system of budget sector cash accounting and in the absence of an understanding or an appreciation of the benefits to be gained from the adoption of accrual accounting, they had approached the task at hand as but a change in format and on the basis that it did not adversely impact on their specific area of responsibility, looked no further than to adhere to the Treasury guidelines and directions as laid down.

Initially that approach not only surprised me, but it also very much disappointed me, particularly having in mind that from a general management point of view, I was well aware of the fact that the Department had, over the years, been to the fore, in fact as I saw it, amongst the leaders in the development, establishment, and maintenance of sound corporate strategic and financial management planning processes.

In the setting of targets, associated efficiency and effectiveness measures, the majority of which carry a dollar sign, had been developed operating costs captured and identified and revenue maximisation strategies implemented. In retrospect, in hindsight, however, I doubt whether my disappointment and my surprise were justified.

The Department of Sport, Recreation and Racing is by its very nature a diverse organisation. Its programs, activities and responsibilities are exercised and delivered through a head office, including the New South Wales office of Racing; 12 regional offices, 5 metropolitan, 7 country; 11 residential sport and recreation centres located throughout the State; the New South Wales Academy of Sport at Narrabeen; and Sports House, situated at the Wentworth Park sporting complex.

For Government budget estimate purposes, the Department's operations and services have been grouped into four major programs: Community participation in sport and recreation; excellence in Sport, including the identification and development of our elite and potential elite sportsmen and sportswomen; safety and ethics in sport and recreation; and development, control, and regulation of the racing industry.

In this latter regard, via its Office of Racing, the Department is responsible for the overall coordination of the Government's administration of the racing industry, the provision of advice to the Minister and the Government on all racing matters and the development and implementation of policies aimed at ensuring the continued viability of the racing industry, as well as the maximization of revenue to the State.

The Department also operates and manages the International Motor Racing Circuit, Eastern Creek Raceway. Responsibility for the commercial operation and management of the Sydney International

Athletics Centre and the Sydney International Aquatic Centre has also recently been assumed by the organisation.

In the capacity of client, the Department is responsible for and currently very active, in the planning, development, and construction of a number of international sporting facilities which are, of course, to be on line for Sydney 2000 Olympic Games.

Further, the Department's charge extends to assisting the Minister in his control and direction of a number of statutory authorities and committees, inclusive of which are the Sydney Cricket and Sports Ground Trust, Totalizator Agency Board of New South Wales, State Sports Centre Trust and quite a few others.

The annual expenditure budget of the Department is in the order of some $91 million per annum while revenue exceeds some $330 million each year.

Indicative of the diversity to which I have referred, is the fact that for financial management purposes, the Department maintains some 18 cost centre groups and numerous associated costs centres, while included in its full-time staff establishment of 450 are professional sport and recreation personnel, planners, program and instructional staff, public relations and media personnel, management support staff possessing financial, legal, technical scientific, human resource and management qualifications, tradespersons and associated support staff and catering personnel. In addition, approximately 3,000 casual staff are employed each year in the conduct of the Department's many and varied programs.

Not all of these staff, of course, possess formal management, accounting or financial qualifications. In fact, having in mind certain of the Department's services and activities, it has to be appreciated that it is not instinctive of or an inherent characteristic of many of these employees to make use of the dollar sign to measure their successes, their failures, the outcomes of their endeavours.

Now, while I readily admit that there are occasions when the use of monetary measures, or the use of a monetary measure, is not pertinent or appropriate, I am personally of the view that this is the exception, rather than the rule.

Accordingly, having, I feel to a major degree, successfully instilled this fact as a mindset within the Department, albeit in the eyes of some I think by the means of duress, as mentioned previously, having come to grips with the established system of accounting and in turn having achieved what was perceived as a high level of accountability, certain members of the staff no doubt experienced great difficulty in understanding the need for and the processes associated with change.

Based on a targeted date of 1 July 1991 for the introduction of accrual accounting in the Department, in late 1989 early 1990, accrual accounting software options were assessed and a selected package acquired. In March of 1990 a Departmental action committee was formed to facilitate the identification, valuation and bringing to account all of the Department's physical assets. In November of 1990 a project team, including a representative from Treasury, was established, which in turn formulated an action plan to meet the deadline set.

In the ultimate, a system of "accrual accounting", and I do use inverted commas on this occasion there, was introduced in the Department on and from the targeted date. Of significant importance, indeed, integral to the future efforts of the Department to successfully implement accrual accounting, was the fact that on the initiative of the Treasury and with that organisation's cooperation, a review was undertaken by an outside consultant in May and June of 1992 on progress and results to date.

That review sought to address the accuracy and the reliability of the information produced; the adequacy of the existing system maintenance procedures, the acceptability of the accounting policies being employed and the documentation of those policies; the extent to which the system was being used by management to generate information for decision making; and the level of management commitment to the new system and the general competency of those accounting staff responsible for its ongoing operation.

The key findings of that review were the Department was not using full accrual accounting to prepare management financial information. It was only preparing full accrual accounts to provide monthly data for Treasury monitoring purposes.

It was not using its computer systems to their maximum advantage. It was experiencing difficulty reconciling Treasury's transitional reports. It had not documented the policies being employed. It was only using partial accrual accounting for management purposes by incorporating accounts payable and it was lacking the appropriate skills to maintain accrual accounting records at certain organisational levels.

The timely completion of this review was invaluable. It provided the means whereby the Department was able to focus on that which had been achieved, that which had not, and very, very importantly, that which required corrective action and further attention.

That review, or more correctly, its findings, has very much proved to be a catalyst in the Departments's endeavours in the introduction of accrual accounting.

30 June 1994 saw the third year in which the Department's annual financial accounts had been prepared on an accrual accounting basis. With the support, assistance, patience and I suppose in many respects, tolerance of officers of the Treasury and the Auditor-General's office, each year has seen an improvement in and a refinement of that process.

As it currently stands, the Department does have available to it an adequate computerised financial management system which, importantly, is being used to improved advantage. Financial management reports available to executive staff are compiled on an accrual basis. Accounting policies employed have been documented and an effective and adequate asset register has been established and maintained, while training of both financial and non-financial staff continues to be ongoing with resultant commitment to and a better understanding of the process.

The immediate future will see further refinement of the Department's accounting and financial processes, particularly its chart of accounts, enhanced staff training and continued rationalisation and restructuring of our finance branch, including the acquisition of further staff resources with appropriate financial expertise.

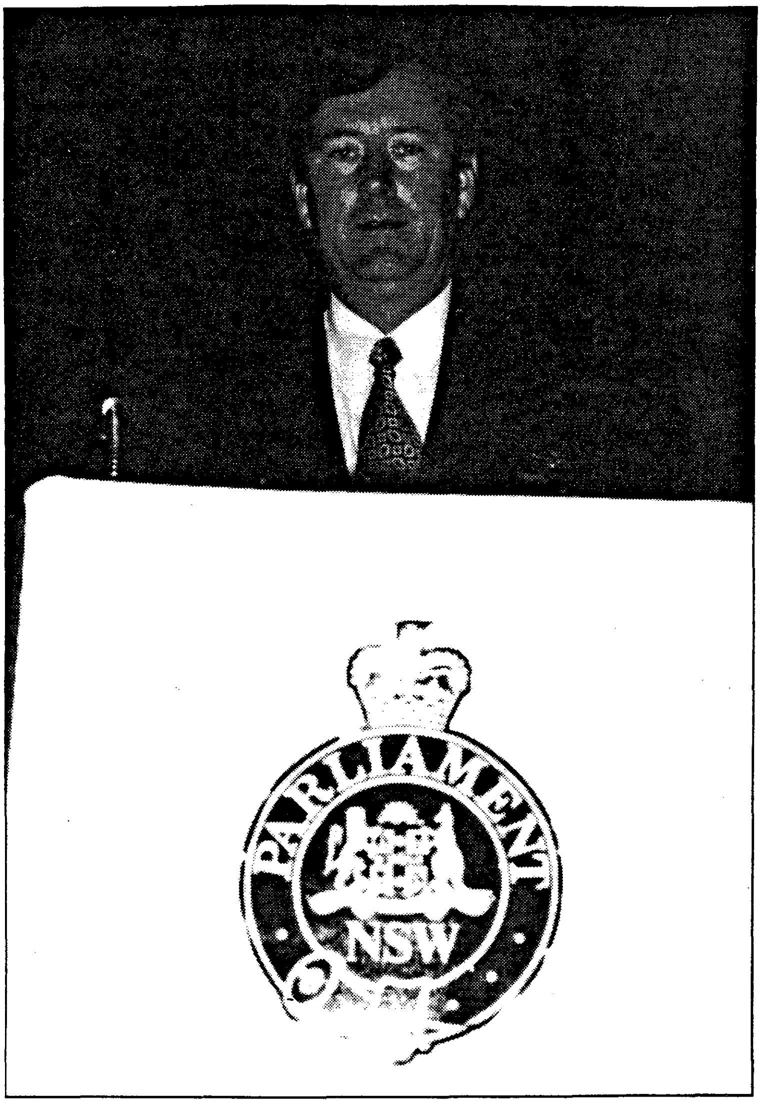
The Department of Sport, Recreation and Racing is firmly dedicated to the maintenance of a sound system of accrual accounting. Many of its operations are of a commercial nature, or have been placed on a commercial footing. In turn, the sound and reliable matching of all costs and revenue is integral to the future success and sound management of those operations.

The introduction of accrual accounting into the Department has, I believe, certainly seen an improvement in public accountability. In addition, along with the introduction of net appropriations in 1991-92 and various other internal management initiatives, it has greatly assisted the Department to be better placed to consider the many alternative programs and strategies available to it in furtherance of its charter and its objectives.

In fact, notwithstanding that the Department has, over the past five years, achieved or in many cases exceeded the bulk of its targets, savings over and above that required of it in the form of productivity savings have effectively totalled just on $9 million. At the same time and not including the more recent commercial operations acquired by it, since 1990-91 it has increased its revenue user base by some 48.27 percent.

"Accrual accounting, a painful reckoning?" in many respects, yes, certainly in the initial stages of its introduction; long term, no, definitely no. Or better put: all things are difficult before they are easy. Thank you, Mr Chairman.

MR RUMBLE: Thanks very much Ken, for the financial overview of your Department and the problems associated with the introduction of accrual accounting. I would like to invite everyone now to morning tea and we hope to be back at 11 am. Thank you.



Mr Ken Dixon
Deputy Director General (Resources),
Department of School Education

"The View from the Coal Face - the Experience of Large Agencies"

MR IRWIN: Good morning, ladies and gentlemen. I am Geoff Irwin from the Public Accounts Committee. It is my pleasure this morning to introduce to you our next speaker, Ken Dixon.

Ken is presently Director (Finance) of the New South Wales Department of School Education, although I understand he is also at the moment acting as Deputy Director General (Resources), which includes responsibilities for the Department's human resources, finance, information technology, properties, administration and legal functions. That is a quite big portfolio. As the person within the Department who had the responsibility for the introduction of accrual accounting, he is, of course, of most interest to us today.

Mr Dixon's previous experience includes positions with the New South Wales Treasury and other government agencies. He has lectured in finance at the Sydney Technical College and the New South Wales Institute of Technology and, indeed, in the past he has been adviser to the New South Wales Public Accounts Committee. It is my pleasure to introduce to you Ken Dixon.

MR DIXON: Thank you very much for that introduction. I recently gave a talk similar to this to the Queensland Accountants in Government conference and I took a bit of licence because I obviously tried to tell them how good we are, but I will tell you the truth here today; I think it would be probably be the best move on my part. Before I do that, I would like to explain a little bit about the Department of School Education and to put everything in its correct context.

Firstly, we are a big organisation, as you would all know. We have 2,221 schools with around 767,000 students, approximately 60,000 permanent employees, including 48,000 teachers and we have also up to 30,000 casual staff, so it is a very large organisation.

In terms of the bureaucracy itself, we operate one State office, 10 regional offices and also 40 education resource centres and that structure fits above our schools. In terms of our funding for 1994-95, we have a budget allocation of more than \$3.6 billion, the majority of which, \$2.8 billion, relates to employee-related expenses. The total education sector represents approximately 27 per cent of the State Government's total current payments in the current financial year, with the Department of School Education itself accounting for around 21 per cent of total current payments.

Like other budget sector agencies in New South Wales, we have operated on a cash accounting system for a long time, in fact from 1880, when the Public Instruction Act was first passed to set up the present structure.

Because Health is the largest of the New South Wales budget sector agencies, the Government determined, as you heard today, that we would be the last cab off the rank in terms of introducing accrual accounting over the five-year implementation period. Given the upheaval the Department was going through in the 90s as a result of a series of major reforms introduced by the Greiner Government in New South Wales, it was quite comforting to know that it would not be getting under way until 1 July 1994. However, as you will be aware from the discussions earlier today, the timeframe was shortened and we were required to introduce accrual accounting from 1 July 1992, but this needs to be put in its right perspective. The reality is that most people in our organisation would not have noticed any major difference in the way in which we manage our finances today when compared with 1992-93, and I will tell you a little bit more about that statement shortly.

For the rest of this session, I would like to give you an idea of where we are at as a Department with the implementation of accrual accounting, to indicate how we are managing the change and to give you an indication of the various issues and problems we are still confronting. I also hope to identify some of the benefits that we hope to achieve as a result of the implementation process.

I will go fairly quickly through some of the steps that we went through to get things underway. As Ken Brown outlined to you earlier, there is a fairly rigorous development plan in the approach that most government agencies have taken. Our first step was to secure a budget to enable the project to get under way, and that budget was based on a project plan. We were able to secure funding of $5.6 million back in the 1991-92 capital works program so it was quite a large slice of money. That has been a fairly costly exercise; in fact, as at the end of June 1994, to date we had spent something like $6.7 million. That includes the cost of in-house resources as well, so we have fully costed the project.

We then set up a working party and steering committee; in fact, the steering committee is still in place today. The working party reported to a high level steering committee, which was chaired by the Deputy Director General (Resources) in our Department and that steering committee comprised representatives from our regions as well as from the Treasury and the Audit Office.

Quite obviously, we took the step at the time to involve as many people in the organisation as we could so that we could get commitment to the project, and it was vital that we solicited the assistance and commitment from our regional office network to make the project successful. At various times through the project, we had as many as 50 people working on the actual task. These included contractors as well as State Office and regional personnel, so it was quite a big operation.

We also used external assistance. In our case, we used the services of Ernst and Young, on a fixed price contract. That went quite well. They are no longer with us. They did the job we asked of them and we were very happy with the service that they provided.

The next step was the selection of a new financial management information system, and I must admit that we saw the prospect of acquiring a new system as a great opportunity; we did not see it as a burden at all. So we went out of our way to make sure there was commitment to the task. We knew that we would have to do more than just establish a few more account codes. We really wanted an integrated financial management system.

In 1992 we purchased from a Sydney-based company called Creative Synergy Pty Limited the J D Edwards system. That system has a general accounting module, address book, purchasing, accounts payable, accounts receivable, fixed assets, the whole box and dice, in effect. In addition, more recently, we have acquired a cash management module, for reasons I will tell you about a little later on.

We now represent the largest user of the J D Edwards system in Australia and we are the first State Government department to purchase the software. There are other users, of course, including the Commonwealth Bank, Pizza Hut and various other agencies.

For many months we had a large team of users from regions and State Office training with the new software, working on system modifications and attending to the various tasks associated with the actual modification of the software to fit our needs. We turned on the new system on 1 October 1993, so the system has only been operating for a little bit over 12 months.

One of the most important tasks that we got under way fairly quickly was the development of accounting policies under our cash accounting system. We really did not have much use for accounting policies per se. We generally relied on the Treasurer's Directions, the Public Finance and Audit Act, and a myriad of manuals that we had developed over a long period of time. We decided to go really out of our way and make our accounting policies and our various documentation top class, and that is what we did. Again this was done with the assistance of Ernst and Young and with great commitment from departmental officers as well.

Our accounting policies cover a range of accounting applications or issues including our objectives from our accounting system; user identification; systems structure, financial reports and management information, and so on.

Another important feature of our development process was, of course, the development of a new chart of accounts. Once again we spent a lot of time in developing the chart of accounts to meet our needs. We tended to rely on the Treasury financial reporting code, where again it was suggested that the chart of accounts comprise responsibility centres, natural accounts and programs and activities. That is the way in which we have our chart of accounts set up today with 12 characters, four numbers each respectively signifying the responsibility centre, natural accounts and programs and activities.

The new account coding structure is one of the most visible features of our accrual accounting project or accrual accounting system to departmental staff. It is for that reason that we took a hell of a long time to make sure we got it right. We also wanted to find a way to integrate our accounting system with our budgeting and our planning processes, and for that reason, we have tried to model our system on the new program structure that you see on the slide. That program structure comes about as a result of an Office of Strategic Planning Review of our programs and we have, in fact, modelled our entire chart of accounts on that particular program structure that flows through the entire structure.

As I said before, the policies and the documentation have been a very important feature of our project. We have prided ourselves on our procedure manuals. We need to recognise that in an organisation the size of the Department, communication is all important and we need to have standardisation through the organisation. For that reason the writing of the new procedures manuals has taken a lot of time and effort and we believe that we have achieved a good result.

The staffing and training requirements again is a very difficult area to contend with and most of the speakers here today have mentioned this particular issue. We now require our financial managers to have input into the Department's financial statements, so there obviously has to be an understanding of accrual accounting processes methods and techniques. We tend to have some trouble in attracting high calibre accounting personnel to our organisation, for reasons I will not go into here, but we are working on that.

We, in terms of our recruitment, indicate that accounting qualifications are required. We have had a number of officer exchanges between the Department and Treasury. We are also trying to tap into Treasury' graduate trainee program for accountants. So we are taking those steps to better improve our resource base. In addition I have commissioned a review of the Finance Directorate within the Department. We have just about completed that review and that will set up a new structure for both the Finance Directorate within State Office and also in some other parts of our organisation to match our needs in the accrual accounting environment.

The matter of training also has been mentioned earlier. We tended to build on the work done by the Treasury and we used Coopers and Lybrand to assist with training both our financial managers and our non-financial managers and our various clerical staff as well. All of our State Office and our regions have participated in training programs. We have also had to train our staff in the new software, in using the J D Edwards system, since October 1993. So training has been an ongoing priority and remains so.

Training is obviously vital, particularly in an organisation here we have, as you would expect, a lot of educators who have not been exposed to accrual accounting; in fact, in many cases, for that matter, they have not been exposed to a financial management environment. Quite obviously that is something we need to address as time goes on and we will continue to do so.

With regard to the establishment of balances of assets and liabilities, we had to prepare a balance sheet as at 1 July 1992 as if the Department had always been on accrual accounting. We knew this would be a very difficult task because you are virtually starting from afresh. The most significant amount of work related to the area of land and buildings and employee liabilities. So the most amount of work was undertaken in the area of our land and building assets and employee liabilities.

In terms of assessing the worth of employee liabilities, we in conjunction with the Audit Office, developed a sampling method which again we got Treasury agreement to. We had to do the sampling method and make this assessment of our long service leave liability because basically we did not have the information available to us. We did not have a readily available record to indicate the total liability of our employees in the area of long service leave. As you saw up on the board before, we have 60,000 permanent employees, 30,000 casuals. We are working on that for the future because we are looking at the further development of a personnel payroll system which will cater for the employee liability issue.

The next area we moved to was land and buildings. We already had a series of asset registers in the form of a Sites Database as well as Asset Registers for our computer equipment and a range of other assets, but we had no one single consolidated asset register. So we decided to concentrate on this particular area. We wanted also to minimise any workload on our regions and schools. I have not really mentioned schools here, but schools are what the Department is all about. A little later on, I will tell you how, if at all, we bring the schools into this accrual accounting environment as well given that we have 2,300 of them.

Going back to land, we did not obtain individual professional valuations for every parcel of land owned by the Department or for every school site; what we did for land was to develop a model which incorporated benchmark values per hectare for each local government area and indices for each departmental site based on those local government area benchmarks. This was a shortcut method and something we are continuing to refine over time.

For buildings, the method we adopted was to determine average replacement costs in order to calculate written-down replacement values based on the number of square metres, the average age of the building and the types of construction materials used in the buildings. You have to remember we have about 16,000 buildings in the asset base, so to actually do the valuation on a building-by-building basis at that time, and even now, is obviously a daunting task.

In addition to permanent structures, we have demountable buildings. These were identified and we valued them separately using an average cost basis, which was applied to the number of demountables that we had in each region, so that is the shortcut method; but if we were going to produce an opening balance sheet figure, we had to go down that particular path.

The next step was to look at the matter of depreciation. Naturally, it evoked a lot of discussion, debate and the accrual accounting steering committee spent a lot of time on it. We looked at things like the life cycle of a school building, the written-down replacement value of buildings, the accounting treatment for building maintenance and arrears of maintenance - all of those things that one would expect to have to consider.

At the end of the day, the approach we adopted is that depreciation is applied to all fixed assets except land and is calculated on the straight line method at rates which provide for costs to be written off over the anticipated useful life of the asset.

Buildings are depreciated at a rate of one per cent per annum and this approach, as I said, followed the discussions that took place during 1992-93 with the Treasury and the Audit Office. Because the buildings are depreciated at a rate of one per cent per annum, that lends itself to the conclusion that the estimated life expectancy of a school building or all school buildings, in effect, is 100 years. Obviously one could argue the veracity of that particular statement.

We acknowledged that we have school buildings that have been in use for more than 100 years. Furthermore over a 100-year cycle, schooling buildings would normally be subject to a number of major refurbishments in order to maintain their service potential. As a result, it is certainly possible to argue that one per cent per annum depreciation charge could understate the extent to which the service potential of the buildings is being consumed.

However, it did allow for a simplistic approach during the early days of the implementation process. Even now, we do not have a system which allows us to actually assess what our depreciation should be on a building-by-building basis. We have 16,000 buildings, as I mentioned, but what we are doing is addressing that particular requirement as part of the development of an asset management system. In fact, we will shortly be letting a tender for that asset management system, which will interface with our J D Edwards software in terms of building a total integrated accrual accounting system.

In terms of our current position, from 1992-93 our budget allocations have been presented in an accrual accounting format. We have reported on an accrual accounting basis in each of the last two financial years, albeit in the first year, it was without our new software. I mentioned schools before and where they fit into the whole accrual accounting framework.

Our most recent audit opinion from the Auditor-General for the 1993-94 financial year contained three qualifications, all of which were covered in the notes to the financial statements. The first one related to the asset valuation/depreciation issue, which I just spoke about; the second one is probably not worthy of mention here; but the third one concerned the treatment of school financial transactions.

In general terms, the Department does not consolidate or aggregate school financial transactions in its financial statements although the major elements - that is what we call the cash grants to schools and the salaries for permanent staff - are incorporated in the Department's statements. In addition, we include in the notes to our statements information on school bank balances. So we do present a good deal of the information.

But there is also quite a degree of information which is not incorporated in any way in the Department's financial statements or the notes. It is obviously something we have to give some attention to. We expect to have further discussions with the Treasury and the Audit Office on this very issue over the next year or so, but from the Department's point of view, there are practical difficulties in, in fact, bringing schools into an accrual accounting framework. We have enough trouble getting them to account properly for their cash let alone dealing with how they would manage the accrual environment. That certainly is something we need to address and we are addressing in the immediate future.

Our new software was implemented in October 1993, as I mentioned. What I did not mention was because it was introduced in October 1993, we had to convert financial transactions which had operated on our former software for the first three months of the year over into the new software, so it was quite a messy operation, a difficult operation. Obviously, I would countenance you if you are going to introduce a new finance system, do not do it mid-year. It is the way to go. But we were subject to a number of imperatives and we had to go down that particular path. The actual conversion process was subject to rigorous review both by ourselves and by the Audit Office and in general terms passed muster.

We are, as I mentioned earlier, involved in a recruitment program. We are looking at our structures and reviewing structures because it is quite obvious to me, and to others, in the organisation that our existing structure does not fit our requirements, there is no question about that, and anyone going down the accrual accounting path, I think, will probably find that out fairly quickly.

We continue to refine our newly developed accounting policies particularly those relating to asset valuation, depreciation asset maintenance and the like. We do that in consultation with the Audit Office and the Treasury. Again, as I mentioned earlier, we expect very shortly to let a tender for an asset management system. This will give us the asset management, valuation depreciation information and so on, that we really need to say that we have effectively introduced accrual accounting.

Where to from here? The learning curve for us has been very short. We would have to say that the project was fast tracked in our organisation given the bringing forward of the implementation date and from our viewpoint it is still early days. We think we have handled the project reasonably well; others might have different views, but we think we have done fairly well given all the circumstances. We have been subject to a number of external reviews which confirm, I think, that we have done okay. We have a new financial management system, a new asset management system on the way, and we have overhauled our financial process.

But I would have to say that, as at this stage, we are still involved in process, the formal process rather than the big issues associated with accrual accounting. We are not using the accrual information flowing from our new system to aid decision-making in any significant way, given the early days. The flow of financial information to the decision makers is not as structured as it should be and a good deal of work needs to be done on our overall reporting framework.

The educational imperatives tend to drive resource distribution irrespective of cost relativities and we need to do more on our reporting capabilities before we can expect an improved outcome. That is something that we will be addressing during 1995 - to make the system and our processes work for us rather than the other way around.

The other thing I would like to mention, again it was alluded to earlier by Thuy, is that although we now operate under accrual accounting methods, we are still required to account and report on a cash basis against our parliamentary funding appropriations and against our other funding sources. This has been a real difficulty for us because our new software never allowed for that to happen, so we never considered this requirement in the early stages of development.

Given that we have such a range of funding sources, from Commonwealth funding to any number of different funding sources, and it is quite a complicated matrix of funding, we have had to acquire a cash module to fit or to sit on our new accrual accounting software. We indeed have not got that cash module in just yet. We hope to have that in in January. At the moment we are still required to separate accruals from cash and that has been a manual process which has had some significant difficulties for us, as Treasury and the Audit Office are well aware.

This overhead on the PAC's terms of reference is being shown really for completeness. We, as a department, are looking forward to the outcome of the PAC's inquiry into accrual accounting. That slide in a nutshell shows the terms of reference in a very simplistic form, but I think all of those things, the effectiveness of implementation of the systems, the use of the information, training, asset management are the very things I have been speaking about here today and they are very fundamental to the success or otherwise of the full implementation of accrual accounting.

Finally, I will make some brief observations on my part following our own experience. There is no doubt that the implementation of accrual accounting and the changes in our systems and processes has placed an enormous strain on our own officers, on our finance officers in particular. The preparation of our financial statements in the last two years has been a very lengthy, laborious, demanding exercise and it has placed considerable strain on the people involved.

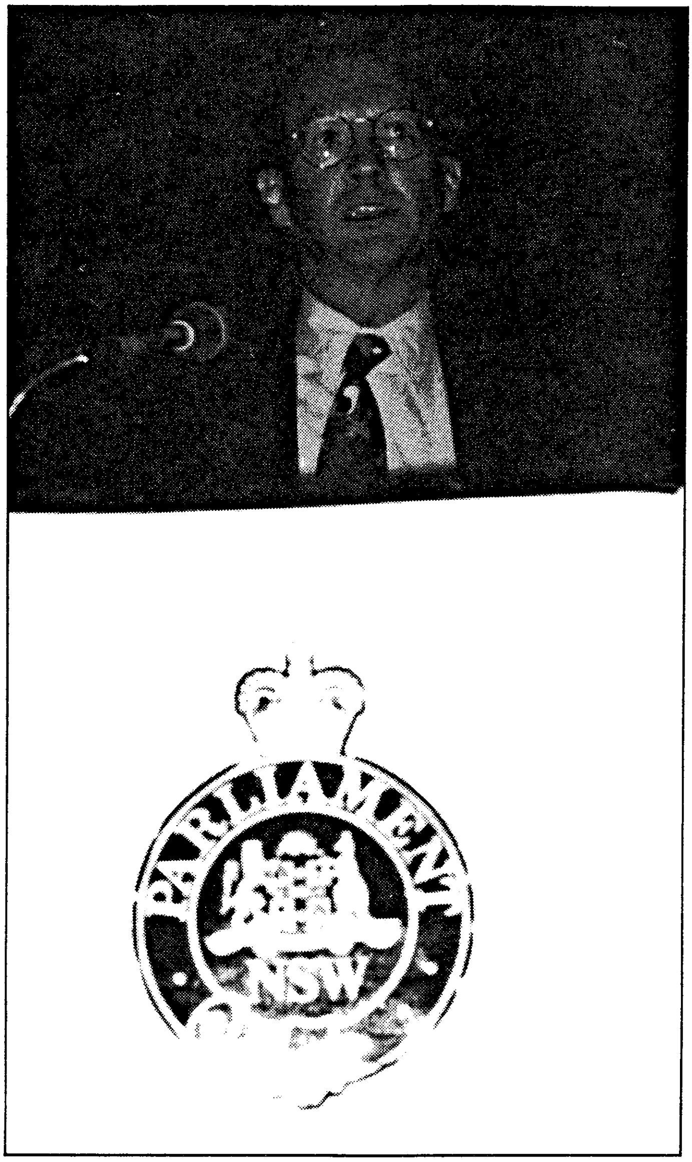
The Treasury and the Audit Office have been involved through those processes and obviously I thank them for their input and patience, but it is a two-way street with all of that. There needs to be some tolerance on both sides; in fact, in our experience, that is exactly what has happened.

We have never seen the implementation or the introduction of accrual accounting as a burden. We have always seen it as an opportunity and we continue to see it as an opportunity. As a department, we are vitally interested in a successful outcome, and that goes right across the Department from the Director-General to our State Executive and down. We remain committed to that task.

We believe that there have been times when policy setting has lagged behind implementation, I think probably understandably given the pace of change. I think some of the policy setting that has taken place in the central agencies, the Treasury, has happened after the event.

Again, I think Thuy mentioned some of those issues in her discussion here today. We would have to agree that that has happened, but I think we have an understanding as to why it has happened. Finally, the links between accounts, budgeting, planning, review and outcome measurement are, I believe, still obscure at present, but integration from DSE's experience is not there yet. Ideally in the school education context, we should be able to track resource inputs through to education delivery and then on to student outcomes. At this stage, that is some little way off, but it is clearly an area for attention in the future. Thank you very much.

MR IRWIN: In thanking Ken for his contribution this morning, I could not help but notice that the topic was "The View from the Coal Face." For those of you who have not had the pleasure of visiting a coal face, I have to tell you it is a place where there is usually a considerable amount of noise and grit and not a whole lot of life. Thanks to Ken for his contribution this morning I am sure the view of the introduction of accrual accounting in a large government department has had a considerable amount of light shed upon it. We thank you today for your contribution to this seminar, Ken. My colleague Terry Rumble will now introduce our next speaker.



Mr Ken Barker
Director of Finance,
Department of Health

Department of Health Presentation

MR RUMBLE: Our next speaker this morning will be Ken Barker, who is presently General Manager (Finance and Asset Management) of the New South Wales Department of Health. He has occupied the position for some six and a half years and he has worked in the Health sector for nine and a half years. He has had 27 years experience working for the New South Wales Government, previously working for Police, Public Works, and Corrective Services, mainly in the financial/accounting areas. Ken also will be speaking to us today on the experience of a large agency.

MR BARKER: Thank you. I guess it might be a bit daunting for all of you people to think that Ken Dixon and I are going to say virtually the same thing. I think you can rest assured that will not be the case as we will be covering different issues.

I guess from the New South Wales Health perspective we also welcome the introduction of accrual accounting by the Government, especially those involved in the financial accounting areas as we saw it as a better way for us to manage the resources which are available to us. I also recognise that not everyone here works within the budget sector of the New South Wales Government so some of the information that I will share with you you may also find interesting.

I am going to do something like Ken Dixon. Before I get into the actual discussion, I will just tell you how New South Wales Health is structured. We have a corporate office, which generally deals with determining policy, monitoring activity and doing those core businesses that is all corporate functions do in big organisation. We then have a devolved structure of 10 area health services, 23 districts health services, an ambulance service, a Royal Hospital for Children, a Sydney Home Nursing Service, and since 1 July this year a Corrections Health Service.

All of those bodies are separate statutory legal authorities. They all have to produce an annual report including a set of annual financial statements, and they do require an audit certificate on their financial statements. The Minister - he has done it this year on around 29 and 30 November - actually tables all their reports in the parliament.

Unlike other agencies which have this line item, line responsibility to their corporate office, all these organisations are separate entities in their own right. They all have a board, which is appointed by the Minister and the members of those boards are honorary people.

They normally have a mix of people who have professional skills, business, private sector experience and medical skills. You need to understand this is a reasonably well devolved highly focused organisation in terms of the sort of people who are running things at the local level.

With regard to the sorts of services we run, we have 24,000 beds available in any one day to treat people. At any time of any day, around 20,000 of them are occupied, and this is 365 days a year. We treat 1.24 million people a year who come into our hospitals and are there for more than four hours a day. Of that number, 365,000 are treated within the one day. We have about 74,000 full-time staff, which is about 100,000 people.

We generally try to turn our beds over pretty quickly and we are doing eight and a half days' length of stay for all beds and this includes nursing home type patients, who usually have long lengths of stay. Acute days are 5.8. Acute care relates to a cardiac transplant or perhaps some oncology services or someone who has suffered some bad fractures and has to stay in hospital.

With regard to our costs per admission in cash figures, in 1993-94, it was $2,549 per admission. The year before was $2,454, which means in one year they have gone up by $5.00 per admission, but, by the same token, our admissions are going up by 4 per cent per year and our cost per bed day on a cash basis in 1993-94 was $447 per day and the year before was $434 per day. So you can see that our costs per bed day are going up at a greater rate than the costs of admissions.

What we did for accrual accounting was the following: when the Government policy came out, we selected five pilots and we chose four area health services and one country hospital. We then formed a working party with those people, including the Auditor-General's office and the Treasury, and we developed what we called the Accrual Accounting Procedures Manual.

That manual is modelled on the Treasury Code of Best Practice, but it has some variations to make it health friendly because none of our devolved entities deal with Treasury; they all deal with the Department. So there are some terminology differences and other historical reasons why we thought it was best that we would have an Accrual Accounting Procedures Manual.

That manual sets out for all of New South Wales Health and its controlled entities how they are to deal with accrual accounting and the issues that arise out of accrual accounting. That covers things like depreciation, valuation of assets, how to account for long service leave, how you treat cash from various resources and the like.

We worked on a plan, which worked for the first three years on getting all our entities to produce over the three years annual accrued financial statements and then in the fourth year we would move towards monthly report on accrual basis. Ken Dixon made the point earlier on that the Government changed the timeframe during the course of the process. We argued that we could not achieve its timeframe, and I will talk about what we actually did do later on, but that is what we started out to do.

We also identified, as part of a major IT strategy, that we needed to update our accounting and financial systems. Through that process, we selected the Oracle product, which is now used in all our area health services; it has been implemented in the last one during the course of this year. We identified the Sun Systems or Systems Union product for our smaller district health services and other entities.

When we came to setting up the Oracle product, that took a longer lead time, and I will talk about the reasons for that. Our Systems Union product, we have virtually set up in a period of around 12 months. This covers basic accounting systems plus materials management. Materials management is important to us because we spend around $1 billion a year in goods and services types of outlays and we therefore need to have a good handle on what inventories are doing and our stock.

We also need something to give us better purchasing power because at present we go out through the tender process and say, "We want to have tenders for the supply of hospital beds,"but we never really know what we want in terms of how many we are going to buy, so that creates dilemmas for our suppliers.

At the end of June 1994, we had invested about 36 million in IT in the financial accounting area. By the end of June we expect to have invested about 47 million. That covers once-off costs in terms hardware acquisition, communication lines, terminals and software licences and maintenance. All that has been internally financed. Whilst we went to Treasury and asked for money, we were told, "Well, you can fund out of your capital program, thank you very much." So we have had to internally finance all of that.

When we actually implemented accrual accounting in our Health services, whilst we at the central level set the broad policy and had the drivers in terms of what we wanted out of the process, it was up to those in local management how they did it. Some of them would have used in-house services; some would have got some temporary accountants; and others might have got some external management consultants to come in and help them do it.

That was purely a local management decision. Whatever they did, they had to fund. Under our IT program that was generally financed on what we call an 80:20 rule; we put in 80 per cent of the money from the total capital program and they had to find 20 per cent of the residue of their once-off costs. They were also responsible for funding all their ongoing recurring costs.

At the same time, of course, we had GFS coming in, which was moving away from the old consolidated level of funding. In Health, we have had to include special purpose and trust funds. Those of you who know anything about the health system will have some passing interesting in what happens.

Hospitals often have fund raising days and fetes. The local Lions Club might donate stuff to them. People die and leave something in their wills to them. Under certain arrangements, doctors who work in hospitals can generate private income and then a percentage of that goes back into the hospitals. You can charge for car parking and a whole range of things. We were capturing some of those, but we were not capturing the whole lot.

So when you came to look at the cost of health, you never really knew what the real cost was. Things would mysteriously appear in the capital works area; it was not here one day and it was here the next, but it never went through the formal capital program. We then had to work out a process and we sent up a policy on how to capture this information and we are capturing it all. That has had a substantial impact upon what we are saying we are spending compared with what we were spending a number of years ago. It has also impacted our capital works program in terms of the size of the capital program.

That was a major reform we had to implement, as well as doing the normal accrual accounting, to bring this money to account. The big dilemma we always faced was that people are always very sceptical of Treasury. They are always saying, "Well, as soon as we identify this, Treasury will rip money off us to compensate for what we have now found, which we have always had."

We have had long arguments with our own people to say that those at Treasury are honest and they do not to things like that. At present they have observed that faith we have in them; we hope that will continue. I know that there is no-one here from Budget Branch, for reasons which are a bit bemusing, but it is a thing that we continually have to argue about with Budget Branch to understand the historical nature of how some of our funding has come to pass.

How we performed: we got our five pilots schemes up in 1991 in terms of their annual accrual statements; in the following year, 1991-92, we got all our 10 areas plus around 18 hospitals producing annual accrued financial statements; and in June 1993 all our systems produced accrued annual financial statements.

Now, in doing that, they all then had to have something like asset registers in place, have all their buildings valued and come through depreciation arrangements, and calculation of employees' entitlements. I am not saying they all did it excellently because we know from the year just concluded we have had one or two problems; but in terms of the broad principles, we had them in place.

For 1993-94 we introduced monthly reporting and budgeting throughout our system. In terms of Health, we have a policy where we devolve everything. So we would say to an area health service - and I will show you how big some of area health services are shortly - "We want you to devolve that down to local management and devolve that process through." So we have had a clear policy where we want the principles of accrual accounting devolved down through the management hierarchy so that the people at the coal face are being confronted with accrual information and have to work out what all that means to them.

We have had a few problems in doing that. We had one area health service, which was giving its management the differences between cash and accrual. They did not understand what they were doing and they thought they were spending within a cash budget when they had an accrual budget and they ended up overspending by several millions of dollars. So we have had some management problems in the process, but we have had to work through them and resolve the outcome.

I guess our culmination was the year just completed, which was June 1994, when for the very first time - and I will show you what this is like later - the Department actually produced the consolidated set of financial statements for all of New South Wales Health. That has been audited by Tony Harris and we have our unqualified audit opinion. This is the first time ever that the people of New South Wales know what the health system is costing to run.

When you consider that we have these 36 devolved entities and they all had to be audited and that all has to be rolled up and consolidated, and we got the audit certificate - and that report was tabled in Parliament I think on 29 November - it was a monumental effort to actually bring that to fruition and we are very proud of the outcome of that effort.

I will go through the process that has to be undertaken to do something like that. It is not an easy task. You have to remember that we have 36 devolved legal entities, who all have to get their acts into order and they all have their boards, who often have slightly different intentions and understandings from those of the Department's. Then we also have a range of contract auditors we have to deal with. So it is not an easy task to be able to do something like that. I think that is one of great achievements of accrual accounting.

Another thing that we have done is introduce what we call product costing in the current year. In Health we have always been very good at telling people how much we spend in a location and whether we spend it in salaries and wages or in goods and services or something like that. As part of the Government's program budgeting reform in the early 80s we produced about, at that stage, 23 programs. We are now down to about 16 or 17.

If someone came to us and said, "How much do you spend in orthopaedic surgery?" or "How much do you spend in gynaecological services?" or "How much do you spend in oncology?" we would all scratch our heads and we would go and do a few manual calculations and some other stuff and come up with a figure.

I do not know how well this slide will come through for you, but as part of the national health program funded through the Commonwealth Casemix program, New South Wales Health won the contract to produce a standard health chart of accounts. In doing that, we have defined a methodology to work out whether anything you have is an overhead cost and if it is an overhead, how you would then bring that through to a final product code. At the end of this year, we will have a much better idea of what we were spending on the products we are in the business of providing, which are orthopaedic services and all the core medical conditions that people come into our business entities to have treated.

"Products" might seem a bit of a manufacturing term but I see health as a manufacture - people come in the front door. We do something to them. We send them out the front door again. What we do to them depends on how they go out the front door, but that is another story. But we certainly produce some form of products and there is a whole range of cost drivers that go into that.

With respect to what we have learned, the first thing I would like to talk about is the question of the Auditor-General and the contract auditors. As I said, we have around 30 contract auditors. They have dilemmas at times as to whether their client is Auditor-General or the area health service board. Our area health service boards have problems as to whether it is the Auditor-General or the contract auditor who is working for them in auditing their accounts.

One of the things that I am quite strong on is that we have to have good liaison with the Auditor-General. It is no good having that liaison in about June or July; we have to come forward very early in the piece. We need a way also to ensure that, where the contract auditors are having problems of differences of opinion, that can come to head office's attention in the Department so that we can try and resolve the issue rather than let it burn out in the field and then before we know where we are, we get a qualified audit opinion from one of our controlled entities.

Often the people in the local level are not aware of the significance of having a qualified audit report. That is a difficult thing to come to grips with, but we may win in the next year. We are getting pretty good at it, but we certainly need to have a very strong liaison with the Auditor-General's office.

The next slide touches on that, and it relates to the different levels of expertise. In most of our area health services which are metropolitan based we have very strong levels of financial expertise. The further you get away from Sydney, the less confident you become, in my view, with the levels of expertise. That is not saying anything derogatory about the people who work out there, but there is an isolation factor and they do not have the regular contact with people.

You have to make sure that, where you have a devolved environment, there is an ongoing education and communication process with those people. That starts at the senior person who works there, who may not necessarily be an accountant or a financial person. You need those senior persons to understand the significance of what their financial statements are about so that they have an interest in it and what their annual report is about so that they can make sure that gets the appropriate level of management attention and resources put into it, so it flows back into a corporate function.

The next item I come to is the difficulty with Treasury caused by this GFS focus. This causes us undue problems in that we have given all our chief executive officers, as we call them, who run the area health services, and the general managers clear lines of financial accountability and Treasury keeps coming back to a GFS approach.

I will just show you what I mean and how we have differences in philosophies. This is an extract from the Treasury Budget Papers for the current year and there they are talking about total current payments, which do not include any component for accrued items.

The next overhead to be put up will show a comment from their narrative report, which goes out, which I think was budget priorities of common sense. In the Health figures, under the top figure there, the $5212 million figure, that is a combination of Health current payments figure plus the capital works allocation of $460 million or thereabouts so we are matching those things there.

Then we come to the final figure I will show you, which is a Health document that comes out at the time of the State Budget, and I will show you what we say when we put our document out. We come out with our document and we say that we have 5.29 billion in recurrent payments, which is our actual total expense figures. If you are a member of the Parliament or a member of the public, you would scratch your head and wonder who is telling you the truth. In actual fact they are both telling the truth except we are pushing the accrual accounting line and Treasury is pushing the GFS line.

We then have another table on our document, which will be put up on the screen, which will show you by area health service and district health service the amount of money that we are holding them responsible for, which is an accrual accounting figure which shows how much their budgets have moved and the size of their entities.

As you can see, these are big entities. These people are running 400 or 500 million accrual recurrent budget figures. They are running businesses bigger than a lot of government departments, employing thousands of thousands of staff and treating tens of thousands of people each year in terms of the provision of public health services. So it is a major problem in terms of what that says.

In terms of internal reporting, this caused us great dilemmas last year in that people did not know what they were being held accountable for. You have the Minister not knowing which figure he has to focus on; you have the Finance Committee of the Department not knowing what is going on; and at the board level, recognising some of our area boards have private sector people on them who are used to the private sector, they are scratching their heads and wondering what is going on when they were getting this cash GFS stuff and yet they have accrual budgets on which they are expected to have their performance assessed. Yet when we get our audit certificate, that is on an accrual accounting basis.

There is certainly a lot of confusion. What we have done in terms of our internal reporting will be shown on an overhead. We for this year have restructured what we are going to send out in internal reports so that when you go to an area health service board or the Department's Finance Committee, you will see what we will now be producing for this current year. Do not rely on the figures; they are made up figures. But we are actually showing by the basic line items the operating statement and across the page we have year to date budget - year to date actual, I think it is. I cannot read it too well from here - and the full year thing.

Then we have a statement of financial position or the balance sheet and in that same simplistic format so that our boards and our people who are non-financial people can understand what is going on with the moneys they are held responsible for rather than having a document I will show you shortly, which is what we have to report to Treasury. Those of you who do not work in the New South Wales inner Budget agencies will really scratch your heads when you see this document.

Improved reporting: I believe we have had substantial improved reporting as a result of this process. I will just show you six overheads - I think there are two from each year - from the 1991-92 set of annual financial statements produced by the Department. This was the last year the Department reported to the Parliament on what it did with its cash allocation.

I will just show you these figures to give you an idea of what we reported in that year. That just shows total receipts, I think. It shows we spent about 71 million there in ConFund receipts. I will not go through all the line items. We will look at the next one that became available for that year. You have to remember some of these things as we go through.

Then we get to what we spent. We said, "Well, we spent 4.6 billion," I think that is the actual payment. We got total receipts of 844, which meant an excess of payments over receipts of 3.7 billion. That was the sort of statement we gave to the Parliament in the year ending 1992.

We then come to June 1993 and the Department then produced for itself an accrual set of financial statements - this was without any consolidation - and what we showed in this year was that we had payments of about 4.6 and this includes - that big figure of 4.3 is the amount of cash we gave out to all the areas and districts to run themselves. Then we take off what the revenue was for the Department and we had a figure in there of about 3.9 I think it is.

Then the next overhead shows the statement of financial position for the Department. So if you are a member of the Parliament reading this, you will read this and say, "Well, I thought they had lots of hospitals they run." But when you come to this page, you will see a value of assets of about 400 million, or something like that. I think that is what it is from where I am reading it. So that was just the Department.

Then for the year just concluded, we will show you what we produced for this current year, which is the consolidated set of accounts. We are now showing that our total expense is just under $5 billion; we had revenue in of about 840; we had a net cost of services of 4.1 billion. We actually put in the narrative in our annual report the reason for our budget variation between the 4193 and the 4116. So in the narrative, we are explaining to the public why we had that favourable variation. We then come on and add the various other charges and you will see that we have come up with a surplus of 243 million. The only reason we have that surplus is because we have a 315 million capital contribution.

Another one of my problems with this format is that if you have not got a good capital base, you end up with a deficit and the agency then says, "Oh, you are not managing properly because you have a deficit." Of course, it has nothing to do with how agencies are managing; it is a problem with how the format is structured, and it could be resolved, but let me go onto some other things. So we showed that there, and then we come up with an accumulated surplus of 5.5 billion, and people say, "What are you doing with all that cash over there?"

You then need to go to the statement of financial position - and the overhead will be put up now - to show that we have not got 5.5 billion in cash. We are now showing for the very first time on the left-hand side the parent, which is the head office side of things, and the consolidated side of things on the right. So we are showing that we have the actual 779 million in current assets. We have got non-current assets of 5.5, which gives total assets of 6.3 billion and then we take out our current liabilities and come back to our equity. That has never been put to the public of New South Wales before in that format at least.

So, using accounting principles, we really now know what sort of business we are running in terms of its financial complexity and its scope. That similar format was followed for all of our 36 controlled entities, which also had to table their reports in Parliament, so that has given us a tremendous leap. As I said, this information we expect to be devolved down to all our organisation units.

Another thing that I would comment upon in what we have learned is that we get involved as part of government policy in dealing with the private sector for the provision of public hospital services. The most recent experience of is that a contract up at Port Macquarie, where there is now an arrangement whereby HCOA, which is private hospital operator, is to provide public hospital services.

When you come from an environment where all you do is fund on cash and you go and deal with the private sector to provide public services and the private sector adds in all its on-costs, which you do not see because you are funding on a cash basis or you do not know about because Treasury looks after it, you really find out what accrual accounting is all about. If you are ever going to deal with the private sector in the provision of public services, do your accrual accounting homework before you sign the contract because when they come and talk turkey with you about what it will cost you and you look at what it was costing you in terms of running a cash-funded public sector entity, you will find there is a substantial difference. You just have to make sure you have done your homework properly before sign the contract on that very important point.

In terms of management implications, I have two more things relating to the implementation that I have spoken about. One of the things we found about IT was when we did the Oracle solutions, we let each of our entities do their own IPS or implementation planning. Whilst there was some relationship, we did not standardise some of the core principles on how they were going to run their IT system.

When we came to do the System Union product, which is for all our rural services, we had a workshop and we set down the standards on how they were going to run their accounting functions; how they were going to process a voucher, draw a cheque. That effectively meant that, where Oracle had a number of years to be implemented and we ended up with different versions in different locations. With the Systems Union product, we rolled it all out in the space of about a year in 23-plus locations.

What we are now doing with the Oracle product is that we are now trying to realign it so everyone has the same version of software so they are all on the same release and when we want to capture data, we will all get it presented in the same format. So if you are going into a devolved environment, that is another trick to learn.

In terms of the management implications, our people are still confused because of the complexities between GFS, cash and accrual and we are trying to resolve that changing the way we report information back to them. I do not believe that will change unless we at the departmental level only can handle the hassles of government and Treasury wanting to know cash information so that it no longer an issue for the people who work for us. While ever they get embroiled in the cash issues that come up from time to time in the health system and they are not looking at it on an accrual basis, it will always be a problem because they do not know what they are doing and they have to work out what they are responsible for. I will not really know whether we have resolved that probably until the end of this year when we have gone through a period of examining what we are doing with our new internal reporting arrangements.

I have spoken about the revamped internal reporting. We are continually pushing out accrual information and it is my view that if we can stop the system focusing on cash and keep that for Treasury and the Department, that will make their life a lot easier. We have acquired in-house briefs, where they put up financial information to examine the accrual impact.

People in Health who develop policy know if we have to employ a nurse, it is so much if we want so many nurses. They never think about all the things that add on. When they want a building, they say, "Oh, well, this new building on a quantity surveyor's estimate will cost so much to build." They do not think about what is the cost of taking down the building that is there, and all those sorts of things. They never look at revenue.

That is a major process in Health and you will always find that in agencies like ours, the cost to build something and run something that is new is never the same as it is if you want to close it down. They always seem to be less costly to close down in terms of the savings never being as great as what it costs to run a new service, and we scratch our heads about that. No doubt we will get there.

Ongoing discussions with financial staff: you have to keep talking to the people involved in preparing the accrual information and making sure they are on top of what is happening. We are now embarking on a program where our Finance Branch staff will be going out, seeing all our key managers on a regular basis. We have always had ongoing discussions with the people in the areas, and we are now expanding that to our districts in the rural areas where we will try to have workshops with them, trying to get them to understand where we are coming from and for us to understand where they are coming from so we can make the two meet.

We have a process where around this month each year we meet. We sit down with our area and district people, or a selected number of them, Auditor-General's office and Treasury and work things out in terms of the current years. We are now in December; we would be talking about the 1994-95 financial statements. We talk about what is the format, what are the changes so we can get our big system organised with those changes.

The worst thing that could happen to us is that if around July, Treasury were to change the rules of the game in terms of the format of the financial statements, because the more work you can do before 30 June, the better off you will be and that includes making sure you know what the key central agencies' - the Auditor-General's office and Treasury - requirements are. You can see what problems happened in the year just concluded and resolve those problems in the process.

We are also going through revamping our program statements and we hope to have that in place for next year rather than this year. The last thing we are doing at present is we are going to come up with a policy called Accounting for Health. Health is now getting into the business of health outcomes or health gains, to see where it would be best to put our money.

We need our product costing information to give us a lead into that and then people want to assess the implications of saying, "Cardiac problems, you are best to put more money into prevention, what do you get out of the money you put into prevention rather than giving someone a cardiac transplant? What are the effective years of life on doing the two? What is the effect of all the costs on that?"

This is very much at the discussion stage. Again if we are going to get into Accounting for Health, I would argue that we should have it on the accrual accounting basis not the traditional cash payments basis, which is where we have been coming from.

The final slides and thoughts I would like to leave you with from where we sit show what I think Treasury needs to do to make life a lot easier for everyone. I think those at Treasury have to change their emphasis to be more accrual focused. I think they have to introduce a capital charging policy and I think they have to have a serious look at how they split their capital recurrent funding up.

Last year we moved $70 million between recurrent and capital. That, for a lot of agencies, is about five years' capital program, but in an agency like ours with a $5.5 billion asset basis it is not very much money at all. I think Treasury has to have a serious look at that. I know Treasury has a discussion paper out on incentives for Budget agencies for capital charging policy. We are quite supportive of the thrust of their reforms. We may disagree with those at Treasury on the options, but we certainly support them in their reforms to do something in that area.

I also believe they have to fully fund their accrued items and they have to make agencies responsible for those accrued items; by that I mean depreciation, which comes into the capital charging policy, and also the provision for superannuation and employees' leave entitlements.

Within Health, unlike a lot of other budget sector agencies, all our public hospital staffs do not access the Treasury pool for accrued long service leave that is internally funded, so if any of our staff go off on accrued long service leave, they actually have to finance it themselves. I do not see why Treasury cannot expand that across all of government. In respect of superannuation, I believe it should do the same for the ongoing responsibilities of agencies, not the accrued liabilities but the ongoing responsibilities.

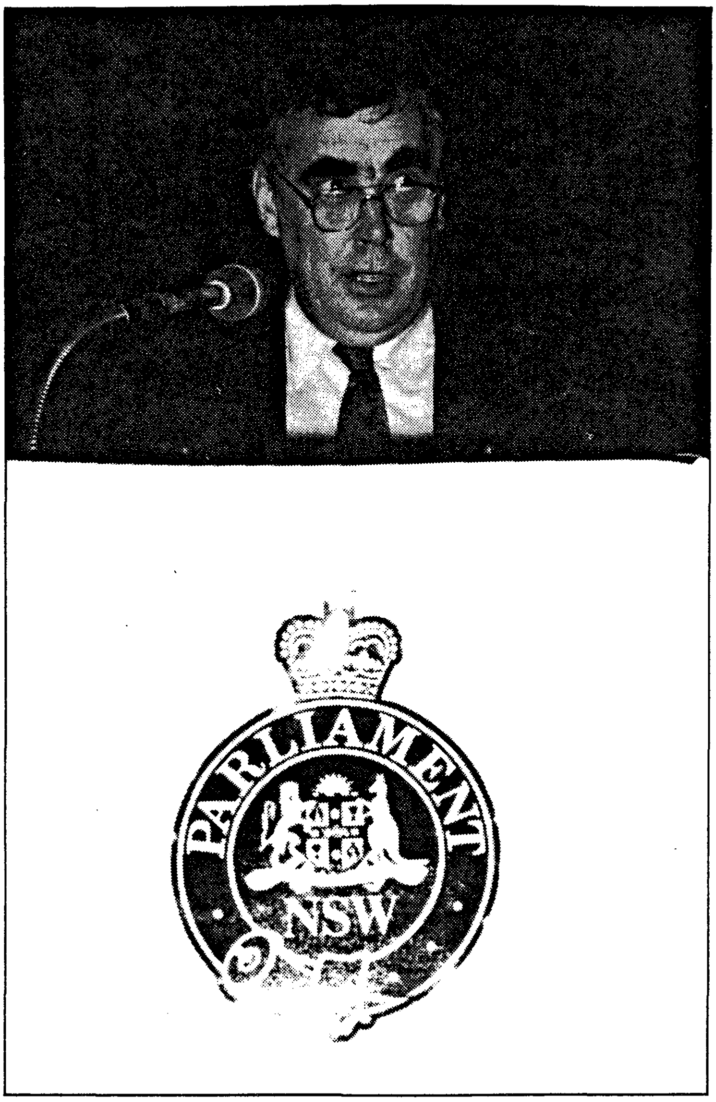
I say both of those things because we are now in the year of enterprise agreements and with enterprise agreements people become more and more innovative in the sorts of deals that they want to try with the workers. What those at Treasury are effectively doing is encouraging agencies to cost shift to them because they fund the super and the leave the while those agencies are not responsible. As soon as you make the agency responsible and they sit down and discuss an enterprise agreement, they will be more conscious of the cost implications for employer's super and for the long service leave provisions that they may be wanting to discuss.

I also believe they have to reform the statutory accounts. I scratch my head and wonder why we have to put in Budget information for cash flows and balance sheets. I do not know how many of you people do the same thing. We also certainly prefer that we have a statement of cash flows to be done on the indirect method rather than direct method. I have also already identified the problems of the deficit on the bottom line of your annual financial statements. As I said, that may come out of some of discussion in terms of the capital charging reforms that they are talking about.

I guess this is about a score card. I do not know what you will give Health on a score card. We certainly did not meet the revised government objective on when we had to produce all our information on an accrual basis. I think at the end of day what we have done, recognising the complexities we believe we have, has been quite a commendable effort. I would give us a credit; I do not think that we would claim a distinction.

I think that for this process to meet what I think government set out to do, Treasury and the Government still have to do a number of reforms so that they can achieve the end objective of what I think they started out to do.

Thank you.



Mr Tony Harris
NSW Auditor-General

"Your friendly auditor wants to say..."

MR IRWIN: Our next speak is Tony Harris, the New South Wales Audit-General. His presentation is titled "Your friendly auditor wants to say ...". I am not sure if this is a public relations exercise to paint Auditors-General in a better light. I do not know why it is necessary to describe them as friendly. In my book, they are at least as popular as other professions such as dentists and so on.

For those of you who are not aware,Tony Harris was appointed Auditor-General in 1992. Before that he had a diverse background, which included some time as the Head of the Office of the Commonwealth Treasurer. He was Commissioner and Acting Chairperson of the Industry Commission; and prior to that, was a Commonwealth public servant and a teacher. Could you please welcome Tony Harris.

MR HARRIS: Thanks Geoff and thanks for the opportunity to have a brief discussion from my point of view of what I think we have achieved within the last few years with respect to accrual accounting and what is in front of us.

I am agreeing with Ken, Ken and Ken and I am not Ken Robson, by the way. There are things in front of us we have yet to do. I suppose in looking at the review, the PAC, in looking at accrual accounting, will look at the cost of the implementation. We have seen from the Department of Health alone that the cost can be quite large across the whole spectre of the public sector.

The cost of implementing accrual accounting and using it year by year will amount to many hundreds of millions of dollars, I should expect.

On the other hand, the benefits are also quite large and in the paper that will be distributed later to you, there are some 20 benefits outlined. Some perhaps overlap and some perhaps are more important than others.

At the macro level we should be very pleased as citizens of New South Wales that we have, for the first time, the document that is outside on the table, an accrual version of the budget sector public accounts for 1993-94.

The benefit that we see from accrual accounting is that we have a net asset position or a net liability position, and thankfully in New South Wales it is a net asset position, in New Zealand the whole of the government accounts, a couple of years ago the government had a net liability position and that in itself is a persuasive message about what kind of society we are leaving to our heirs in financial terms, as best we can measure it.

When the whole of government report comes out for 1993-94 on an audited basis, an accrual audited basis, that will be another step that will actually, I suggest, signify that New South Wales is more advanced in accrual accounting than any other jurisdiction in our region. And indeed, when the Americans talk about the advances in Australia, they actually mean the advances in New South Wales in terms of accrual accounting and they are learning from us for their own processes, which they hesitantly started to think about several years ago and did not start, but which we ourselves have adopted. So the benefits can be large.

It is also true that the benefits are not being realised. I suppose Ken Barker said it when he said, "We don't know how much we spend on," but we do not know, for example, I presume, how much an appendectomy costs hospital by hospital, so we can start to put in some bench marking exercises to get some microeconomic benefits that accrual accounting ought to deliver.

We also know that there are other problems around that we have not yet promptly addressed. One big issue that accrual accounting puts on the table, which cash doesn't, is how far does the audit process go. What is a controlled entity? Where do we stop the audit process? I suppose in a recent report we outlined some entities like the Luna Park Trust, which we do not audit and yet we have some sense that we ought to audit because it involves government assets and liabilities and the line has been drawn rather too early in the piece.

A second issue that troubles us is the state of the standards. It is not true to say I am just an economist. I have had a long interest in accounting and I was a member of the Society from my earlier days out of university, but it seems to me that the accounting standards have developed very slowly over time and that if economists had the same standards as accountants, we would all be trading in gold, instead of having financial notes.

So the accounting standard has lagged the processes somewhat and this is particularly so for government sectors, because the government sector deals with the economy in a much more sophisticated way, much more interesting way than does the private sector deal with the economy and I do not think the accounting standards have developed to enable that recognition to be given to those difficulties and differences.

I suppose a key example comes out of that famous work we did on the famous Sydney Harbour tunnel, where we, the Government, made a loan of some $250-$270 million interest free, subordinated for 30-odd years. Now, how that is handled in accounting standards is an interesting question and is not one that you would often see in the private sector. You would not often see a firm lending interest free subordinated 30 year amounts of money to another private sector entity that never had to face the question of: is this capital? Is this a loan? If it is a loan, do we bring it in at DCF terms, or do we bring it in at nominal terms?

Similarly, a big difference between the public sector and the private sector is that the public sector agencies generally require huge subventions from Treasury in order to show their financial results, in order to survive, indeed. As Ken Barker says, we end up with these very large deficits. How meaningful are these very large deficits? Ought they be considered as deficits or ought not the government be entering into the contractual relations with agencies which enable agencies earn their way? This is, I suppose, something like the New Zealand model. This is not an issue addressed in its fullness in New South Wales, which one day we shall.

Ken Barker introduced another very important issue that I wanted to spend some time with today and that is the cost of capital. Again, in the private sector, the cost of capital will be reflected in the revenue charged, otherwise the firm will go out of business. The shareholders will be most upset. When you look at agencies in the New South Wales public sector, that cost of capital issue is not yet properly reflected.

I will give you some examples. Corrective Services, as an agency, had a net cost reported normal of about $280 million last year. The capital it used to provide those services - the cost is not fully embedded in that net cost of services only the depreciation, or the use, or the run down of the capital is there, not the charging for the capital - they in fact have about $800 million worth of net assets. If we use a convenient figure of 10 per cent - in fact the cost of capital to the State at the is closer to 11 - we would find their net cost of service would have to be increased by about 30 per cent in order to reflect that issue.

If you take Community Services, on the other hand, their net cost of services would only need to be increased by 3 per cent to illustrate the cost of capital that they employ to provide their services. We might have very similar cost of service figures, but once you put in the capital cost you have much different cost of services figures by those two agencies.

I suppose the biggest and most interesting in looking at this exercise of cost of capital is the Department of Water Resources, which has a net cost of services of about 21 million, but it uses $3 billion worth of assets. If you charge for those assets, the net cost of services obviously would be something like 321 million and there is a very big difference between those two figures.

Another one which is interesting is the Art Gallery, which has total expenses of $17 million, not net costs, but total expenses of $17 million, but has half a billion dollars worth of assets. The expenditure on art is rather more than $17 million. We should add about another $50 million to that, just for that Art Gallery.

The cost of capital is an issue that also needs to be addressed. Then we come to a subset question and that is, how do we relate on an accrual basis when the Government joins with the private sector in joint arrangements. And again, we have seen in work that we have done, that the accounting standards probably - and I think this is agreed by us, by Treasury and by accounting firms, the accounting standards fail when we try to unscramble joint arrangements derived between the public and private sectors.

So these are some of the challenges that are before us, in spite of the benefits that we have already seen at the macro level. Some of the challenges before us are quite large, and driving down, again as Ken Barker said, accrual costing so that you do know the costs of an appendectomy in hospitals across New South Wales, is probably the most fundamental of the challenges that lie before us.

Most agencies perhaps do not have an accrual accounting system. They have accrual accounts that they produce once a year. They do not have an accrual accounting system that allows them to think and manage and plan by accrual accounting precepts.

Having said that, I must also suggest that cash is also important and you cannot take your eye off the cash system. It was only accrual accounting that allowed Bond to survive for so long. Had he been concentrating on cash, he might have failed rather earlier than he did.

From the audit point of view, what are we seeing in front of us? We are certainly seeing those issues which I spoke about already, those problems or challenges, as they are better described, that we are facing. We are also seeing still that we are more inclined to be accounting advisers than as auditors we ought to be. This is not so much so for the larger organisations, but for the smaller organisations.

We tend to get a series of accounts which improve through our auditing techniques. We say no, that figure is wrong, it should be this figure. We will cross out that figure and we will put in the audited figure. We tend to build up their set of accounts from our auditing practice, rather than we auditing their set of accounts.

Valuing assets is a problem that still intrigues us and will continue to intrigue us while there are monopolies in the New South Wales Government arena. We cannot adequately ever value transmission lines, water pipes, dams, power stations while there is no market for those assets. They use surrogate values, but those values are imperfect. They are a cause of contention because the values of the assets in part determine the price of the service, but the price of the service also determines the value of the assets and that cyclical issue called the Cambridge problem, I think it is, cannot be solved by mere accountants, certainly not without a free market helping us determine what the assets are worth.

For example, Bayswater Power Station is the denominator asset for Pacific Power and it values all the other power stations by the Bayswater costs. The trouble is, when the efficiency of Bayswater improves, as it did in the last year, it pushes up the value of all Pacific Power's assets, irrespective of demand, irrespective of the fact that we know we have assets out there which are unproductive, because they have more generating capacity than there is demand at this stage.

There is an absence of a market denominator. Because Pacific Power is a monopoly producer of electricity, which means it is impossible for us to adequately determine the value of assets.

We have also seen that the same problem exists for the Water Board, now Sydney Water, and we are talking about, as it moves towards pricing on the basis of water supply, how are we going to value water. That is an issue that has not been addressed, as I understand it, in any private sector arrangement, perhaps not even the United Kingdom. They are some of the issues that we in Treasury and the water people will find quite interesting to grapple within the next few years.

We heard from Thuy this morning that the valuation of heritage assets is something we are going to resolve, but it seems to me quite difficult that the Botanic Gardens could be valued at $1, whereas the seawall was valued $1 million, or that the lifts in

Parliament House were valued at several hundred thousand dollars but the building was valued at $1. Those issues relating to accounting policy seem to me to need attention. Obviously the Treasury is giving it some attention.

So the problems seem large and indeed the problems are large, and it probably means that it is rather more interesting being an accountant in the public sector than the private sector. If you want a challenge, both an auditing challenge and an accounting challenge, come to the public sector, because that is where the problems are at the moment. I do not know if they are being addressed as helpfully as they ought to be.

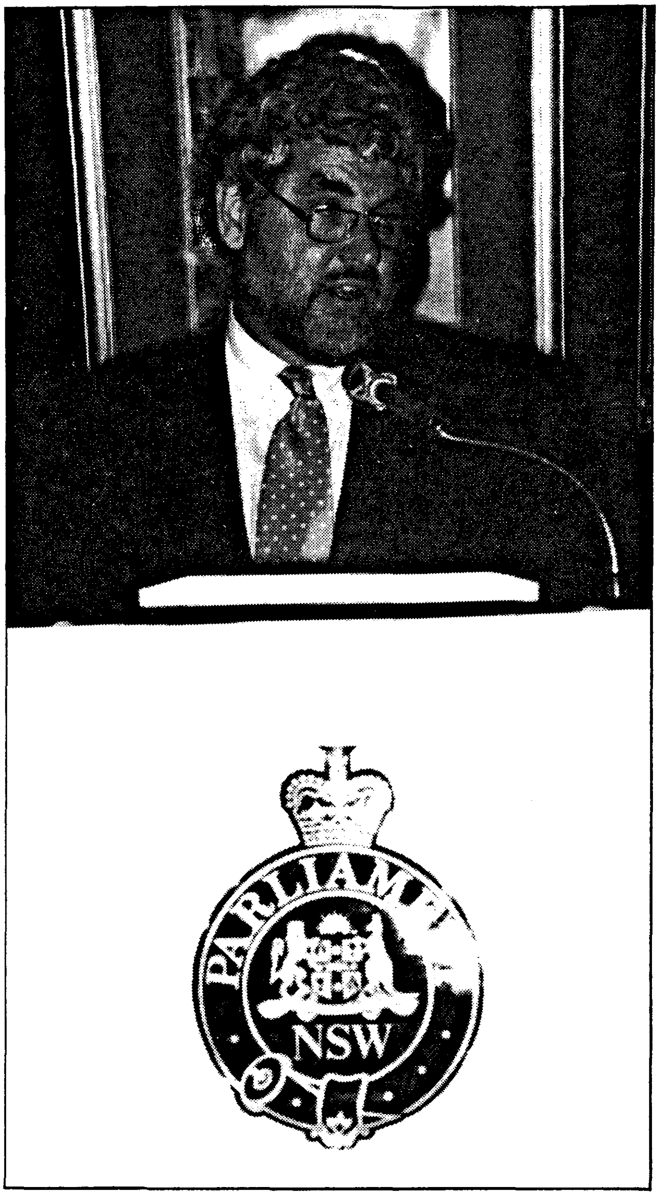
The one thing we get out of it from day-to-day, all of us here, is some satisfaction. For those of you from interstate and I know there are some, we welcome the opportunity to help you in your pursuits.

I suppose we would all say collectively that accrual accounting is something that has to be done. It is not optional and it is pleasing to see that all of the States and Territories in Australia have chosen to follow New South Wales;quite adventurous, expensive, but worthwhile pursuing. Thank you.

MR GLACHAN: Thank you very much, Mr Harris. I am sure that has given you all a lot to think about. I hope you have enjoyed this morning's session. The part I was particularly interested in was from the Department of Health perspective, taking people in the front door, fixing them up and sending them out the front door again. I wonder what happens to those who go out the back door. We did not hear about that, and how do you account for them.

Now we come to lunch. We are going to have Professor Bob Walker speak to us. He is our lunchtime guest speaker and we will resume here at 2 o'clock.

(Luncheon adjournment).



Professor Bob Walker
School of Accounting
University of NSW

"What does it all mean?"

MR HUMPHERSON: It gives me great pleasure to introduce Professor Bob Walker. Bob Walker is currently Professor of Accounting at the University of New South Wales, and has held that post since 1978. He has been an academic since 1965, when he joined the staff of the University of Sydney as a teaching fellow, after working in public accounting and as a freelance journalist.

He has published extensively in research and professional journals. He was a foundation member of the Accounting Standards Review Board 1984-85, and has been a consultant to the National Companies and Securities Commission, Australian Taxation Office, Australian National Audit Office, Northern Territory Treasury, the Australian Stock Exchange, the Accounting Standards Review Board and the Commonwealth, New South Wales and Northern Territory Public Accounts Committees on a range of accounting, auditing and financial reporting issues.

He is currently Deputy Chairman of the Australian Shareholders' Association, and is a contributor of commentaries on accounting and regulatory issues to the "New Accountant".

Ladies and gentlemen, would you join with me please in welcoming Professor Bob Walker.

PROFESSOR WALKER: I thank you. I missed what Andrew Tink said about me this morning, but I did not miss what this gentleman said about me during the budget debate. Politeness allows me to pass on. I do not know why he asked me to spoil your lunch.

As a third generation accountant, I suppose I should be a true believer in the virtues of applying accrual accounting in the public sector. I should be saying this is the conference you had to have. The difficulty is, I am not really a true believer.

Back in 1988 I wrote in Australian Business that Nick Greiner's advocacy of accrual accounting could transform debate about public sector finances, particularly about the level of public sector debt, and resource allocation within the public sector. I am afraid I do not think that really happened, even in New South Wales.

I do not think there has really been a transformation of the debate. Despite the availability of estimates, for example, of State's aggregate liabilities in the outcome of the accrual accounting process compilation of whole of government consolidated statements - despite the availability of that data, we do not see politicians using it.

We see press releases talking about real budget sector net debt - I have to scratch my head to work out what that means. We see debate about changes in debt, a narrower concept than liabilities. As for resource allocation decisions, even though in 1988 I thought it would help, I did not foresee at the time that accrual accounting could be used to distort the reported financial performance of government trading enterprises - often perhaps to try and legitimise price increases, or to support contracting or privatisation.

I still support the use of accrual accounting in the public sector, provided the techniques are not used too creatively. Accrual accounting can be a means of ensuring that managers are better informed about the financial consequences of certain decisions. It can be a means of ensuring that governments are more accountable to Parliament, and the community. But accrual accounting can also be a device to create illusions.

When I was present at the Public Accounts Committee's 1988 seminar on accrual accounting, some of the rhetoric there was a bit overwhelming. We were told that the introduction of accrual accounting would show the true costs of government programs, the true financial position of government and so on. At the same time the zealots who were advocating this turned a blind eye on the fact the Bonds and Skases of the world were using accrual accounting to create quite different illusions of their financial performance.

In the end, what we have is a form of accrual accounting in the public sector which differs from anything we have ever seen in the private sector. We have seen, for example, commissions of audit established by incoming governments prepare whole of government financial statements, which were usually used to dump on the financial performance of predecessor governments. For example, down in Victoria we were told about headline figures of $69 billion gross liabilities, including $9 billion liabilities that the previous Government's whole of government financial statements had not counted.

Then we have seen an incoming government like the Kennett Government avoiding the same kind of report itself, so it was accountable on the same basis. New South Wales is the honourable exception in this regard.

Back in 1988 there was some healthy scepticism in the public service about the merits of introducing accrual accounting to the public sector. The transcript of the last seminar records that the then secretary of the Treasury, Percy Allan, observed that several other matters had a higher administrative priority than the introduction of accrual accounting. He was critical of proposals to make expensive changes for the sake of change alone.

But then we had an election, and there was a change of government, and the New South Wales Treasury rapidly developed new perspectives. It claimed to be in the forefront of world accounting reform.

That is a bit exaggerated, of course. Several European countries have been preparing financial statements on an accrual basis; Spain, Greece and Poland come to mind. Even the United Kingdom routinely presents its national budget using elements of accrual accounting. They accrue tax receivables.

Since then we have seen that the argument about accrual accounting has been largely won. Most states have committed themselves to phasing in accrual accounting over the next few years, and yet there has been very little formal assessment of how successful it has been where it has been operating. Let me offer a brief assessment.

Has accrual accounting changed the conduct of public sector managers? Let us ask that. In January 1993 the New South Wales Treasury's newsletter Treasury Talk reported the results of a post-implementation review of the introduction of accrual accounting. A survey undertaken by three major accounting firms and Treasury officers found that internal reporting in a number of departments was still on a cash basis, or a very limited accrual basis. Accrual information was prepared manually outside the accounting systems. Managers were still requesting cash-based information from the new system for decision making purposes, rather than accrual.

Personally, I do not find that very surprising. If one thinks about it, most of the decisions made by managers in the public sector would concern how to allocate the current year's budget most effectively. Even major capital investment decisions will be evaluated in terms of projected cash flows, not accrual data. Hopefully, managers will adopt a more holistic view of state finances and assess costs and benefits beyond the effect on their own programs or departments.

It may be that accrual information will be relevant when efforts are being made to evaluate the cost-effectiveness of major programs, but in the end, accrual accounting information may be useful in that context. It may be necessary, but it certainly will not be sufficient. The same thing can be said about cash-based accounting, it could be useful, it could be necessary to some extent, but it will not be sufficient.

But if one goes back to what was reported by Treasury in that post-implementation review, university researchers look on evidence of that kind as casting doubt on the validity of claims that accrual accounting information is inherently useful. If no one is using it, apparently it's not useful.

Not so the consultants who prepared this report, and not so Treasury who of course displayed the evangelical zeal of converts to the cause. Treasury reported that there was a need for a significant change of management philosophy and outlook and that their needed to be a change in organisational culture. Personally, I would place greater store on education and training than on indoctrination but is an "accrual" world.

It reminds me a little, this focus on accrual accounting data, of the accounting professor who hired a student to drive his car around the block to lower the average cost per kilometre. If you get very focused on preparing data for the sake of it, you sometimes lose sight of what really is the relevance of that data for particular types of decisions. I think, unfortunately, in the process of introducing this new set of ideas we have somehow lost sight of some major elements of the use of this kind of accounting data.

In part, the introduction of accrual accounting has been accompanied by changes in the approach towards public sector management. The crime has been to let the managers manage. Letting the managers manage is also equivalent to letting the managers mismanage. I take as an example the fact that my analysis of the expenditure of government departments since 1988 shows that direct departmental expenditure has increased by about 36 per cent, as opposed to CPI increases of 16 per cent.

When I have sought information about this, I am told that the information is not available and it would cost too much to collect. It seems to me that some of the key information about public sector financial management may be, out of sight out of mind, and this idea of decentralising responsibility to financial managers of departments - and it is not clear to me that accrual accounting has actually improved the conduct of public sector managers in managing state finances.

Let me turn to the question of whether accrual accounting led to better reporting to Parliament. Budget sector agencies have made the change, and it is interesting to note back in 1988 Percy Allan observed that the Public Accounts prepared on a cash basis were produced in about six weeks. He suggested that timeliness was very important, and expressed concern that the introduction of accrual accounting might lead to delays. On that score, at least, he was very right.

This year the Public Accounts included financial data for the public sector on an accrual accounting basis and they were very late. Many in politics deplore retrospective legislation, but on this occasion our Treasurer was probably quite enthusiastic about changes which meant the time for presentation of the Public Accounts was extended. Without these retrospective changes he, and certain Treasury officials, would have been liable to $2,000 in fines for not meeting reporting deadlines.

However, I believe that the usefulness of the Public Accounts is largely a function of what set of entities they cover. It is probably well understood now that the Public Accounts do not cover all government agencies. Once they related to the Consolidated Fund, now they relate to the Budget Sector, but that is a set of entities which the Government believes should be reported separately. It is not the same set of entities that the Australian Bureau of Statistics believes should be reported on separately as a reflection of the performance of general government.

The approach in New South Wales is to say that the set of entities is broadly in line with the GFS basis, which to my mind is like saying you are partially pregnant. So indeed last November the PFA Act was amended to allow Treasury to decide what GFS means.

Whether we use cash accounting or accrual accounting, the difficulty is that the reported numbers are not very useful to analysts because we keep changing how the agencies are classified. We have seen the Budget Sector shrink as more and more agencies are put off-budget. Treasury says that some agencies have been newly included, but the financial effect of these changes hasn't been reported, and I gather that the data is not available.

In short, I believe that the major limitation of the usefulness of public sector information, both cash and accrual, is that the reports of budget results only cover this sub-set of entities. I am well aware that Mike Lambert suggests that my views reflect absolute ignorance of budgetary processes in the public sector, and he claims that, since budgets are a device whereby Parliament allocates funds, the budget sector should include only those agencies which are primarily reliant on budget allocations for their continuing operations. The reasoning, if you inspect it, is fallacious. I think it is subject to a lack of a distributed middle.

But the fact is that budgets already include allocations to agencies which are deriving some of their revenues from taxes and charges. There is no technical reason why budgets cannot reflect both the projected revenues and expenses of those agencies. The scale of those revenues really makes no difference. In any case, while the Health system is part of the budget sector I suspect that the greater part of payments made for services provided within that system may come externally from the Commonwealth.

But my point is simply that until government reports cover a consistent set of entities from year to year not much reliance can be placed on the figures, whether you are using cash or accrual accounting. One way to ensure consistency is to require the presentation of budgets and budget results on a whole of government basis.

However, New South Wales does prepare whole of government financial statements on an accrual basis, and it is the acknowledged leader in Australia. If accrual accounting is so good, we might ponder why these documents are not given the attention they deserve. Whereas the release of cash-based budgets is the occasion of great ceremony, where we have budget lockups, journalists are put into darkened rooms, shown slides, and subjected to repeated messages. Then they are ushered into an adjacent room, where on one end of the table are the budget documents, and on the other end is the food. They always go to the food.

When we come to the presentation of whole of government financial statements, these are always released in a very low key way. As I understand it, they are not even formally tabled in Parliament. Often they are produced quite late, January or February. I think they might have even hit March one year.

The 1994 budget papers referred to these statements as being analogous to the financial statements produced by a holding company and its subsidiaries. The fact is that if a stock exchange listed company did not produce its financial statements until January or February, it would be delisted. The delays in producing these accrual accounting reports just would not be tolerated in the private sector.

I am well aware that the reason for delays is that the process is all so new. That is the argument. Multi-national companies with 400 or 500 subsidiaries reporting in half a dozen countries and subject to half a dozen regulatory requirements still manage to knock out consolidated statements in time to meet stock exchange requirements. New South Wales has been doing the job for six years. I wonder whether some of our private sector entrepreneurs would get much sympathy if they defended their financial statements on the basis that they had only been in business for six years. Mr Skase: "I am not guilty, your Honour, Quintex was only going for six years."

The second issue which must be confronted when talking about the effectiveness of accrual accounting as a means of reporting to Parliament and the community at large, is that the style of accrual accounting which has emerged, it is very different from that used in the private sector. I suppose the major differences relate to the writing up of assets. Private sector managers tend not to write up assets because that leads to increased depreciation charges and hence lower profits. Private sector managers like to report higher profits.

But in the public sector the opposite seems to be the case. I believe that the RTA's upward asset revaluation of its system assets by $43 billion was an Australian record, possibly a world record. I well recall Wal Murray putting out a press release with a debt equity ratio of 1 to 43, we have the strongest balance sheet of any entity in Australia. But the end result was that the RTA started recording losses rather than profits as result of increased depreciation charges. Was anyone better informed? I do not think so.

In any event, what really concerns me is that the RTA's financial statements do not show the overall performance of the road system, because the RTA only keeps some of the revenues which it collects from the road system, others go into the Consolidated Fund. Anyway, back at the time of course the Auditor General found this upward asset revaluation of $43 billion gave a true and fair view.

When Treasury produced its own whole of government financial statements they weren't happy with the balance sheet which showed the road system at such a high figure relative to the rest of the assets, or maybe they said they were concerned about the basis of valuing land under roads. The end result; they wrote down the assets, as I recall, by $23 billion. The Auditor-General said that gave a true and fair view as well.

The RTA's accounts are a perennial source of delight, particularly in their treatment of off-balance sheet financing transactions. My general point is that one cannot pick up a balance sheet from a public sector agency, and read it in the same way as a private sector balance sheet, because the accounting policies are very different.

But let's return to some of the rhetoric. When it came to talking about whole of government consolidated statements, the Australian Society of CPA's discussion paper, "Making Governments Accountable", suggested that such documents would enable the community to "assess whether elected representatives and managers of public monies had properly discharged their accountability."

I think that is a big ask if the reports are not tabled in Parliament, get released without fanfare, get minimal media attention, usually from political journalists rather than finance journalists, and if those statements are prepared using curious and changeable accounting techniques.

I will not go into detail, but there have been occasional errors in those documents: unfunded superannuation liabilities were understated by about $3 billion for four years until 1991 before detected. Last year there were major write-downs of $2.5 billion of asset values, mainly assets held by TAFE and the Department of Health. These were treated in the balance sheet as adjustments to the open figures rather than charges against the operating statements as required by the accounting standards.

The end result was that the statements recorded a surplus of $353 million. If they complied with the standards I think they probably should have showed a deficit of $4 billion. If they had also taken into account Tony Harris's qualification the deficit might have been $6 billion. Well, the stated rationale for the treatment of asset write-downs was that there had been errors in the values initially estimated for those assets. That is one explanation.

Of course there is another explanation: We were all very blessed. New South Wales was insulated from the declining property values which affected the rest of the community. But if one looks further into these whole of government statements, one can find that the New South Wales Treasurer has exempted budget sector agencies from having to adjust their assets to recoverable amounts, if recoverable amounts are less than book values.

Private sector corporations cannot do that. And worse, this rather radical treatment hasn't even been highlighted in the statement of accounting policies. In fact, they have actually said there is full compliance with accounting standard 10.

So what I am suggesting is, the idea of introducing accrual accounting has been terrific, but it is not at all clear whether we have got better accountability to Parliament while we have financial statements which are prepared on the basis of unusual accounting techniques. Worse is to come, I suppose. We have got AAS29 on departmental reporting being introduced shortly, and I must express some dismay at that because it is not clear to me who the users are of these kinds of financial statements. I think there's far greater interest in the expenditure on programs. The fact is, departmental structures change from year to year as there are changes in Ministries.

Anyway, let me summarise. It seems to me that the alleged benefits of accrual accounting have been oversold. Accrual accounting figures can be fiddled, even more so than data prepared on a cash basis. Whereas in the private sector companies are subject to some form of regulation by the Australian Securities Commission, and directors are fearful of presenting misleading information because of the threat of litigation from disgruntled investors, there are no equivalent disciplines in the public sector. The Audit Office, both here and in other jurisdictions, is probably under-resourced, Mr Harris, relative to the significance of its role in the community.

Moreover, I then suggest that budget sector or whole of government data will only be meaningful if those figures are prepared on a consistent basis over time and, hopefully, between states.

Consistency will require greater adherence to accounting standards than we have seen to date, and consistency will also require some agreement on matters such as the frequency of asset revaluations. We have seen, following really from the National Performance Monitoring Project, agreement that GTE should value their assets at current written down replacement values or deprival values as the basis for asset revaluation.

The usefulness of those financial reports will largely be a function of how frequently those assets are revalued, because if there are frequent revaluations the earning stream will not be a very useful indicator of progress of reform.

The next point I would suggest is that a major impediment to the usefulness of whole of government reports is the increase in use of off-budget financing schemes through private sector involvement in public infrastructure schemes.

Andrew Tink is not here at the moment, is he? But I am not sure whether the Public Accounts Committee's recommendation that Parliament be given contract summaries of these deals three months after they are signed is going to be a very useful improvement in accountability to Parliament. Certainly the claim that accrual accounting would enable the citizenry to examine the financial implications of the source allocation, and resource allocation decisions made by government, is a bit of a joke when looked at in the context of these kinds of deals.

If Parliament cannot even learn what the contracts are, what hope have we got of actually gleaning much about them from the financial reports? What really should be of concern is that recent changes in Loan Council rules have created incentives for the further proliferation of these contracts. The Loan Council no longer functions as a rationer, but simply as an organiser of disclosures about allocations.

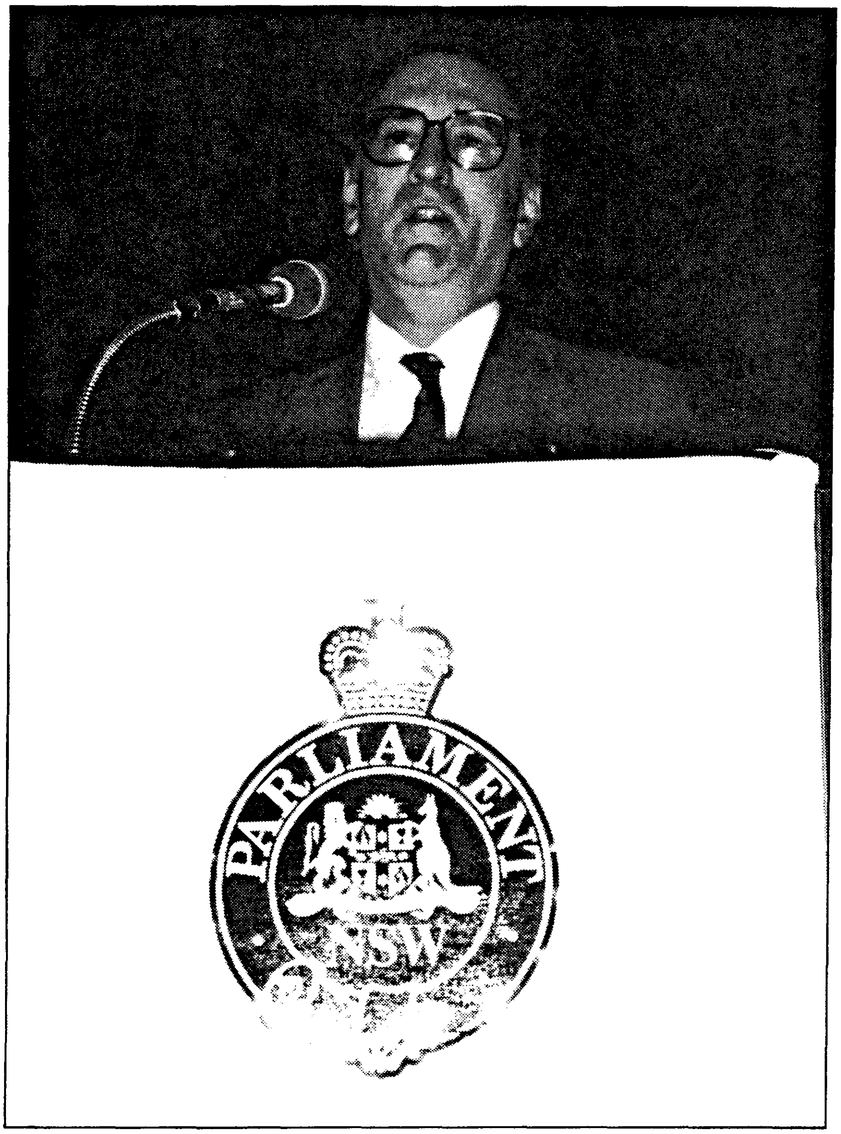
But ultimately, I suppose, the usefulness of accrual accounting data will depend on the prevailing culture in the public service. If preparers of accounting information see their role as being to show the government's performance in the best possible light rather than reflect the facts in terms of consistently apply the accounting standards - then the data will not mean very much. We already see election cycle budgets. My fear is that we may see election cycle accounting.

Finally, let us be realistic and note that financial statements only report on financial matters. Parliamentary accountability, to my mind, requires greater attention to reporting on the nature of the services provided, particularly by budget sector agencies, but also by GTE's.

I think the private sector model of reporting simply on financial performance has been proven inadequate. It is ironic - I am wearing my hat of involvement with the Australian Shareholders Association - we keep hearing how in overseas countries there is greater concern these days about the failings of corporate governance in focusing simply on financial performance and not reporting on the quality of services provided to customers. Surely those lessons have to be learned by the public sector as well.

Also, I think, full accountability to the community will never be simply provided by financial reports, because a large element of the States public sector investment occur in infrastructure assets. Accounting reports can never simply capture how effectively a government has managed the resources under its control. Ultimately, I think we are going to need fuller reports on the physical state of our infrastructure.

Thank you.



Professor Carrick Martin
Deputy Vice-Chancellor (Administration)
Macquarie University

"The Chief Executive's View"

MR IRWIN: Good afternoon. Can I introduce our last speaker as such, before the panel session. May I introduce to you Professor Carrick Martin. Professor Martin is the Deputy Vice-Chancellor (Administration) at Macquarie University. He has progressed to that position from being Professor of Accounting there in 1980 and then Head of the School of Economic and Financial Studies.

Professor Martin is also the President of the New South Wales Division of the Australian Society of Certified Practising Accountants and he was formerly Chairman of the National Education and Membership Advisory Committee of the Society and for five years was a member of the Accounting Standards Review Board. He is also the senior author of a popular first-year text book in accounting. May I introduce Professor Carrick Martin.

PROF MARTIN: Thank you. I am here under false pretences so I had better make some confessions. First of all, I am not the Chief Executive Officer of Macquarie, although I do happen to advise Di Yerbury quite often on matters of accounting reports. Furthermore, I am an academic by background. I have been asked really to give a chief executive officer's view of accrual accounting and its adoption at Macquarie University so I have to try and wear my boss's hat and cease to be an academic or an accountant for the moment, so that is one confession.

Secondly, to all my academic colleagues, my apologies for not getting into the ins and outs of accrual accounting theory. I also must confess that not all of the benefits I am going to speak so glowingly of in the next half hour have been realised. But then again I have adopted accrual accounting; I considered the benefits certain so I have booked them.

Accrual accounting to me has a very simple kind of beginning. It is simply a coherent framework for accounting practice derived from some sort of conceptual framework with two main premises: a recognition of assets and liabilities when sufficient certainty exists; and the maintenance of capital, which is a benchmark to be passed before any surplus may be reported.

The second point is often forgotten, but I think it is quite relevant to the situation of our university.

My view of accrual accounting is that it is really a practice that embraces all of those approved accounting standards, conceptual frameworks and the like and brings a reporting system into the family of conventional accounting.

I would probably agree with Bob Walker on most of the criticisms he would offer on accrual accounting and its defects, but from where we began in the late 1980s at Macquarie University, anything was an improvement. I think I am here today to sell anybody who is not using accrual accounting at least the first steps to conventional accounting. Then you can read the critique of that once you have that part organised. I think all the remaining rules follow from those two premises. I regard revenue and expenses as simply a derivative of the asset liability definitions, for example.

The view taken in my paper is consistent with AAS29 "Financial Reporting by Government Departments," which, I imagine, will have some influence on accounting practice beyond government departments in this country in time to come.

From a senior executive's point of view, accrual accounting, to my mind, gives benefits of: consistency with commercial practice therefore comparability; for the first time an articulated set of financial statements, profit and loss statement and balance sheet, allowing the integration of financial information; a focus on performance rather than strict accounting for inflows and outflows; and the possibility of dealing with the conservation of the capital base.

I believe quite strongly that the benefits of accrual accounting really lie within the organisation as much as they might for anybody without trying to understand what the organisation has been doing. So we have more comprehensive and relevant information at all levels of management over a longer time horizon because of the ability to deal with the leads and lags, leading to what, I believe, are more informed decisions within the university.

Why do we adopt accrual accounting? Well, of course, the New South Wales Government said we should. If there is one thing that upsets a Vice-Chancellor more than anything else, it is getting a qualified audit report, although I do not know why; they have all been getting them for years. But when Andrew Tink, who is a member of the University Council and constantly reminds one of that fact, perhaps that is another reason, but we certainly were very happy to oblige.

But I would like to suggest that there was an even more pressing reason why Macquarie and other universities had to move towards full accrual accounting and this was the change in the financial fortunes of universities that began in the late 1970s really and which accelerated with the Dawkins era.

It is easy to preside over growth when student numbers are rising and there are funding increases to match. The cash flow approach is just beautiful. You can iron over the cracks with a little bit more money coming in. But what we have seen is growth in student numbers and a decline in dollar per student funding.

We have also received clear messages from Canberra that we are expected to augment our operating grants to a considerable extent by the earning of moneys outside. I might say that Macquarie has taken that perhaps as literally as anybody. I think if you include HECS, something like 54 per cent of our income is now earned from non-recurrent sources, which places us as number one in Australia - or last depending on how you view the world.

We have also been told that those in Canberra will no longer inject special funds for capital works or for refurbishment or for any of the other schemes that they used to dream up. In other words, universities are on their own and they have to be responsible for their own destinies.

Let us take it as a given that universities' strive for social goals is not reflected in the financial reports, and if I seem to be concentrating too much on the financial side of it, do not believe that I have forgotten that universities really are not there to make money, although it would be nice.

In straitened circumstances, attention moves from accountability for cash flows to some heightened awareness of the need to enhance revenue and to contain costs at all levels and the bottom line becomes significant, particularly when it is negative. It is not just the bottom line, of course, it is every line, and that is the point to be made about accrual accounting. It is not that one is profit-seeking or not; it is that one seeks to gain as much knowledge about every line in the financial statements as possible.

How does this affect the Vice-Chancellor? Well, Vice-Chancellors had hitherto been concerned about balancing funds over a three-year horizon. They now know they must plan five, ten, fifteen years ahead, at least so far as capital needs are concerned. After all, the capital works needs will not be met by specific grants any more. It is arguable, though barely so, that the old modified accrual accounting approach was okay in the past, but it is certainly not okay now.

So the Vice-Chancellor is beset with problems about how to allocate inadequate resources between schools and offices, what income seeking ventures to engage in. Should we really set up that college in Central Java which may or may not make money or may be materialised tomorrow? Should we really allow our Centre for the Exploration of Coal to continue or is it a sunk cost? Should we still teach 14 languages? All kinds of questions of a commercial nature arise when one gets down to the tin tacks of running an organisation such as a university.

The modified accrual accounting system is the one we used. I do not know what that means, but it is the one we used. It was followed until 1992. I claim it has no theory to support it. It is a system that recognises some assets but not others, some liabilities but not others, and it is caught halfway between pure cash accounting, which I think we can understand although I am not sure, and accrual accounting, which I know we do not understand, but at least there is a body of theory about it.

The result is an ad hoc undisciplined approach to accounting not only at the top level but right through the university, as in the following examples from Macquarie's 1989 accounts. I took up my job in 1989, so I guess I am partly responsible for what is going up for that year. That will be in the printed form.

You will know, of course, that reported outgoings under this system are a mixture of assets and expenses, and equipment is shown as an expense flow just the same way as computer supplies are. So if you are out there in a budget unit and you are required to put some codes on the expenditure, why should you care whether it ends up going through the equipment account or the consumables account? That is the way practice has been almost up to this day. Why? Because this is what comes out the other end. Of course significant non-cash expenses are conventionally omitted at the top level and therefore at devolved levels as well.

Here is an extract from the 1989 annual report of Macquarie University. I consider it unfathomable. Perhaps you will understand it if you are using or have used modified accrual accounting. What I have given you here is no unique measure of the bottom line surplus for the year. If you go down there a little bit, you will find that there is something that is getting close to it.

I think that is the wrong overhead. Could the other one be put up, please? Even I did not pick it at first. It is a better story this way. You can read the income and that looks fairly conventional and expenditure is modestly stated, but then again that is the way it is in the published reports of companies anyway. These provisions look a little worrying, but they are there. Then we have some sort of prior period adjustment, which we do not know much about. But then we have a surplus for year prior to adjustment. Ah-hah, the bottom line! Well, no, not really, because under that there is investment income generated by and applied to the provision for long service leave. How on earth did that stay out of the income stream or, for that matter, the long service leave stay out of the expense stream?

But is that the bottom line, 5.3? No. We have to turn over. The other overhead is now relevant. We keep going with a whole lot of mumbo jumbo, then we get this the one: "Amount transferred to accumulated funds surplus." "Ah," the accountant says, "that must be it, because what goes to accumulated funds has to be the surplus, hasn't it, 5.3?" Well, no. There are some other increases in accrued/deferred employees entitlements not included above, and the professorial super scheme of which I am a member and I thought was a big expense, but there you are. Then we have "Result for Year - Surplus - after adjustments to reflect movements in unfunded liabilities." The report then runs out, so I presume that is the bottom line.

The point I am trying to make really is that if that is the bottom line, everything that goes before it must not have much meaning either.

Within the statement of balances, the modified accrual accounting basis dictated, of course, that all non-recurrent assets other than government commitments to fund superannuation be omitted; however, all the liabilities had to be in there though, so there was a born mismatch.

We had a problem. We actually proudly borrowed money from Westpac to put up a building for $9.5 million. When it came to accounting for it, we wanted to put the building on the balance sheet because, after all, we had a liability on the other side to match it against. The auditors said, "Well, you have to show the liability" (we all agree with that). But that building really ought to be written off because you are using modified accrual accounting." So the bottom line, such as it was, was about to suffer an even greater indignity.

We argued about that with the auditors and insisted. Then they said, "Well, you can have an asset in there as long as it is exactly the same sum as the residual liability." "Why?" "Oh, because it will balance then." Anyway we insisted and we were qualified and I suppose we learned a lesson from that. In defence of the auditor's position and ours, there was no answer; there is no answer to that sort of dilemma.

Outside the operating grant, the university adopted a form of fund accounting. This meant that when we felt we had an expense coming on or a large expenditure, we could transfer money from the so-called investment account and put it into a tin box, and we created many tin boxes over the years, which found their way into this set somehow. I think we call it hollow logs, and we have a number of those. Of course, they were beautifully hidden because the balance sheet did not set out to report them and the bottom line never reflected them anyway.

I think the most reassuring thing about these accounts is that they were said to be true and fair by the Auditor-General, who helped us prepare them, so that is good to know, isn't it? It is clear we could not go on like that.

To me the benefits of accrual accounting start with understandable balance sheets and profit and loss statements. I have reproduced our 1993 accounts there and they are pristine pure and the Auditor-General said they are true and fair as well, even though they are a little different from the 1989 accounts. It took us about three years to get there, but we were determined that we would adopt accrual accounting and we did.

The great thing to start with is that these reports, as you will see, are no different to those of any commercial organisation really. They have similar terminology except in the way of accumulated funds, and the CEO can understand them and interpret them in the light of any knowledge of commercial reports. That to me is important because the CEO must subscribe to the bottom line and to the income and expenditure in the reported statements. The CEO has to own those statements and work towards them, in my view of the world, for what is coming, and there was no way anybody would own the statements in 1989.

Secondly, the advantage to a CEO is the fact that an exercise has been gone through by the staff in searching out the principles and in documenting them and they are also of instructional value to the chief executive officer. We took the Vice-Chancellor through the accrual accounting principles that we had come up with and which we intended to use.

I think my story is best told if I say that the great advantage is that one starts with, at the top end, a set of reports that has some meaning, although limited perhaps; then the whole of the organisation's reports can fall into line.

In this next overhead, I have tried to depict the story. This is where we began, you might say, down at the devolved reporting level.We had a budget unit, which we required to keep accounts based on its operating grant income less its cash and credit charges - no more no less. If it ran into difficulties, we upbraided it; if it did well, we praised it.

Quite outside of that, there were these special funds I told you about, some non-recurrent earnings from the poor old overseas students; some money from slush funds, consulting accounts, donations, whatever. They were separately accounted for, even within one unit, by another 20 funds, which were set aside and so different surpluses or deficits might accumulate there, which were never really married back to that first statement. No-one cared because the bottom line in the reports did not need that kind of marriage anyway. Then there were other activities they engaged in likewise, which were kept separate.

To me, the starting point is to say that when one attempts to adopt accrual accounting, there is an automatic framework there of chart of accounts, which all devolved budget units can be made to accord with at a more detailed level and to account exactly in the given categories. The result must be a tighter articulated set of reports at all levels to promote comparability.

One might say, "Why do you need accrual accounting to achieve this?" Could not the Vice-Chancellor simply say, "You will all keep your accounts in a consolidated form?" - as the next overhead will now show - with the government grant simply listed with all other income from funds, donations, activities, whatever and broken up into various categories. The special category can be for research grants which we must treat differently because they are in a sense moneys on trust.

Why could we not say that you must account this way? Why could we not require the units to code correctly? I think experience suggests that with classifications and codings made within budget units, until it can be seen that they affect the university's bottom line and that it matters to the CEO, there will be a tendency in the unit not to care too much. The rules will be seen as ad hoc, arbitrary and possible to disregard.

So where I am trying to move the university and those who work with me is to this consolidated set of reporting, which is pure accrual accounting within the budget units. We want each budget unit financial statement to be a replica of the university's main financial statement and to aggregate up to it.

You might notice that I have added depreciation, which is an unusual thing, I think within devolved budget units of a university, but unless we have that in there, there will be no reminder that there are costs to be catered for in the way of replacement of equipment and facilities.

I know that text books, including mine, say that depreciation does not provide funds for replacement; of course it does not, but a depreciation charge in there is some sort of reminder, some sort of way of building in a cost for the recovery of outlays on equipment. And if it is in there, it will find its way to the little plans they have got for setting up operations in Indonesia, where they are probably likely to forget equipment that they will buy and use up in that time and the university's infrastructure resources, which will contribute.

I have gone further to an imputed rent on accommodation. I am sick of trying to find ways of getting rooms from schools, so I thought we might charge them for the rooms - I think we may have a space surplus in a year or so - and internal charges for internal university services follow. Maybe you think I have gone outside the realm of accrual accounting. To me it is all part and parcel of the attempt to bring a full appreciation of costs on a time basis to any operating unit. We have Jim Brophy here today, who is helping us out with our inquires in that regard.

So each unit in time will have a net surplus, which will be an accrual surplus and not one for which will be responsible fully as a management unit but which will tell us about its ability to contribute towards the university's bottom line.

If we get into financial planning and revaluation, I have listed in the paper countless examples of ways in which universities really are commercial undertakings and probably always have been. My argument would be, though, that unless these undertakings are accounted for in such a way that they integrate with the university's main accounts in a plain fashion, it will always be possible to forget particular costs associated with them and therefore to make poor decisions.

If the university central reports do not adhere to accrual accounting, then it is very unlikely that the reports of any unit will do so. So for financial management planning, I think there is a lot that one can say internally about the discipline of adopting accrual accounting. Perhaps I could go on to a few others which come to mind. These are nowhere near complete.

Maintenance of capital: I have said that universities these days and in the future will need to preserve their base for physical and operating capital. The Federal Government has taken a bold decision not to give us any more earmarked capital grants but to roll in capital funding as part of our grant. We know what the game is, of course. In five years time the roll-in will not be visible and the budget will be shrunk and we will find we have no money for capital again, but it is a good honest attempt to make the universities plan ahead and be responsible for their refurbishment needs.

So the universities will have to demonstrate in their public accounts that they have made adequate provision for maintenance of the fabric of the university. To my mind, depreciation has significance here, so long as it is based on replacement cost, of course, which is another subject.

This generation has to contribute toward the eventual replacement of buildings and equipment and it is basic to the nature of accrual accounting that no surplus is declared until the recovery of capital outlays is put in there. So I see accrual accounting as a very basic discipline for the maintenance of capital.

Current asset management: I suppose you have all guessed that as being a benefit of accrual accounting. It has certainly been good for Macquarie. We now have a balance sheet emphasis, now that we can read our balance sheet.

In Macquarie the change of orientation has been proposed in our current asset management. There was a time when we did not chase our debtors too much, particularly when they were former students. These days we have debt collectors chasing them all over the place. Our credit terms have been tightened. As a result of that, the receivables have fallen by 50 per cent since 1989 at a time when our commercial activities have grown enormously. So we can claim some success in that direction.

Why did we do it? Not just to get a better looking asset on the balancing sheet but, of course, to maximise the supply of investable funds. The same is true of inventory control: where in the past schools and offices used to buy up big at the end of the year, we now let them carry over their surpluses and encourage them to buy responsibly. It occurs to me we probably should pay them interest on their surpluses so that they really are encouraged not to spend all their money.

Fixed asset management benefits particularly from this integration with the financial statements - I began with that as my first thought for this paper and it grew from there - because prior to the adoption of accrual accounting, we had been told "You must have an asset register"; so we created one. It was huge. Everything we bought went on - a long, long list, very complete. The trouble is nothing was ever taken off it because it is too difficult to find and count the assets.

Every now and then the internal auditor would do a little inspection and I guess that pricked a few consciences, but it did not stir any great resolve to have an identity between the asset register and the actual assets. Stock counting was regarded as a meaningless chore because, after all, the inventory did not figure in the balance sheet anyway.

Now that the university must account for its plant and machinery and adopt depreciation schedules, all of that, of course, has changed and an integrated asset management system is part of our daily life.

The whole intention must be to minimise our non-monetary assets holdings, and not so much minimise but to optimise them, so as to maximise the supply of investable funds. We are also now more concerned about the timing of receipts and payments. We put in a "new beaut" new accounting system that instead of paying creditors in 90 days, which was the university's wont, it used to pay them to in three days. We soon put a stop to that. The loss of cash and interest was enormous.

The universities also set up an Investment Policy Advisory Committee. One great use of our Council members is that a number of them have been chief gurus in the finance community and they offer excellent advice to us in that respect. We put our funds out to management, within our investment powers of course, and so far we are doing very badly because yields on bonds have not gone as - well, they have gone up, but the prices have not gone too well.

All in all, I am trying to give you a picture of the university when it takes its balance sheet seriously and when it takes its bottom line seriously as seriously pursuing the maximisation of interest. You might say why did we not do that before? Well, we were; but of course, you see, if you could not read the bottom line, the profit figure, and if the interest income was somewhere else in the statements anyway, as you saw, there is no real incentive, is there, to go out and chase interest income for those who manage it? Nowadays, it all has to be brought in, and interest is important to us as the Government's operating grant, probably more important actually.

The university also holds substantial reserves overseas because of its forages overseas and here we have to use approved accounting standards, bearing out my thought that we are not just wedded to accrual accounting but to all the approved accounting standards that go with it.

All of the above, to my mind, fulfil the Vice-Chancellor's desire for the most efficient management of the university's assets. I say that what while it is possible without accrual accounting, accrual accounting puts all the incentives in place. That is why I said at the beginning that accounting creates reality. It should not, but the way the accounting numbers are determined, actually does affect people's behaviour and one or two people at Macquarie have done theses on that subject to prove it. I never believed it until I got in this job.

On liability recognition, it is pretty obvious that by following the approved accounting standards, particularly by being more assiduous in providing for accrued recreation leave, we are giving the chief executive officer the satisfaction of knowing that there will not be any uncomfortable surprises from staff movements. We have recently funded a rather large early retirement scheme where the payouts on long service leave were no difficulty for us because we had fully provided for them in the accounts.

Return on investments is a bit of speculation, but it seems to me that when one has come this far, one then starts to look round for some ratios that might be useful in comparison with other institutions. I am given the thought that one of the problems often said to exist in universities is that they have these enormous physical resources which they underutilise. For example, they close down at Christmas time. All of you think all of the academics go away until the end of February; in fact, that is when they do their research and plan their classes. But the fact remains that the buildings are not fully utilised in that time nor are they utilised on weekends as fully.

A whole interest will develop now, particularly since we are responsible for our physical assets, in trying to link an indicator of activity with an indicator of investment and since all the students pay fees these days and since a lot of our other income is really now based on fee-paying students for postgraduate courses and the like, I am inclined to think that some sort of linking between return and investment is possible.

The options available to Vice-Chancellors are quite considerable. With information technology now becoming a very powerful force, perhaps the most powerful force, for change on university campuses, we will note that fewer students will actually be on campus, even fewer staff will be on campus than are now and they will work at home with computer links and the students will work remotely with computer links, and we will need fewer buildings.

We will probably need one great big information services centre with books - we will still have some books - and a whole lot of electronic interfaces, rooms where staff will actually meet students in small groups, which would be nice to get back to, but a whole lot of other work would be done off campus. We may well be selling or leasing our buildings in the next few years and we can then make investment decisions trading off investments in IT infrastructure against investments in buildings and noting the return on investment that results. Fanciful, you think? Well, maybe, but it occurs to me that that is what lies before us.

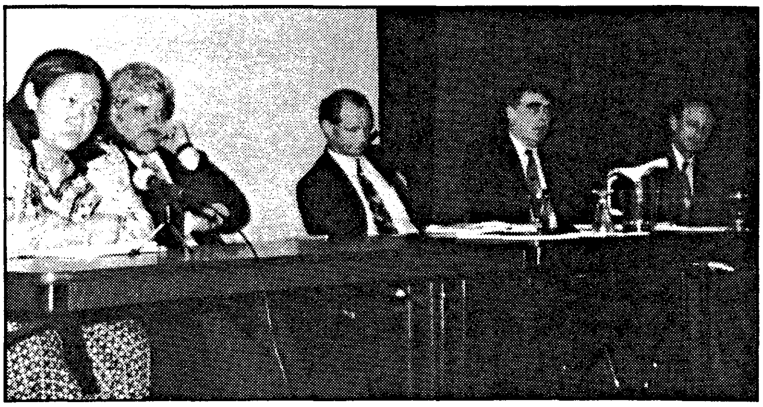
Finally, of course, if one ever does get to the point of comparability in university financial statements - that is if we all do adopt some form of accrual accounting, and we all are required now to report to DEET on a given format - that some sort of benchmarking would be possible between universities. Indeed some subscription services already exist within Australia and overseas. So I would see that as the end point of the story, where the Chief Executive Officer is able to gain some real insight into how Macquarie expenditure patterns line by line equate with those of other universities and like institutions.

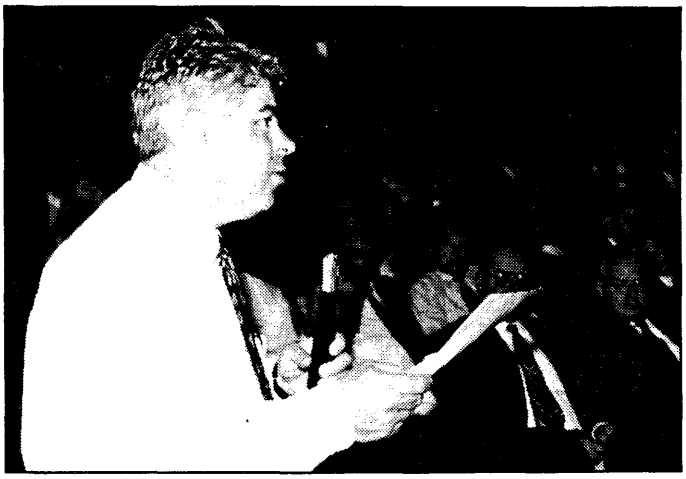
I have probably oversold accrual accounting. No doubt Bob Walker would take that view, but then again I told you anything is better than what we had and if you can see in it benefit, that is fine. Universities are no longer sacred institutions. They are accountable for their financial performance and must accept that fact.

If we characterise past history as a preoccupation with expending given funds in approved ways and achieving some sort of financial balance in the short run, then we are really moving into a different view of the world where universities must in the future manage resources efficiently so as to maximise their utilisation over the long-term.

We will always need cash flow reporting for budgeting and accountability, but accrual accounting adds that extra dimension by providing a measure of surplus and a balance sheet that has meaning - some. The real significance to chief executive officers, though, is in the provision of accounts that are understandable, integrated, comparable and internally consistent, but above all, offering a more comprehensive view of the organisation's performance and obligations over a longer time horizon and they should therefore facilitate better decision making at all levels of management. As it is with universities, so I guess it should be for other public sector organisations.
Harris, will comprise our panel if

MR IRWIN: Thank you, Professor Martin, for what I believe has just capped off much of what we have looked at here today. Unfortunately, he is unable to remain with us for our open forum, as I believe he has a meeting in a couple of minutes time.





Open Forum Discussion

Open Forum Discussion

MR IRWIN: We do not have any special format, other than having our three panel members here (Ken Barker, Bob Walker, Tony Harris). It is intended that we get both questions and comments from the floor. Can I ask you that if you are speaking from the floor to speak clearly.

For the benefit of our Members who aren't here and others, we are taking a transcript of the proceedings so can I ask you, as we would like to attribute to you any comments and questions, could you clearly give your name and your organisation and speak as clearly as possible to assist our transcription service, so that we can get all of your comments and questions.

Other than that, there is no set format. I think we might play it by ear. Can I now open the seminar to comment and questions from the floor? Thuy Mellor is to join us as well. My apologies, Thuy.

If we do not at this stage have anything from the floor, perhaps some of the members of the panel who have been here to hear some of the comments of the other speakers might want to address some remarks to them, or otherwise comment on some of the statements that have been made. We have one speaker from the floor.

MR BERNIE (Department of Energy): I have heard a lot of the speakers today talk about the importance of assets and liabilities and a balance sheet and I guess my question is directed towards Thuy Mellor in terms of the current inner budget financial statements. We have an interesting animal called an investment statement, but I was wondering whether we are going to see a balance sheet actually appear and be formally recognised by Treasury.

MS MELLOR: I thought I sort of alluded to that this morning when I said that unfortunately the computer system is one of those things that Treasury perhaps should have thought about two or three years ago. We should integrate the information for budgeting and reporting purposes.

So at this stage, because our computer system for budgetary purposes has been developed - they were developed I understand about 10 years ago - so they really cater for cash and we have done a sort of band-aid treatment, amendments to the system. That is the best we can do at the moment, but we are hoping in two years time we will have the new whizz bang financial data base. The plan is we should just ask departments, or all agencies, to give us the normal three operating balance sheets and cash flows and then we will certainly, with a little bit of supplementary information, be able to convert that into cash based information for GFS (government finance statistics) purposes.

That is the plan and I think the plan at the moment is that that system will be in place in about two years time.

MR IRWIN: We have another question at the back.

MR CLARKE (Department of Health, NSW): My question is addressed to

Professor Walker. The Treasury financial reporting code essentially provided for non-current assets to be valued at market value. Do you consider that that is an enormous improvement over valuing non-current assets at historical cost?

PROF WALKER: I certainly do. I think the point I was making was that if you are into that kind of accounting system, you cop the write downs through your PNL account and don't engage in adjustments to opening values.

When it comes to looking at some of the valuations that are placed on non-current assets which don't have a market, we are using figures which are derived by currently looking at replacement values. I think we should recognise this was the accounting system which the private sector rejected in 1960, current cost accounting, yet it has been embraced with great alacrity by the public sector because it gives you a better rate of return.

If you look at the stream of performance indicators that might be introduced, I think that is going to be dramatically distorted unless you have something in your asset evaluation figures for things like ports and airports and other major assets.

If you adjust the figures each year because you change your idea of the current replacement value, or other range of factors, the kind of information you are wanting to get out of the accounting system isn't going to be as useful as it might otherwise have been.

Accountants tend to be very inward looking and look at the three logical implications of applying accounting techniques and forget the way this might be used by people who are going to read accounting reports. With some qualifications, I agree it is useful to look at those values.

If you are looking at certain types of assets for which there is a market, you look at them to adjust changing market values. If you are going to live with accrual accounting, look at the write-offs and their operating scope.

MR IRWIN: Did you have a comment to make on that as well?

MS MELLOR: I think I have to say something, even though I was not here to hear what Bob Walker had to say earlier, but from what I understand, any changes in the valuation did not go through the PNL. I think that if I understand the issue correctly, I do not think that is the case. What we were trying to do in the past is when you have mistakes, when you start out on accrual accounting, that is when we went through the PNL like in this set of accounts, the public accounts, when the assets have been there for a long time, a minimum of 5 years if not 10 years, when they have not been, those assets have not been recognised in the past. Now because of the process that the authority goes through, they are now identifying and valuing those.

I do not think it makes sense to put that through as something you suddenly put through your PNL, as something that is part and parcel of the results for the year. It has nothing to do with the activities of the year. That's why we advocated it should go directly to the balance sheets, rather than the operating statement.

We actually followed accounting standards and even the AAS29 allowed for that, because they recognise it does take time for people to go through that process to identify assets. As I mentioned this morning, we have 200 years of no records.

PROF WALKER: AAS29 did not exist previously. If you are going to have accrual accounting, you have got to live with all its implications. It is something we have to accept and not try to produce a result.

MR BARKER: I know you mentioned Health has been one of the participants in the revaluation and it is within the consolidated process of 1991, 1992 and 1993. What happened was one of our regions got thousands in the wrong column, so instead of having an asset value of 80 million, they had an asset value of 800 million. I think they are around the right figures. We had to reduce our values by about 750 million because they got it wrong.

There was no way in the world that particular part of our system had such a high asset value when you came back and looked at it in retrospect. I don't know what the TAFE example was, but that was the main reason Health had to do the adjustment it had to do. It was just an error of fact.

MR IRWIN: There is another question from the floor.

MR WARNE (Albury Council): This is a bit of a chicken and egg question. Tony, in his presentation, made mention clearly that accrual accounting was a conceptual thing for an organisation. Just from observations today, the results that have been achieved have tended to be in financial reporting aspects, and I think Thuy mentioned it in her presentation this morning, that having her time over again, you concentrate firstly on carrying out accrual accounting processes in preparation of budget and evaluating budget.

Would you like to comment further on that and perhaps other members of the panel might like to make their thoughts known as well.

MS MELLOR: Ken Barker also this morning touched on that issue. On the one hand we go out and do accrual accounting but agencies still have to show this cash position according to these accounts and line items, so we can understand why it is frustrating for agencies to really know what Treasury is all about.

That is why we recognise that if we do it now, with the benefit of hindsight, we would have spent a lot more time working out how we could link the accrual reporting to the budgeting process, because we see it as two sides of the same coin. That is, the budget is the extra entity position. It shows what it is you plan to achieve. The reporting at the end, what you actually achieve, is something different so that gives some measure of performance and together with some other performance indicators in financial terms. Then the performance of the agency and the management standards can be judged on the same basis.

As it is, we have the budget on a different basis. We have not explained that very well. I have to acknowledge that. Does that answer the question?

MR WARNE: I think that covers it.

MR IRWIN: Does anyone else on the panel wish to comment on that issue? If not, we will move on to the next question.

MR BROAD (Consumer Affairs): I would like to really touch on what Ken Barker spoke about this morning. Thuy, I don't know if you were here then. Certainly in our organisation the concept of GFS, accrual accounting and all the rest of it is very difficult to explain to senior management staff and, in my case, two Ministers, one of whom has a Bachelor of Commerce degree. At the coal face it is very difficult.

Given that the other states and the Commonwealth are moving to accrual accounting, does the New South Wales Treasury in the medium term support a fully funded net cost of services as the financial standard? In other words, as I understand it, we use GFS because all other states are on cash. If that is no longer the case, in a few years time, can we completely move away from GFS?

MS MELLOR: I did not know anything about GFS either in 1990 when I joined Treasury but I had to learn very quickly. I suppose it is a bit of an excuse on Treasury's part, but it is a valid excuse in terms that we have to report to the ABS on GFS.

The Government is committed to have a uniform presentation with the other States and the Commonwealth on the basis of GFS. I do agree with you that GFS is quite difficult to understand. I only understand the general principles. Maybe Tony Harris can confirm that, being trained, firstly, as an economist.

What we intend to do is when we have this new computer system, we would get information on an accrual basis from all departments, from all agencies and the conversion from the accrual information to GFS or any other basis, mainly GFS, will be done by Treasury rather than the present system whereby we have to ask you to provide that information.

MR BROAD: I do not think that is the issue, Thuy. It is the presentation in the budget papers, the Estimates Committees, etc. I don't think it is a matter of who calculates it. It is the question that it is in an external report and you then have to explain to Ministers, Members of Parliament, your own staff, the Executive. Really I am proposing the issue, why do we need GFS if we are all moving on to an accrual basis.

MR BARKER: It is a real management problem when you have three or four different sets of figures and they are all right, but in a debating situation, it becomes very uncertain as to who is talking about what figure, because you have an accrual accounting figure, which is your total expenses, then you have total payments, net cost of services and consolidated funds support and they are all right in a way, but it is far simpler if all agencies have to worry about is the one figure and where their various funding sources are coming from.

You guys worry about GFS because I think when you look at what, in my view, goes in to make the GFS up, I think that it is time some of the central agencies and Treasury got together and maybe redefined the rules. Maybe they redefine them again, because we had some problems in the recent year in terms of what was the source of funds for our capital program, because of the GFS and the subsequent impact on the deficit, but when you look at it, they don't have any real impact on the deficit. Because of the way the rules are, they have to go in.

MS MELLOR: The GFS is not just Australia. The GFS is international and there are another 120-odd countries around the world we see using it.

MR HARRIS: The GFS also forms part of the system of national accounts as well. It is one of the blocks that make up the national accounts that are reported on quarterly with the GDP when the governments call on the economy. It ought to be reconcilable to cash, as cash is reconcilable to the balance sheet on accrual accounting.

I take the point that maybe cash is the better figure than the GFS. Maybe when the United Nations and the IMF see what New South Wales has done, they might see it is possible.

PROF WALKER: I take the view if we didn't have the GFS, we would have to invent it. Basically this is the basis upon which the ABS brings some standardisation into the way the States present their financial results. At the moment the Commonwealth, the Northern Territory and the ACT comply very rigidly with the GFS basis in their budget presentations, but other States don't.

Their definition of the budget sector is a matter of self-selection by and large. Often it is the consolidated funds. Sometimes, as in the case of Western Australia, it was even less.

The point, I suppose, is the ABS in formulating the GFS basis, which is an adaptation of the United Nations SNA basis, has come to realise there are some shortcomings in it, and I guess the big ticket item is that unfunded superannuation was not counted. Why? Because all the countries that the United Nations were looking at, a lot of them didn't have books, let alone accrual accounting books, let alone picking up the unfunded superannuation commitments, which is something we have only started seeing since 1984 in New South Wales on a systematic basis.

There is a need to retain a GFS basis for budget sector reporting, but certainly the ABS has more work to do in order to make it more relevant. I think the original question though was whether Treasury should start funding the cost of services, which did not get answered.

MS MELLOR: I think one of the things Treasury has a view on, but I think the question of Treasury's view is not necessarily the Government's view, when we talk about funding the total cost of services, rather than just the cash you need at the moment, it is something that I alluded to this morning. It is something that we would like to put on the table to be debated.

New Zealand goes that way and the Department gets funding for all costs and it is a Department decision for replacement of assets and so on. It is something that we would like to raise as an issue for debate, but I am afraid Treasury cannot and does not make that sort of decision.

PROF WALKER: Let us debate it now for a minute. I think it would be a crazy idea. If a past generation of taxpayers has funded investments in infrastructure, there may be different priorities now. It does not make at all good sense, to my mind, for agencies to be funded, given cash representing the amount of depreciation on an asset acquired years ago, revalued upwards since, why should that be the priority for funding through the budget?

I would have thought that each government has to set its own priorities as to how it thinks the resources it has available to it can best be spent. That may be quite different from giving people cash to compensate them for depreciation charges on an asset bought previously.

MR HARRIS: In my talk I spoke a little bit about the cost of capital. It amuses me that the Darling Harbour Authority makes a profit each year, or can make a profit - sometimes it makes a small loss, sometimes it makes a small profit - but it amuses me because the person or the agency that is picking up the debt......is Treasury, so we have the Darling Harbour getting all of the revenue that it can while Treasury meets the cost of the debt that was used to develop Darling Harbour.

That, I think, gives a wrong picture about society's involvement in Darling Harbour. People look at it and say, "wasn't that a good investment", but instead of making $1 million a year, it loses nearly $2 million a week in uncovered interest. When that becomes public, then the society is better placed to say do we really want another Darling Harbour if the cost is $100 million a year.

PROF WALKER: There are two separate issues here. One is concerning how you identify the reporting and the other question is the impact on operations of the public sector by introducing a capital charge. The latter is a radical idea that not even the New Zealanders have entered into. It is a far right economic rationalist ideology in my view, which is going to substantially re-shape the way the public sector operates.

Let us start with the first point, the reporting entity issue. There are always problems about whether a particular set of activities as a reporting entity is capturing all the operations, and if Darling Harbour has borrowed then maybe we should look at the financial arrangements which do not associate those debts with the Darling Harbour Authority.

It goes the other way. We do not associate the revenues from the road system with the RTA. This is where there is a great deal of flexibility in implementing accrual accounting. The second issue, though, concerning whether you introduce a capital charge regime, is a way of virtually imposing of government agencies an edict that all of their investment decisions must meet a particular hurdle rate for investment perhaps.

They are told they are going to be charged for capital. This encourages them to perhaps not embark on new investments and capital works unless they can secure a hurdle rate which is, at least, above that imposed on them through the capital charge regime. This troubles me because one of the roles of government is to undertake activities which the private sector does not undertake, because indeed there is market failure. There is not a rate of failure.

Introducing this into State finances can have quite dramatic effects, I think, both on new investments and also the pricing regimes which are effectively going to be introduced for government services.

MS MELLOR: Can I just add, Mr Chairman, that I think there seems to be a bit of confusion. Treasury recently put out a paper on capital charge for comment by agencies on the capital charge incentive. One thing I have to say is that New Zealand actually introduced that capital charge for the last two years that I know of, if not three, so the Department actually paid the capital charge to the Treasury every six months and the capital charge is nothing to do with new capital investment.

The capital charge is simply a charge on the capital made available to the agency. If you did not have that, the agency would have to go out and borrow, or have to pay dividends, so it is simply a capital charge on the capital available. That is what we are talking about. Treasury is not talking about hurdle rate, or anything like that.

PROF WALKER: I would like to explore the implications. A New Zealand academic told me a month ago that they not introduced it. I am not sure where the facts lie on it.

MS MELLOR: This is from New Zealand Treasury and I can send you the paper.

PROF WALKER: I would be interested to see it. Academics are always out of touch. The implications of this idea of charging agencies for the use of the capital, let us tease it out.

If you have a water board which has billions of dollars of investment in it, they have revalued the assets upwards to billions and billions of dollars higher than what they were in the books at before, if we are then going to impose a charge for the use of those resources, and according to Tony Harris 24 per cent is not a bad rate if you are in a risky business like the State Bank, the implications of this - you say use the private sector rate in looking at a retention value for a government owned enterprise but let us take 18.7 - is that you can start overlaying on your accrual accounting system a system of transfer payments like Carrick Martin's imputed rent, which will completely change the pricing structure.

I take the view that as a taxpayer for a long time, I have already paid for some of this infrastructure. This is double dipping, charging me Bankcard rates for something I have already contributed to through my taxes. I think it has long term implications which deserve closer attention.

MR CLARKE (Department of Health): One of the issues that has arisen here today, because of complaints about having to report both accrual and cash information to central agencies, is having to do just that, report two sets of information and financial statistics as well. It seems to me that in our accrual or our computerised accrual accounting systems, we should already be capturing receipts and payments, so it seems to me what we should be doing is designing those systems to also provide both ad hoc and routine reports on cash payments for cash receipts, as well as routine and ad hoc information on accrual accounting. Why can't we simply do that to overcome the problem?

MR BARKER: What we are all trying to do is buy off-the-shelf systems which are geared for private sector things, because they are the cheapest. The days of getting people down to write your own accounting systems are long gone. Therefore, every time you go to buy an off-the-shelf system, you have to modify it to meet whatever reporting requirements are imposed upon you.

If you could actually just take it as written, which is the private sector focus, you have got your accrual information there. What I would argue is that Treasury in their budget setting process determines how much consolidated fund support they are going to give in a budget to departments.

There is then the argument about GFS, which comes into it, but we can certainly report back about how we are drawing down that level of ConFund support. There are protected items in there about certain things which we have got to manage and you just can't use that for anything.

Then you have the difference which you get from your user charges and we can monitor that. I guess in terms of cash that is viable, but if agencies are limited to how much they can draw down in consolidated funds support and there is control over how many they manage their protected items, taking the Bonds and Skases of the world and the fact you cannot go out and get bank overdrafts and mortgages, if an agency is in real cash problems, Treasury is going to find out about it pretty quickly when they monitor their level of cash draw down from the consolidated fund.

It is not something agencies can go and do badly - then Treasury is not aware of from their internal monitoring procedures. I don't think we can get into the Skase and Bond scenarios of the world from the inner budget sector perspective.

Now, the GTEs could be a different story and I cannot comment on them. I have a rather simplistic view of how we can do that quite well without all the complications that are presently imposed on us.

MR CLARKE: I take that point but information on cash outflows is essential for effective financial management. That is done in the private sector, with which I also have a relationship, for effective financial management. It is done with slight modifications to off-the-shelf software and I cannot see why that cannot also be done in the public sector to enable cash and accrual information to be reported if internal and external users require that information.

MR BARKER: I guess I don't really know. I take what you are saying, but I think like a lot of our costs have been involved in modifying software. The substantial part of the costs in our IT program have been involved in modifying software. I do not know whether I am understanding correctly what you are saying but I agree. People have to manage their outflows and their revenues. They do that on a cash and accrual basis but it get into the reporting area that becomes a problem.

MR CLARKE: I am not addressing my comments or questions to the Department of Health specifically; I am addressing them generally to the public sector. I take your point though.

MS MELLOR: If I can add just one thing there, I think what you said is right. You can derive cash information but it is not to the detail that is required to meet the classification of GFS. That is the issue. I spent a bit of time this year learning about GFS and the classification system and the level of details which that system requires. It needs a lot of details at the very low level. That is why it is a problem. It is not just cash receipts and cash payments on an overall basis.

MR IRWIN: We move on to the next question then.

MR AARTS (University of Technology, Sydney): Am I naive in thinking that spending all of that money on information technology is beyond the capability of these systems to translate the reports that are required for Treasury, as distinct from the reports that are required for internal management purposes?

MR BARKER: I did not hear the question.

MR HARRIS: I think it is a similar question to Tony's, that the system should be capable of providing ad hoc reports. I suppose what we are hearing is a system is capable of that if you spend enough money on it.

MR AARTS: I must admit I am sitting on the outside of this and listening to the discussion taking place here, and I must admit I am getting a bit confused. I hear of a lot of money being spent on information technology. I hear that the Treasury requires GFS reporting. I hear that internally within the agencies there is a requirement for reporting on a accrual basis. I also hear there is a potential for budgeting proposals on an accrual basis and that there is a variation between the requirements of the internal agency requirements and those of the Treasury.

I would have thought if I were chief executive of an organisation that spent over $40 million on information technology systems, if such a system could not translate for me at the push of a button what the requirements of the internal accrual accounting reporting requirements are from the agency into the GFS requirements, someone needs a very substantial kick in the backside. That's my point.

MR BARKER: I am saying we do that. The problem becomes, when you are the chief executive officer, of our devolved duties, that they get confused with all their different levels of accountability. What we have done in Health is devolve this process right down to the lowest level.

Unlike those other agencies which have managed the accrual program centrally and left their organisations on a cash funded basis, and Ken Dixon said in his speech that Schools has not yet been addressed in terms of the implementation of accrual accounting, in Health we have gone to every level of the organisation. You then are mixing up these different concepts which are very difficult for people to understand.

What we have now tried to do is simply (change) our reporting process in terms of what is going to go to their boards and their chief executive officers and their managers, and try to convince all those in New South Wales Health that they are only funded on an accrual accounting basis. We are going to try to do what Thuy is going to try to do at Treasury, and get the system out of the process of having all these complicating factors involved.

You still have the bigger overview when people are talking about budgets and that type of thing, that there are different levels and different figures people can talk about. With our investment in IT, we have had to do it for a whole range of things, to address some of the things Tony is talking about, to get the real cost of particular procedures. You can state averages, and bench marks and a whole range of things. We have had to put the investment in. We just have not put our investment in so that we can go and produce a general ledger system and write out a few cheques and receipts for money.

We have had to build in a way which could give us a whole lot of management uses as we get our systems further refined.

MR CIEMIEGA (Department of Water Resources): You have received some comments referred to by Mr Harris and Mr Tink. We have heard comments from Treasury, various government departments and the Auditor-General's office on the benefits or otherwise of accrual accounting. I would like to know what are the views of the government, the legislature, on the benefits or otherwise of accrual accounting particularly on the things like disclosure of potentially unfunded liabilities, which come to light in financial statements prepared on an accrual accounting basis.

MR IRWIN: I gather that is addressed to me. I am afraid I cannot answer on the part of the committee, except to say that, essentially, that is what this report is all about. I would hope that, when that report is prepared, it will go a long way towards answering just those questions.

MR PLOWMAN (MP Victoria): Professor Walker, you offered a mild rebuke to the Kennett Government for failing to come up with a report that was comparable with the report issued on the performance of the past State Government. I would have thought that one of the skills of government is to ensure that when you do not want something comparable reported, then you do not introduce it.

I wonder whether I could address this question to the panel, not just to you: will accrual accounting and the sorts of things that Andrew Tink talked about, transparency and so on, in fact make reporting by government to the parliament and to the public more transparent or will it in fact give governments the opportunity to sidestep issues?

PROF WALKER: I think the potential is there to improve accountability of governments to parliament and ultimately to the community, but it very much depends. What we saw with that commission of audit report in Victoria was a report which counted as liabilities all the kinds of off-balance sheets financing schemes that they could identify. Now, if that were done each year and was consistent, I would totally applaud it.

What concerns me, of course, is that a lot of these schemes are actually being devised so that they will not get trapped by accrual accounting because they are outside the accounting stands. I think Tony Harris has already reported his estimate that some of the schemes that what he has identified and found - I understand he has identified 45 schemes and still counting - already might constitute about 10 per cent of the gross State liabilities. If we end up with reports which capture those kinds of things, we will get an improvement in accountability.

I guess the next point is that when we talk about accrual accounting, it is interesting to note that we are not really picking up a total package of financial reporting requirements that we see in the private sector. For example every corporation has to report on directors and executive emoluments and right of party transactions. We are not seeing that. We are not seeing what chief executives get paid in our government trading enterprises.

So having accrual accounting in itself does not necessarily mean that you get transparency. You need a package of other disclosure requirements as well. Indeed, we have some of those in our PF&A Act and I am not sure that they do not need revisiting.

MR HARRIS: There is not much that I need to add to that. I think that New South Wales constituents should be pleased that now they have in the public accounts something that has meaning and clearly the report on the consolidated accounts had very little meaning. The GFS has significantly more meaning than the report on consolidated accounts, so I think Thuy and her staff ought to be pleased that they were able to produce something that the Government could table like that.

It does introduce a degree of complexity that I do not think financial or other journalists have been able to understand yet, but they will, and the community will eventually over time be able to understand it better. So long as Auditor-Generals' in every jurisdiction are able to express their doubts about certain accounting treatments, then that will also help accountability.

MR BARKER: If I could just add a couple of things in response to what Bob was saying. Our annual report for that year makes two notes to the accounts, which deal with our involvement with the private sector: one where we indicate our contractual commitment for the next 20 years and the quantum amount of that; and two, where we give a note on an underwriting liability for another arrangement. That is quite public information and that is part of the audit process.

The annual reports in New South Wales also require for all SES officers from level 5 and above to have their name, their title and the level they are paid at. There is a range of money that they can be paid on; they do not specify the specific amount but at least that is a broad indication of what their package is.

I am not familiar again with the GTE's because they are outside of the budget area. You also have to list information on asset reporting and a whole range other things.

For our annual report this year, we have also identified in our narrative what is costing each member of the community per year to provide as a contribution to health services and we have tried to put some balance sheet type of indications in there so that people are given a different spin on it rather than the pure total payments sort of information, so we have tried to put that cost information there.

In terms of its transparency from a health perspective, the real issues will start to arise when we can start to get our product costing information available. Then you can relate that to health outcomes and health gains when people may wish to debate whether they want to spend 800 million on cardiovascular disease as opposed to 300 million on oncology. In the oncology area, they want to spend so much on those who smoke compared with those who do not smoke and they want to put so much into sun prevention as opposed to some other area.

The other thing that we are also working upon, which comes back to the capital charge issue, is that in a number of health areas - I mentioned our trying to contract the private sector for the provision of public sector services - if you are going to go down a competitive model route where you are making people a budget holder and then they bid to provide those services, you need to have those things built in if the private sector is going to be one of the participating entities who can provide the services.

In Health, taking all the arguments aside as to who should do it and who should not do it, there are private hospitals out there who, in a large number of cases, are doing exactly the same as the public sector. Now, whether they can do it more efficiently or not, who knows? If you are going to try and maximise your use of available moneys, you have to be able to compare that.

We are going through an exercise, which is quite public, with St Vincent's Public Hospital, where it wants to have some form of agreement on how it will be financed in the next umpteen years. And the capital charging issue comes up because if those at St Vincent's want to have a contract for services, they will want to know how they will able to replace their capital stock.

That is something we have not got our minds around in government yet, let alone within Health. They become very important issues of policy if you are in an agency which can get into that. Some agencies will never get into that area. But the bigger you are, the better chance there may be to get involved.

MR IRWIN: Do we have any further questions or comments?

Can I just take this opportunity then to conclude the proceedings unless any members of the panel have any further comments to add. We seem to have engendered considerable discussion and touched on some of the broader issues here that I think have made this seminar today so interesting.

As I said, this has been very informal. We now have not so much a change in plans, but we have confirmed a few earlier plans. We will adjourn at this point and we can reconvene around 4 o'clock for any further comment then.

(Short adjournment).

MR IRWIN: We will wrap up at this point in time. I thank those of you who have stayed to the very end. I particularly thank all of the contributors to today's seminar. For me, at least, and I am sure for many others, this has opened out this area of accrual accounting to horizons quite different to those I arrived with this morning.

On behalf of the Chairman of the Committee, Ian Glachan, and the other members of the Committee, Andrew Humpherson, who is back with us at the moment, I also thank everyone who has participated.

As you might have read from our brochure advertising the seminar, this is part of the inquiry that the Public Accounts Committee is conducting, and the input from our contributors today. The input and the questions that we have had from you, the audience, has been an important part of our inquiry. Much of that, I am sure, will make up the final report of the Committee.

So, on behalf of the Committee, I thank you for your participation in the seminar. I finally thank our transcription service, who have borne with us today, even until the very end. It is greatly appreciated, as I say, because the transcript of today's proceedings is an important part of our inquiry and is an invaluable asset for us.

To wrap up the exercise completely, I for one certainly look forward to the report of the Committee. As you heard earlier, a question was asked, which I think came down to this whole area of political accountability and really what accrual accounting meant for that, and from my perspective anyway in looking at this whole issue, that really is the kernel, looking at how that all relates back to the issue of political accountability.

One again, I thank you for your participation today and, if there are further contributions or if there is anything in this topic or area that you believe can assist the Committee, we would be very pleased to hear from you. Thank you again for your participation.

(At 4pm the seminar concluded)

APPENDIX ONE:

ATTENDEES AT SEMINAR *ACCRUAL ACCOUNTING - RECENT DEVELOPMENTS IN ACCRUAL ACCOUNTING: THE SCORECARD TO DATE*

NAME	COMPANY/TITLE
John Aarts	Director AIMS
Mark Abela	Public Accounts & Estimates Committee Victoria
Fiona Adamson	Office of Financial Management NSW Treasury
Peter Andrews	Director, Financial Services Department of Courts Administration
Michelle Armfield	Audit Manager KPMG Peat Marwick
Paul Atwood	Partner Coopers & Lybrand
Steven Austen	Senior Finance Officer Accounting & Audit Policy QLD Treasury
David Bailey	Financial Manager Department of Mineral Resources
David Balwin	Director - Financial Services Qld Treasury Dept
Sofia Barons	Senior Finance Officer Dept of Conservation and Land Management
Gary Barton	Financial Accountant WRAPS
Mark Bernie	Acting Manager Finance Office of Energy
Michael Berryman	Budget Officer Tourism New South Wales

NAME	COMPANY/TITLE
John Bertacco	Auditor Roads and Traffic Authority
Kay Blance	Deputy Chief Executive Officer Supreme Court of NSW
Brian Blood	Partner Arthur Andersen
David Blythe	Manager Finance Administration Royal Australian Navy
Phillip Bradley	Chairman NSW Crime Commission
Colin Broad	Assistant Director - Finance Department of Consumer Affairs
James Brophy	Brophy Management Services
Paul Bull	Partner Pannell Kerr Forster
Craig Burke	Director of Research Public Accounts & Estimates Committee Victoria
John Burns	Manager Felser Russell
John Carter	Senior Parliamentary Officer House of Representatives Parliament House Canberra
John Cassar	Corporate Financial Analyst NSW Department of Water Resources
Michael Cassidy	Sub Accountant Department of Courts Administration
Ross Catterall	Partner Bentleys
Gregory Chan	Accountant Casino Control Authority
John Chan-Sew	Office of Financial Management NSW Treasury
Lyn Chang	Manager - Finance NSW Adult Migrant English Service

NAME	COMPANY/TITLE
Siggy Ciemiega	Senior Internal Auditor Corporate Development & Audit Department of Water Resources
Faye Cierpiatka	Asset Accountant National Parks & Wildlife Service
Locke Claire	Manager Pannell Kerr Forster
Anthony Clarke	Director, Audit NSW Department of Health
Greig Cohen	Manager Finance & Personnel Land Information Centre Department of CALM
Les Coulcher	Acting Director Finance Ministry of Education and Youth Affairs
Phil Crossley	Director - Financial Services Department of Corrective Services
John Curtis	KPMG Peat Marwick
Barry Daley	Manager Financial Services Campbelltown City Council
Col Davis	Assistant General Manager Building Services Corporation
Peter De Silva	Financial Controller Building Services Corporation
Adrian Delany	Ministry for the Arts
Anthony Deane	Planning Officer NSW Department of Health
Colin Donohue	Manager Land Titles Office
Terry Dooley	Manager, Financial Services Chief Secretary's Department
Vincent Dossan	Internal Auditor RTA
Lance Favelle	Corporate Financial Controller
Garry Fenlon MLA	Queensland Public Accounts Committee

NAME	COMPANY/TITLE
Steve Fisher	Manager Finance & Administration Office of Real Estate Services
Michael Gaffikin	Professor & Head of Department of Accountancy University of Wollongong
Vicki Goacher	Accountant Taronga Zoo
Neville Goldspring	Assistant Director Dept of Sport Recreation & Racing
Graham Goodman	Internal Audit Manager North West Health Service
John Grady	Business & Regional Development
Garry Greedy	Valuer-General's Office
John Gregor	Finance Manager Royal Botanic Gardens & Domain Trust
Graham Hall	Principal Analyst, Resource Planning Ministry for Police and Emergency Services
David Halpin	Manager Finance & Investment HPAA
Noel Hancock	Manager Corporate Financial & Field Accounting Roads & Traffic Authority
Peter Haneman	Senior Budget Officer Department of Mineral Resources
Greg Harper	Assistant under Treasurer ACT Treasury
Roger Harris	Director, Performance Evaluation Commonwealth Department of Administrative Services
Ronda Hawkins	Finance Manager Supreme Court of NSW
James Henderson	Senior Lecturer, Accounting Australian Catholic University
Rex Hollier	Senior Officer ACT Treasury

NAME	COMPANY/TITLE
Amanda Holloway	Partner Pannell Kerr Forster
Robert Holmes	Principal Auditor Comprehensive Audit Section NSW Police Service
May Jacobson	Manager Training & Development QLD Treasury
Brad James	Sub Accountant Department of Courts Administration
David Johnstone	Professor Department of Accountancy University of Wollongong
Trish Kernahan	Accountant Ministry for the Arts
Michael Kersch	Partner Felser Russell
Brian Kimball	Senior Manager Ernst & Young
Ken Krezel	Audit Manager Internal Audit Branch NSW Public Works
Andrew Kuti	Manager, Management Accounting NSW Fire Brigades
Rod Lloyd	Financial Manager State Library of NSW
Greg Logan	Head, Financial Planning and Operations Ministry of Education and Youth Affairs
Ray Lovat	Accounts Manager Attorney General's Dept
David Mackie	Senior Auditor Internal Audit Office University of NSW
David Magann	Treasury Accountant Lake Macquarie City Council
Harry Mantzouratos	KPMG Peat Marwick
Elizabeth Marwick	Manager, Administration Coal Compensation Board

NAME	COMPANY/TITLE
Jill McKinnon	Associate Professor in Accounting Macquarie University
Ivan Medin	Manager - Corporate Services Supreme Court of NSW
Frank Micallef	Australian Accounting Research Foundation Senior Project Director
Dianne Minnis	Regional Manager Purchasing Development Centre Department of Admin Services
Phillip Mison	Asst Manager Financial Services Kiama Municipal Council
Jim Mitchell	Deputy Auditor-General Audit Office of NSW
Richard Moore	Coopers & Lybrand Partner
Ian Morrison	Assistant Accountant NSW Fisheries
Carolyn Moss	Finance Accountant Lake Macquarie City Council
Stephen Mudge	Financial Controller Corporate Finance NSW Public Works
Peter Muir	Regional Manager Commonwealth Department of Finance
Geoff Newton	Performance Audit Manager Audit Office of NSW
Minh Nguyen	NSW Treasury Office of Financial Management
Elizabeth Ogle	Accountant/Financial Controller Office of the Director of Public Prosecutions
Frank Orton	Finance Manager Department of Community Service
Tony Pang	Director - Audit Internal Audit Branch NSW Public Works

NAME	COMPANY/TITLE
Norm Parkwood	Division of Applied Physics CSIRO
Mark Pellowe	Office of Financial Management NSW Treasury
Tony Plowman, MP	Public Accounts & Estimates Committee Victoria
France Perrine	Senior Financer Officer Historic Houses Trust
Les Quinnell	Office of State Administration Premier's Department Assistant Director General (O.S.A)
Stefan Raicu	Manager - Finance Department of Housing
Paul Ranby	Performance Evaluator Commonwealth Department of Administrative Services
Michael Rankin	Manager Financial Services Kiama Municipal Council
Peter Ray	Assistant Director Accounting & Budgets Division Premier's Department
Wayne Rosen	Financial Controller Hornsby Council
Brian Rothery	Manager - Equity & Strategic Programs Department of School Education
Lothar Sadlo	A/AGM Budget & Procedures ATSIC
Noni Saillard	Principal NA Saillard FCPA
Peter Scarlett	Manager Corporate Finance NSW Public Works
Bruno Scarfo	Financial Controller NSW Lotteries
Merilyn Schilg	Senior Officer ACT Treasury

NAME	COMPANY/TITLE
David Seaman	Manager Bentleys
Michael Sewell	Deputy Manager Financial Services Campbelltown City Council
John Shanahan	Partner Deloitte Touche Tohmatsu
David Sinclair	Audit Manager Bracey Davidson & Co
Paul Slater	Deputy Principal (Financial Services) University of Sydney
Karen Smith	Journalist Australian Financial Press
Daryl Smith	Business Analyst State Rail Authority
Neville Smith	Assistant under Treasury WA Treasury
Alan Stead	Management Analyst/Auditor Corporate Development & Audit Department of Water Resources
Alan St Flour	Associate Director Financial Management & Planning Department of Health
Michael Stubbs	Acting Assistant Manager Finance State Emergency Service
Thaassim Tass	Director MGlobal Professional Services
Wilfred Tarvey	Accountant Department of Planning
Paul Thompson	Manager - Finance NSW Rural Assistance Authority
Frank Thomson	Budget Controller Dept of Courts Administration
Stephen Topple	Senior Lecturer, Accounting University of Technology, Sydney

NAME	COMPANY/TITLE
Ken Trotman	Professor and Head of School - School of Accounting The University of NSW
Alison Turnbull	Financial Accountant Office of the Ombudsman
Helen Ware	Assistant Director Finance & Technology Department of School Education
Bill Warne	Director, Corporate Services Albury City Council
Adrian Whiting	Principal Pannell Kerr Forster
Michael Whitley	Administration Manager University of NSW
Adrian Williams	Operations and Controls State Forest of NSW
Robert Williams	NSW Treasury Office of Financial Management
Terry Willison	Senior Management Auditor Premier's Department
Kerrie Wilson	Senior Financial Systems Auditor University of Sydney
Terry Woodcock	O.I.C. Ledgers NSW Dept of School Education
Nick Woolford	Senior Auditor Water Board

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