

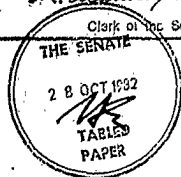
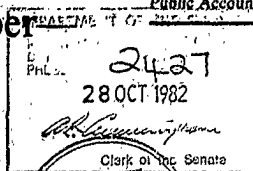


**The Form and Standard
of Financial Statements
for Commonwealth
Undertakings
—A Discussion Paper**

Report

199

Joint Committee of
Public Accounts



THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

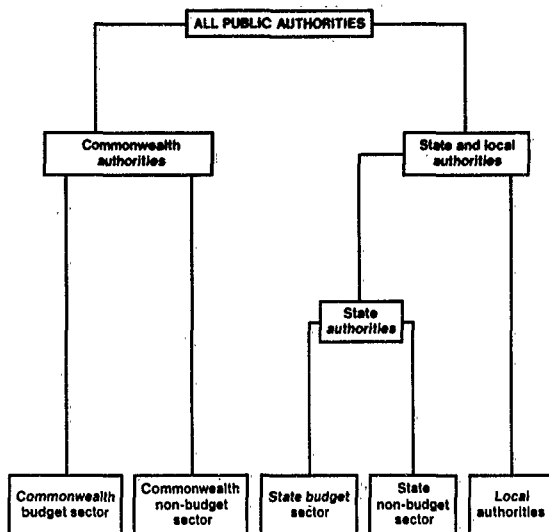
JOINT COMMITTEE OF PUBLIC ACCOUNTS

199TH REPORT

THE FORM AND STANDARD OF FINANCIAL
STATEMENTS OF COMMONWEALTH UNDERTAKINGS
A DISCUSSION PAPER

Australian Government Publishing Service
CANBERRA 1982

The Australian public sector linkage



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CANBERRA

JOINT COMMITTEE OF PUBLIC ACCOUNTS

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DUTIES OF THE COMMITTEE

Section 8.(1) of the Public Accounts Committee Act 1951 reads as follows:

8.(1) Subject to sub-section (2), the duties of the Committee are:

- (a) to examine the accounts of the receipts and expenditure of the Commonwealth including the financial statements transmitted to the Auditor-General under sub-section (4) of section 50 of the Audit Act 1901;
- (aa) to examine the financial affairs of authorities of the Commonwealth to which this Act applies and of intergovernmental bodies to which this Act applies;
- (ab) to examine all reports of the Auditor-General (including reports of the results of efficiency audits) copies of which have been laid before the Houses of the Parliament;
- (b) to report to both Houses of the Parliament, with such comment as it thinks fit, any items or matters in those accounts, statements and reports, or any circumstances connected with them, to which the Committee is of the opinion that the attention of the Parliament should be directed;
- (c) to report to both Houses of the Parliament any alteration which the Committee thinks desirable in the form of the public accounts or in the method of keeping them, or in the mode of receipt, control, issue or payment of public moneys; and
- (d) to inquire into any question in connexion with the public accounts which is referred to it by either House of the Parliament, and to report to that House upon that question,

and include such other duties as are assigned to the Committee by Joint Standing Orders approved by both Houses of the Parliament.

PREFACE

The Joint Parliamentary Committee of Public Accounts has over the last two years been increasingly involved in promoting improvement in the form and quality of financial disclosures by Commonwealth agencies. Members of this Committee have addressed the issue in Parliament and at many seminars held by interested groups, particularly the professional accounting bodies.

The enthusiasm shown by all sections of the accounting community - Commonwealth, State and Local Governments and the private sector - to participate in these discussions has impressed the Committee. We are conscious that a strong effort from all professional accounting interests is required if substantial progress is to be made in improving financial reporting in the public sector. However, there are special features and problems associated with public sector accounting which need to be drawn to the attention of those involved with the formation of standards.

The Committee believes that, because of the emphasis from some quarters on the adoption of private sector accounting standards by government statutory authorities, a discussion paper which contrasts the environments of public sector and private sector reporting is useful at this time. In evaluating the standard setting process in the private sector the Committee is concerned only with its relevance to the public sector. It makes no judgements on the adequacy of the process or standards for the private sector itself.

In the longer term it may be possible to draw a closer link between private sector and public sector reporting. In the meantime, the Committee observes that differences, including the noticeable tendency of the community to identify operations of statutory bodies with the appropriate Minister rather than with management, are becoming more pronounced. If the control of these bodies is seen as a function of the Westminster system of government then accounting principles based on the separation of ownership and control may need modification. A distinct and rigorous philosophy of accounting in the public sector may need to be formulated.

This discussion paper provides an appreciation of significant issues in public sector reporting. In its preparation the Committee's aims were to:

- to open discussion on important questions concerning the development of accounting standards for public sector bodies;

- to review current literature from local and overseas sources which might be relevant for the above purpose;
- to present recommendations and conclusions of the Committee which reflect the Committee's experience in evaluating situations in public accountability; and
- to encourage research into difficult areas which at present are subject to inadequate knowledge, and the uncertainty in relation to the adoption of traditional accounting procedures.

If these aims are met then the standard of financial information and reporting in the public sector will improve significantly. The Committee would welcome further contributions or comments from interested individuals or organisations on any aspect of this discussion paper.

The Committee wishes to express its appreciation to its senior advisor on accounting Dr M.E. Aiken, and also to thank Mr D.A. Shand, Dr I.D. Ball and many others for their considerable assistance and advice in the preparation of this paper. The Committee also wishes to place on record its appreciation for the work of the Sectional Committee under the Chairmanship of Senator J.O.W. Watson. Other members of the Sectional Committee responsible for the preparation of this paper were Senator G. Georges, Mr J.M. Bradfield and Mr D.M. Connolly, MP.

For and on behalf of the Committee,

David M. Connolly, MP
Chairman

M.J. Talberg
Secretary
Public Accounts Committee
Parliament House
CANBERRA ACT 2600
16 September 1982

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THE FORM AND STANDARD OF FINANCIAL STATEMENTS OF COMMONWEALTH AUTHORITIES - A DISCUSSION PAPER

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LIST OF RECOMMENDATIONS

The Committee recommends that:

1. A genuine research effort should be mounted employing resources from both within the accounting profession and outside of it, to systematically construct a relevant theoretical framework for financial reporting by public sector authorities. Such an approach should involve:
 - (a) determining user needs;
 - (b) an examination of the concept of certainty in relation to the needs for budgetary disclosure and commitment accounting in the public sector;
 - (c) discussion between private and public sector accountants on the strengths and weaknesses of conventional financial reporting to identify the likely economic consequences and effects on consumers of the adoption of various financial accountability measurement systems. (para 2.41)
2. Any adoption of private sector accounting standards should be seen as a short term solution. (para 2.41)
3. The process of standard setting in the public sector should be cognisant of the following features of financial accountability:
 - a) legal, contractual and fiduciary constraints;
 - b) budgeting and prediction for resources allocation and control in authorities and programs;
 - c) determination of full costs of services and programs and formulation of efficiency criteria for performance evaluation;
 - d) equitable calculation of the burden of financing resources for governmental operations; and
 - e) the relevance of concepts of capital to be maintained under full costs calculations and 'user to pay' policies. (para 3.32)
4. Reports on efficiency and effectiveness should be published and, where criteria are available, be audited. (para 3.32)
5. Financial Reports of government authorities should reveal:
 - a) resources available to the authority;
 - b) obligations;

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- c) changes in resources and obligations;
 - d) resource flows;
 - e) liquidity;
 - f) budget forecasts of operations; and
 - g) commitments and contractual arrangements. (para 4.60)
6. Cash based accounting should be eliminated as the primary focus for financial reporting by authorities except for extremely small agency situations and accrual accounting should be adopted. (para 4.60)
 7. For non-business undertakings, to avoid unfairness to management but to also show full costs relating to the organisation, a modified form of the activity statement proposed by the Joint Working Party should be developed, distinguishing between those items which are controllable by management and those which are not. Complementary full accrual financial statements for the responsible department would also show those costs relating to the undertaking for which the department assumes responsibility. (para 4.60)
 8. The validity of the concept of depreciation to government owned infrastructures should be carefully considered in relation to both government policies for cost determination and aversion and the economic and physical nature of the resources. (para 4.60)
 9. Funds Statements of Commonwealth authorities are to adopt a total resources rather than working capital or cash basis of funds and are to be published as part of the formal financial statements. The proposed Statement of Accounting Standards - Statement of Sources and Application of Funds should be adopted by all governmental business institutions. (para 4.60)
 10. The Statements of Activity suggested by the Joint Working Party for agencies with less than full autonomy and management accountability in the commercial sense should be evaluated for early implementation in place of cash based financial reporting. (para 5.31)
 11. The Joint Working Party should join with accounting and other interested groups to further evaluate the nature of financial reporting by public sector bodies. Government financial support at Commonwealth and State levels should be sought by a suitably organised proposal from the accounting profession. (para 5.31)

12. Measurement of the investment base on which a fair rate of return is expected should be a major objective of research in public sector accounting under the 'user to pay' philosophy. (para 6.38)
13. The presentation of unit costs of different goods and services into a multiple period comparative statement should be an integral feature of all financial reporting requirements for governmental bodies. Such reported information should be subject to audit. (para 6.38)
14. Budgeted and actual performance should be shown where possible in published financial reports of governmental authorities. (para 6.38)
15. Where problems exist in determining evaluation criteria the matter should be addressed in the organisation's Annual Report. (para 6.38)
16. Annual Reports should provide non financial information about key performance indicators and adequate explanations of what these predict for the future operations of the authority. (para 6.38)
17. Program statements should be prepared by all Government undertakings except where such a statement would disclose necessarily confidential information. (para 6.38)
18. Commitment accounting should be implemented with respect to
 - (a) large scale contracts in respect of operations, and related revenues, and
 - (b) capital expenditure control. (para 6.38)
19. The audited financial statements of all government organisations should be presented to Parliament within six months of the close of the financial year to which they relate. (para 7.25)
20. An Accounting Standards Review Committee should be established to examine government accounting and reporting standards, and to make recommendations for improvement. This Committee should consist of representatives from the Parliament, the Public Service and the Accounting Profession. (para 7.25)
21. Federal and State Governments should provide financial support for necessary research to develop a comprehensive set of accounting standards for the public sector. (para 7.25)

22. Discussions should be held between relevant Commonwealth and State government ministers and officials on the desirability of introducing a uniform set of accounting standards and procedures for public sector authorities at all levels of government throughout Australia. An appropriate mechanism for this issue to be considered would be for a working party to be established by the Premiers Conference. (para 7.25)
23. The use of donated and other 'free' assets by public bodies should be brought to account in the financial statements at a realistic valuation. An inventory of items of national importance owned by departments or authorities should also be included in annual reports. (para 7.25)

CHAPTER ONE

INTRODUCTION

A brief evaluation of financial accountability in the public sector; some unique features of government organisations which may affect the desired form and content of their financial statements; an outline of the background to this discussion paper.

1.1 The role of financial reporting in the public sector has become the subject of increased awareness by the community and the Parliament, especially over the past few years. One reason has been the growing sophistication, complexity and size of governmental activities, functions and operations. This has led to a greater devolution of powers and responsibilities, and therefore more autonomy, for public officials and statutory commissioners and managers.

1.2 Such a transfer of duties and tasks does not lessen the responsibility of governments and parliamentarians nor interfere with their established roles of safeguarding and promoting the interests of the electorate and society as a whole.

1.3 Statutory authorities do not follow the general rules of ministerial departments where the Minister is responsible for the conduct of public administration by his department. However, both statutory authorities and ministerial departments are forms of executive power and, as such, both are accountable to Parliament for their activities. In respect of statutory organisations the Parliament has exerted its authority through the Committee system, particularly by the Reports of the Senate Standing Committee on Finance and Government Operations.

1.4 The creation of statutory authorities by Parliament occurred because of the desire to free certain public activities from the everyday political pressures of ordinary departments. Parliament has intended that this freedom should remain granted only if certain responsibilities are met. Chief among them is the expectation that statutory authorities should inform Parliament of their operating conditions and performance. Parliament has been urged to define carefully what it means when it invokes the words 'accountability' and 'responsibility' in relation to statutory authorities. The Committee considers that this discussion paper gives a concrete demonstration of Parliament's intentions and shows the type of information required.

1.5 Parliament has a duty to oversee the general operation of all forms of executive power. Among the control

mechanisms available to Parliament in relation to statutory authorities is the ability to direct the form in which accounts are kept. The Public Accounts Committee, in Section 8(1) of its Act, is charged with the specific responsibility to report to the Parliament on the form of the Public Accounts. The ultimate mechanism available to Parliament is use of its legislative powers to amend or even abolish the functions of an authority. The general principle is that Parliament must remain well informed about the functions and performance of all of its executive agencies. If Parliament is prevented from obtaining full and accurate information, its ability to review the use of executive power is greatly impaired and Parliament's own duty to represent the interests of the whole society may be undermined.

1.6 The Public Accounts Committee is also mindful of its charter under the Act which requires the informed examination and relevant reporting of matters connected with the financial and operating activities of departments and authorities. Effective execution of this task can be greatly assisted by financial reporting which comprehensively portrays activities and performance and which is also timely, meaningful and reliable.

1.7 It is stressed at this early stage in the discussion that few governmental operations are autonomous to the extent that applies in many private sector organisations. That is, private sector firms face direct competition for their services and their Board of Directors are not subject to direction by outsiders equivalent to a Minister. This is not the situation for even large scale authorities. However, where a public sector commercial operation faces competition for its services there is a case that can be made for it to be treated similarly to a public company and the remarks made in this paper should be modified accordingly.

1.8 Despite the existence of the reserve powers of Ministers provided in enabling legislation, the link between management and ministerial authority is often rather tenuous. Certainly it is much weaker than the relation between departments and their Ministers which is a fundamental plank of the Westminster system of government.

1.9 These statutory authorities are subject to scrutiny through financial and auditing provisions of appropriate legislation including the efficiency auditing provisions of the Audit Act 1901. Such controls enable the Joint Parliamentary Committee of Public Accounts and other interested parliamentarians to examine various financial and technological aspects of an authority's performance. However, given the existence of more than 300 Commonwealth authorities and the diverse range of services which they provide, it is clear that the Parliamentary resources for their evaluation are at present under considerable pressure. Thus the adequacy

and comprehensiveness of public reporting by the bodies themselves are matters of prime importance to the community which often provides funds for their operations through taxation or charges and levies for their services.

1.10 The medium for the communication of the results of performance is generally an annual report containing financial statements for the year. For most authorities this Report will also include a statement by the management which explains the financial statements and material achievements and problems which have affected them during the year. In line with accepted modern techniques of business this statement by management often emphasises key non-financial and industry performance criteria. These can assist in judging the present state of performance and in assessing the potential of the organisation to provide needed goods and services in an efficient manner. This information when linked to financial estimates and historical and current data, should enable costs of operations to be determined and the relevance and future viability of the authority to be assessed.

1.11 This Report stresses the importance of adequate financial statements prepared by statutory authorities in terms of uniformity, consistency, quality, timeliness and usefulness. The Report will also address the need for complementary information of a policy or technical nature to be included with the financial statements.

1.12 Widespread and intensive use by organisations of an annual report rather than simply the publication of financial statements, indicates that a concept of total information provision is now accepted as the standard instrument of performance communication. The role of the Australian Institute of Management's Annual Report Awards Scheme for both the public and private sectors is acknowledged to have been influential in generating a greater awareness of the need for excellence in organisational reporting to the public.

1.13 The annual reports and financial statements of many statutory and other authorities in both federal and state government sectors have been subjected to criticism regarding the adequacy of the information provided and its relevance to users. The absence of standards governing such reports has led to a lack of comparability between the financial statements of different public sector organisations. The following list illustrates some of the criticisms which have been made by various writers and users of public sector financial statements. These cover some but by no means all of the problems addressed in this Report.

Financial Aspects

- use of only cash flow accounting by some organisations, meaning that no information on cost of

operations is disclosed and no statement of assets and liabilities is presented;

- no breakdown of costs or revenues on a functional, program or activity basis;
- non-standard treatment of some accounting issues not covered by Australian Accountings Standards such as liability for long service leave;
- no explanatory notes on the accounting principles observed in preparing the statements and no indication of the extent to which Australian Accounting Standards have been observed, coupled in some cases with non-observance of the standards by business undertakings;
- the disclosure in the balance sheets of many separate "funds" with no indication of their purpose or what restrictions they represent on the use of assets, e.g. are they committed or available funds?
- lack of information on financial commitments;
- no statement of source and application of funds indicating changes in the financial structure of the organisation and policies on financing capital assets, debt redemption, etc;
- a confusing "capital" section of the balance sheet under which the nature of past long term financing of the organisation is not clearly disclosed.

Other Aspects

- lack of information on objectives of the organisation and the extent of their achievement (effectiveness); and
- lack of information to judge the efficiency of operations of the organisation.

1.14 However the issues go much deeper than these to include detailed questions of measurement and disclosure which could involve a substantial departure from the traditional private sector accounting model as discussed later.

1.15 In an attempt to improve financial statements by establishing a set of standards or guidelines a Joint Working Party, of officials from the Commonwealth Department of Finance and the Auditor-General's Office, was established. In June 1980 the Joint Working Party issued for public discussion and comment an abridged report and exposure draft on proposed

guidelines for the form and standard of financial statements of Commonwealth undertakings.

1.16 The Joint Working Party designed these guidelines to provide a viable set of practical standards for use by auditors and ministerial advisors in their routine examination of government undertakings. The guidelines are structured on a two tiered approach, which proposes the establishment of a general quality standard governing information disclosure and form for all organisations, as well as defining input and processing standards for specific agency categories. A copy of the Joint Working Party's Report and exposure draft is at Appendix A.

1.17 There is a pressing need for the development of public sector accounting measurement and reporting standards to provide uniformity, consistency and relevance in the presentation of financial data about organisational performance. The Public Accounts Committee believes that the development of standards should involve an explicit consideration of the needs of users of financial statements such as Parliament, taxpayers, recipients, grantors and employees, rather than concentrating solely on the modification of private sector accounting standards. The Committee considers a fundamental principle should be that accounting standards should be tailored to user needs, and is concerned that there has been a paucity of research into the actual requirements of the users of government financial statements in Australia. Consequently research should be undertaken as a matter of urgency.

Particular Features of Public Sector Organisations

1.18 The following features may affect user needs and thus the desired form and content of financial statements of public sector organisations.

1. Public sector instrumentalities are financed largely by public moneys rather than by voluntary subscriptions of capital. In a situation where the user pays for the services provided by the public sector authority, there is a prima facie case that such capital advances made to the organisation should be maintained in real terms and that current interest rates be charged to cover opportunities foregone by government.
2. Large private sector corporations have qualities of autonomy over and above separate legal status which indicate that they are entities in their own right. Statutory authorities, because of reserve powers of Ministers provided in enabling legislation are to a substantial extent agencies of government which means that different concepts of financial accountability

might reasonably be applied in accounting measurement and reporting processes. In the private sector similar problems are associated with reporting for subsidiary companies.

3. The use of private sector cost definitions geared to operations in competitive markets may in a government monopoly situation lead to economically undesirable pricing and output decisions in government business instrumentalities. Moreover, their relevance is doubtful in non-business instrumentalities.
4. The need for information to be withheld from competitors is a feature of the private sector world of commerce. Some care is required to observe constraints on information provision in the public sector. However, the Committee envisages this sanction to have a reasonably limited application for public authorities. Therefore, key performance indicators, budget information and accounting for large scale commitments, which are not disclosed in private sector reports, might be introduced into the reporting framework for public sector bodies.

1.19 In illustrating possible differences which might occur between accounting models for the private and public sectors it is convenient to turn to measurement of the full cost of operations. This is an important issue which has been causing concern to parliamentarians, public officials and the managers of statutory organisations. In the private sector, measurement of full costs is associated with a matching process, whereby costs are matched to the revenues for the period. When these costs are covered by revenues, then capital has been maintained in either nominal terms (historic cost accounting) or in terms of financial capacity to replace capital assets in market places (current cost accounting) as they wear out or become obsolete. After capital has been maintained surplus revenues are profits available for dividends or other purposes of the organisation.

1.20 This general framework is applicable to the public sector, especially when additional criteria necessary for efficiency measurement in the public sector are taken into account. However special problems arise in the public sector environment. The depreciation concept seems to be adaptable to the public sector where capital assets are of a kind which can be bought and sold in the market, but less clear for those

capital assets which cannot be. Situations arise where large governmental agencies construct networks or infrastructures for the delivery of services. These are often maintained indefinitely, or at least for long periods of time. It may be argued that private sector concepts of asset valuation such as selling price or replacement cost have little relevance to large public sector infrastructure assets such as dams or pipes in the ground.

1.21 The Committee wishes to point out that other methods are available for determining full costs. For example the maintenance in real terms of advances from government to build capital infrastructure and the payment of current interest rates on the adjusted amounts covers the full cost of funding such ventures. This seems to be a more appropriate method of calculating full cost than depreciating long term assets on the basis of their original cost or a more recent management valuation of the infrastructure. Under a 'user to pay' ruling, pricing to consumers would need to cover interest payments together with obligations to repay government loans and advances over a reasonable period of time. This is further discussed in Chapter 4.

Conclusion

1.22 This Committee believes that the Joint Working Party's Report is an appropriate starting point for the development of improved accounting standards for Commonwealth undertakings. However further research into accounting standards in both the public and the private sectors is necessary, before the financial statements of organisations will fully satisfy user requirements.

1 These costs include a charge for depreciation or wear and tear and obsolescence related to the capital assets being used in operations.

CHAPTER TWO

PROBLEMS OF THE PRIVATE SECTOR FINANCIAL REPORTING MODEL

An examination is undertaken of the standard setting process in the private sector and of inadequacies of the traditional financial reporting framework. A preliminary examination of the cash versus accrual accounting debate is made. The undesirability of linking policy and theory to produce an acceptable policy result rather than a portrayal of relevant economic facts is analysed. The overemphasis on certainty rather than relevance of financial information in setting these standards in the private sector is discussed. A conclusion is reached that private sector standards, while having a necessary role in the development of public sector accounting standards are not in themselves a sound and complete basis for the construction of public sector financial reporting standards. A major research effort is required to establish a relevant framework for financial reporting by public sector authorities.

Accounting Standards and Financial Disclosure

2.1 For many years it has been an article of faith held by accounting practitioners and their representative bodies around the world that excellence in external reporting of financial information is inextricably tied to the development of effective pronouncements and standards issued by those bodies.

2.2 In undertaking the task of examining the need for promotion of adequate standards of financial disclosure by public sector institutions, this Report examines both the strengths and weaknesses of the standards setting process in the private sector. It also identifies points of deviation which may affect the transition of private sector concepts and procedures to the public sector.

2.3 The Committee feels that such an examination is justified because there is evidence to indicate that reservations relating to the adoption of private sector standards in Government Authorities are not held by accountants in private practice. The Committee realises that it is taking a somewhat controversial stand at least as far as private sector firms would view it, in querying the applicability of all Australian Accounting Standards to the public sector. However it has reached this view after careful consideration and trusts that its arguments will be closely examined.

2.4 Arguments about the adoption of private sector standards in the public sector usually centre on the relevance of accrual accounting, modified accrual accounting or cash receipts and payments as the preferred basis for financial reporting and measurement in public enterprises. These terms can be defined as:

Accrual basis of Accounting - The method of accounting whereby revenues and expenses are identified within specific periods of time, such as a month or year, and are recorded as incurred along with acquired assets, without regard to the date of receipts or payment of cash.

Accrual depreciation - The total depreciation suffered by an asset or asset group, based on rates fairly determined, or estimates of useful life. This is now generally referred to as accumulated depreciation.

To illustrate this common point of view G.G. Macmillan states:

Accrual accounting is the generally accepted basis of accounting. Unless adopted, the true cost of providing goods and services or of capital expenditures for the reporting period will not be shown. Difficulties in getting accrual accounting adopted universally are implementation problems, not matters of principle.¹

2.5 It has become apparent to the Committee since the release of the Joint Working Party's Exposure Draft on Financial Statements of Commonwealth Undertakings, and the subsequent tightening of the approval of the Minister for Finance for cash based financial statements, that matters of principle are involved. While the exposure draft stresses the need for accrual accounting, some comments are in order.

2.6 Firstly, the concept of accrual accounting is already widely adopted by the large trading entities of the Commonwealth and disclosure by these authorities, while not meeting this Committee's ideal for effective financial reporting, are certainly more detailed and effective than the minimum required under companies legislation and private sector accounting standards.

2.7 Secondly, governments have historically operated on an annual cash basis because this is fundamental to democratic constitutional safeguards which have been evolving since the days of King Charles I in England. The basic safeguard is

1. G.G. Macmillan, 'So What's Different About Government Accounting', The Australian Accountant, August 1981, page 461.

that no monies shall be collected or spent except in ways and amounts approved by the Parliament through Budget appropriations. Thus, protestations against the use of accrual accounting for determining the wealth and increase in wealth for a period have been a reaction to the inconsistency of accrual accounting with this doctrine. From an information provision viewpoint this inconsistency does not exist, as accrual statements can be prepared in conjunction with the cash based system and thus satisfy a greater range of user needs.

2.8 Additionally, Table 6 in Budget Paper No. 10 clearly indicates linkages between statutory authorities and the cash-based finance system for parliamentary management and control of the economy.² Thus there is no requirement to show this information in cash based financial statements by statutory authorities.

2.9 However full accrual accounting, by showing depreciation expenses in the income statement and the fixed assets in the balance sheet or statement of financial position, may imply managerial control over these items when such control in fact does not exist. Management may have no authority over the composition and amount of assets or even their ultimate replacement. Such statements may be unfair to management and thus misleading where responsibility and accountability for the full costs of operations have not been transferred from parent departments.

2.10 Full accrual accounting may also involve rather arbitrary or subjective asset valuation or cost allocation procedures. In certain situations therefore full accrual accounting may be seen to violate a requirement of absolute certainty with respect to the control of public monies or assets.

2.11 It is evident to this Committee that the application of a general system of accrual accounting to public authority reporting is desirable. However the extent of accrual accounting in particular situations may need to be related to the authority devolving from government or the level of control exercised over particular costs and assets. This is further discussed in Chapter 4.

2.12 Unsophisticated or irrelevant accounting techniques have the capacity to cause subsidisation or taxation of consumers of the services of statutory authorities through inappropriate accounting based pricing and expenditure determination. As this subsidisation or taxation may lead to transfers between the budget and non budget sub-sectors, the

2 Australia Parliament, Budget Paper No. 10 1980/81, The National Accounting Estimates of Receipts and Outlays of Commonwealth Government Authorities, Table 6 - 'Consolidation of Commonwealth Government Budget and Non-Budget Sub-sectors', AGPS 1980, Parliamentary Paper No. 147/81.

accounting techniques can materially influence government economic strategy. This is the primary reason why claims for preparation of financial statements based on private sector concepts of the full cost of operations should be carefully evaluated.

2.13 Other assertions made by the private sector that its accounting standards should be fully applied in the public sector have been based on the view that financial statements of both public and private sector undertakings should meet user needs, be prepared on a consistent basis, etc. While these basic principles underlying financial statements may be the same, it does not follow that the desired accounting standards would be the same, if, for example, different user needs are identified for public sector financial statements.

2.14 Ideally there must be full disclosure within the constraints of cost effectiveness of information and its relevance to community needs. If the need for commercial restraints on the provision of information which apply in the private sector are apparent for an authority, then there is a prima facie case for reorganisation of the authority on a public company basis. This is a policy decision for Government. In the vast majority of cases authorities are either large monopolistic trading, research or educational institutions supported by government guarantees, or are specific industry or service functions whose competition, if it exists at all, may be in some indirect form of alternative service.

2.15 These observations are not intended to create doubts about the need to determine full relevant costs of operations. They are a convenient lead to a discussion of the possible utility of private sector standard setting processes in government.

Accounting Standard Setting in The Private Sector - An Outline

2.16 The private sector environment places limitations on full accounting disclosure through the need to restrict privileged information for competitive reasons. The following matters are also relevant: the extent to which disclosure is specified by statute; perspectives of disclosure held by private sector associations including the professional accounting bodies; the Association of Australian Stock Exchanges and The Institute of Directors; and the reality that capital is voluntarily subscribed rather than appropriated by taxation.

2.17 Given these factors the accounting profession when formulating standards should be encouraged to expand upon legal requirements for disclosure. Mr John Coleman, Deputy Chairman of the National Companies and Securities Commission (NCSC), has recently commented on the efforts of the profession:-

Whatever developments occur in company reporting requirements, the Commission's concern is that the development of accounting standards should proceed in a vigorous and systematic manner and will be continuous. Impressive work has already been completed by the Australian accounting profession - probably more, and at greater cost to the profession, than the business community as a whole realizes. There is much further work to be completed - standards for funds statements, joint venture reporting, investments and industrial property rights are examples at random. The difficulty of forming a conceptual framework for such standards has been amply demonstrated in the United Kingdom. The Commission is anxious that this should not be the Australian experience too.

2.18 The Committee is also anxious that an adequate conceptual framework for the standard setting process in the public sector be developed at an early date. However, this requires research at a higher level than refinement of existing standards and gap filling. The recently published treatise on the objectives and basic concepts of accounting by Professor A.D. Barton should be carefully studied. However, the difficulties which surround higher level research on the purposes and structure of financial reporting need to be considered. Perhaps the greatest difficulty is the attitudes of businessmen in the private sector who prefer a pragmatic and flexible rather than a conceptual approach to accounting standards development. This approach is illustrated by the following statement by Mr Terry McCrann, Business Editor, The Age:

Accountants should temper their desire to be aggressive pioneers (the rush to current cost accounting did neither the profession nor relations with companies much good) and instead promote the service aspects of accounting. This is not to suggest that the Australian Accounting Research Foundation and other bodies should not expand the horizons of accounting which essentially just means improving the service, but that damaging confrontations should be avoided.

- 3 J.A. Coleman, 'Company Reporting: Some Questions', The Australian Accountant, September 1981, page 536.
- 4 A.D. Barton, Objectives and Basic Concepts of Accounting, The Australian Accounting Research Foundation, Melbourne, 1982.
- 5 Terry McCrann, 'Developments in Australian Company Reporting', The Australian Accountant, September 1981, pp. 532-3.

2.19 We may see from these two statements about financial reporting that the Australian Accounting Research Foundation and the profession itself are in an invidious position. On the one hand the Deputy Commissioner of the NCSC wants rigorous and systematic development of accounting standards within an effective conceptual structure for research. On the other hand, businessmen would seem to be largely unconcerned about the need for other than a pragmatic approach which avoids confrontation between accountants and companies. They consider that deficiencies in the accounting process can be handled by the use of narrative statements in the annual report.

2.20 Given the present limited resources of the Australian Accounting Research Foundation, this Committee is uncertain about the Foundation's role in the public sector. While supporting its efforts, it is apparent that the Foundation's problems, particularly at the policy level, are very different from those associated with control and evaluation of the spending of public monies.

2.21 However, this Committee is confident of the ability of the accounting profession as a whole to accept the challenge of standard setting in the public sector realistically. This means that advocacy and dogma will be replaced by a genuine concern to discover the environmental characteristics facing government accounting as a whole and skilled accountants from both the public and private sectors will cooperate strongly in the resolution of material issues.

2.22 An examination of the conflicts which exist between the research and practitioner functions in accounting may help to resolve the question as to whether private sector accounting standards provide a sound basis for the development of financial reporting criteria for government entities.

The Certainty Criterion and Functional Objectives in Private Sector Standard Setting

2.23 There has also been a further breakthrough in recent times by accounting researchers.

2.24 In a recent article commissioned by the editor of The Accounting Review, Dopuch and Sunder⁶ examine the search by practitioner bodies and academics for the objectives of financial statements in the private sector. Their conclusions point to the reasons why both abstract research and the search for relevance by attempting to specify objectives have so often proved to be futile:

- 6 N. Dopuch and S. Sunder, 'F.A.S.B. Statements on Objectives and Elements of Financial Accounting: A Review', The Accounting Review, January 1980, pp. 1-21.

No conceptual framework, however logically conceived, can counter practical issues regarding the reliability of estimates of, say, replacement costs. The 'true' replacement costs of assets are not observed until those assets are actually replaced (nor are 'true' exit prices observed unless the assets are sold). So the issue is not whether current costs are useful 'in making economic decisions'; rather the issue is what criteria may be used to produce alternative estimates.

2.25 These researchers argue that the major criterion of accounting information at present is certainty, not relevance, to financial decisions. The objectives of financial statements if they are not decision oriented are probably functional objectives such as increasing the employment and security of accountants, auditors, and teachers of accounting.

2.26 Elimination of such pragmatic functional objectives points to the need for definite policy decisions about what accounting and financial reporting should achieve as well as the formation of rigorous theories to allow implementation of the goals selected. The present intermingling of policy and theory in the standard setting process will not, in the Committee's view, provide adequate standards for public sector financial reporting.

2.27 The Committee again reinforces the point that it views the setting of standards for financial reporting by authorities as being firmly linked to user needs for reliable and relevant information. However, it recognises that users of financial statements are not an homogenous group with common interests and that there has been little evidence of any user group being able to impose its needs for specific information on financial accounts and reports. However, given definite policies for financial statement preparation and adequate theories and concepts to support these, users might well be better served in the public sector than elsewhere.

2.28 A problem of over-reliance on certainty in private sector standard setting relates to the publication of forecast information. This is an integral feature of public sector reporting and is seen by the Committee as a fundamental requirement for control of statutory authorities' performance. Although not accepted in the private sector, the need for such forecasts has at least been considered by members of the profession. Mr John Coleman, Deputy Chairman of the National Companies and Securities Commission, recently made the following comment:

7 Dopuch and Sunder, op. cit., page 8.

8 Dopuch and Sunder, op. cit., page 10.

But the investor may only be interested in past information to the extent to which it can be used to predict the future. If this is correct, and recent evidence concerning the importance of Chairmen's reports may be consistent with this view, then the systematic publication by a company of forecasts concerning future trading - what it intends to do - might be more useful to the investor than statements recording past events - what it has already done.

Concepts or Rules as the Basis for Financial Reporting

2.29 The Committee has referred to linkages between statutory authorities and the finance system of the Commonwealth which is a primary component of the information system for strategic economic planning and control of the country's affairs. If the accounting and financial reporting systems of these authorities do not reflect the realities of economic events, then deleterious effects on economic management and the life styles of citizens can occur without the knowledge of parliamentarians and their economic advisers.

2.30 As previously outlined, if disclosed accounting profit or surplus is a major determinant of pricing policies under a user pays concept of public sector service, then determination of such profit or surplus must be fair. To the Committee this means that it must be factual in current economic terms rather than hypothetical or the product of traditional and sometimes irrelevant accounting techniques.

2.31 It may be assumed that in most private sector transactions efficiency and value for money are geared to market places in which the supply and demand for goods and services interact to determine a reasonable price structure. Also, management may move out of unprofitable areas at its discretion while seeking an overall favourable mix of services which must ultimately be linked to profitability. In this context the after-the-event stewardship reporting function using historical cost concepts which generally show a more favourable profit/assets employed ratio may be appropriate in the eyes of businessmen and the community. It is usually only attacked when a slow reporting response to poor performance becomes evident at times of financial crisis for organisations.

2.32 For these reasons similarities between competitive business firms and statutory authorities funded by public monies or guaranteed by the government are rather tenuous. While comparability with the private sector is desirable, it should not be at the expense of soundly based financial reporting criteria geared specifically to the accountability

9 John Coleman, op. cit., page 536.

problems faced by public enterprises and the need for compliance with the precepts of economic theory which guide governmental decision making processes.

2.33 A credible underlying theory of accounting linked to economic reasoning, rather than simply a bargaining process to achieve some pre-determined objective is needed if the financial performance of statutory authorities directly linked to government is to be attempted in a manner which complies with the requirements for accuracy. Solomons says:

The criterion by which rules are judged is not the effect which they may or may not have on business behaviour. It is the accuracy with which they reflect the facts of the situation.¹⁰

2.34 Fairness in policy making is mandatory and rigorous reasoning in theory formation and consistency with accepted concepts from other disciplines such as economics is essential. Professor R.J. Chambers pointed out some years ago that a scientific approach is needed:

If the study of the subject proceeds in this way it should be possible to avoid what Roger Bacon described as 'four stumbling blocks which hinder well-nigh every scholar; the example of frail and unworthy authority, long established custom, the sense of the ignorant crowd and the pretense of wisdom.'¹¹

2.35 The implications of adopting non scientific policy laden standards for use by government instrumentalities are very severe in terms of the adequate operation of the system of public sector financial accountability and control. Private sector constraints of competition largely may not apply.

Failings of Existing Accounting Standards

2.36 The three major failings of conventional financial statements prepared under the management valuation/historical cost traditional conventions are:

- 1) failure to determine full cost by ignoring the existence of inflation;
- 2) failure to provide a framework for communicating management's expectations and estimates (a material

10 David Solomons, 'The Politicisation of Accounting', The Journal of Accounting, November 1978, p. 72.

11 R.J. Chambers, 'A Scientific Pattern for Accounting Theory', The Australian Accountant, October 1955, p. 434.

deviation from adequate accountability and control in the public sector); and

- 3) failure to specify the nature and effect of large scale contracts and commitments.

2.37 These three deficiencies were stressed in a Statement of Basic Accounting Theory of the American Accounting Association in 1966.¹² However, the history of ignoring major defects in conventional accounting theory is much longer, running back almost to the turn of the century.

2.38 The profession has taken a substantial step in the last decade towards attempting to identify weaknesses through the use of a conceptual structure which emphasises formulation of the objectives of financial reporting.¹³ This Committee believes that identification of user needs for financial reporting by statutory authorities is fundamental to improved communication and fairness to both preparers and users of financial statements.

Conclusions

2.39 This Chapter has been concerned with evaluating attempts by the accounting profession to produce standards which are acceptable as basic criteria for the preparation of financial reports and statements by public sector authorities. The Committee is of the view that such standards have not yet been developed, and although a holding operation using existing standards or modifications thereof may be necessary for a short period, this is unsatisfactory. The non-scientific nature of standard setting in the private sector has been noted and some inadequacies of existing standards discussed. A major research effort should be mounted using all available sources of expertise. This would develop fair policies for adequate disclosure together with necessary concepts and theories permitting consistent implementation and application of the principles involved.

2.40 The Committee notes that the recent report of the Australian Accounting Research Foundation on the Objectives and Basic Concepts of Accounting deals with policy issues relating to the provision of information and provide guidance

12 American Accounting Association, A Statement of Basic Accounting Theory, 1966.

13 American Institute of Certified Public Accountants, Objectives of Financial Statements, New York, 1973; Financial Accounting Standards Board, Conceptual Framework for Accounting, Accounting and Reporting, 1974 and 1976; and Financial Accounting Standards Board, Reporting and Elements of Financial Statements, 1976.

for the use of available conceptual structures. It should also indicate areas where research efforts would be valuable. While supporting this initiative the Committee again stresses that adoption of private sector accounting standards for use by government authorities does not necessarily provide effective criteria for external reporting where public monies are involved, although as a short term expedient modified private sector standards may have to be adopted. The financial system of public accountability and control is too important an element of economic management to be influenced by the unsophisticated remedy of simple adoption of private sector standards.

Recommendations

2.41 The Committee recommends that:

1. A genuine research effort should be mounted employing resources from both within the accounting profession and outside of it, to systematically construct a relevant theoretical framework for financial reporting by public sector authorities. Such an approach should involve:
 - (a) determining user needs;
 - (b) an examination of the concept of certainty in relation to the needs for budgetary disclosure and commitment accounting in the public sector; and
 - (c) discussion between private and public sector accountants on the strengths and weaknesses of conventional financial reporting to identify the likely economic consequences and effects on consumers of the adoption of various financial accountability measurement systems.
2. Any adoption of private sector accounting standards should be seen as a short term solution.

CHAPTER THREE

CONTEMPORARY VIEWS OF FINANCIAL REPORTING BY PUBLIC SECTOR BODIES

A survey is undertaken of the literature of financial standard setting for the public sector and for non-business organisations. The notion of identifying environmental factors peculiar to public sector enterprises as emphasised by the United States General Accounting Office is supported. Identifying the objectives of financial statements of government bodies is discussed. Attempts to fit public sector financial reporting within constraints given by traditional financial compliance reporting models are rejected. The Committee approves the extension of the reporting framework to include audited reports on efficiency and effectiveness where the necessary criteria for evaluation have been established.

Extending the Traditional Reporting Framework

3.1 The role of statutory authorities in society has become pervasive given the size and number of such institutions and the importance of the services which they provide. While they are given substantial autonomy their activities must be seen as an extension of policies and programs sanctioned or initiated by the Government of the day. Thus concepts of efficiency and program effectiveness which are now most important in the evaluation of the operations of departments in the Commonwealth arena should be extended to all major aspects of the bureaucracy, whether or not particular services of the Commonwealth are performed outside the departmental structure. In the private sector the accounting system provides information on efficiency and effectiveness through profit measurement and the reporting of unit costs in a cost accounting system. In the public sector such measurements cannot be fully incorporated within the accounting system.

3.2 In his review of The Report of the Royal Commission on Financial Management and Accountability (Canada), Douglas G. Hartle points to the Commission's emphasis away from the past audit of financial management and towards evaluation of the ultimate impact of policies and programs.

The real issue is not probity and prudence. It is the quantity and quality of programs - assuming if you will that they can be administered with probity and prudence - that is the heart of the matter.

1 Douglas G. Hartle, Canadian Public Policy, V.3, Summer 1979, p. 380.

3.3 However, to formalise information needs for evaluating the efficiency of operations and the effectiveness of government sponsored policies and programs of statutory authorities requires recognition of the combative nature of the Parliamentary process which needs to be taken into account if adequate disclosure and control over public sector bodies is required.

3.4 The Committee believes that knowledge of pressures facing those concerned with the operations of statutory authorities should not be implicitly accepted as a reason for accepting financial statements based only on traditional fiscal compliance concepts of stewardship (probity and prudence) and associated accounting standards from the private sector. This form of reporting may be accepted when appropriately modified, because of its relevance and merit. It should not be accepted, however, simply because it provides less pressure on Parliamentarians and officers of statutory authorities than do alternative reporting frameworks.

3.5 Identification of the nature of Parliamentary processes which may affect government decision-making is important. Pressures do exist which may cause administrators to believe that formal disclosure of budgets, key performance indicators and other relevant information about statutory authorities is unwise. This view should not be used to militate against effective standardisation and disclosure. Such an approach might harm both Parliamentarians and officers of the statutory bodies alike.

Identifying Objectives of Financial Reporting by Governmental Bodies

3.6 An important change relating to the perspective for standard setting in the private sector was made clear by the Accounting Standards Committee of the United Kingdom in 1978. Michael Bromwich points out:

They coined a distinction between those users' objectives which are legally oriented, in which... certainty is the main aim and those needs which are oriented more towards economic factors in which judgment may be more important than certainty.²

3.7 Such a change in thinking would obviously mitigate criticisms of private sector standard setting made in Chapter Two. It is evident that identification of objectives for reporting by public sector bodies, as revealed in recent research studies, already embodies the need to distinguish between 'certainty' and economic relevance as basic criteria which are needed for different purposes.

2 Michael Bromwich, 'The Setting of Accounting Standards: The Contribution of Research', Essays in British Accounting Research (eds. Bromwich and Hopwood) 1981, p. 41.

3.8 A notable achievement in this regard is the recent National Council on Government Accounting Research Report.³ An abridged Summary of Objectives contained in the report is as follows:

Overall Goal

The overall goal of accounting and financial reporting for governmental units is to provide:

1. financial information useful for making economic, political and social decisions and demonstrating accountability and stewardship; and
2. information useful for evaluating managerial and organisational performance.

Basic Objectives

The objectives of accounting and financial reporting for governmental units are:

1. to provide financial information useful for determining and predicting the flows, balances and requirements of short-term financial resources of the governmental unit.
2. to provide financial information useful for determining and predicting the economic condition of the governmental unit and changes therein;
3. to provide financial information useful for monitoring performance under terms of legal, contractual and fiduciary requirements;
4. to provide information useful for planning and budgeting, and for predicting the impact of the acquisition and allocation of resources on the achievement of operational objectives; and
5. to provide information useful for evaluating managerial and organisational performance:
 - (a) for determining the costs of programs, functions and activities in a manner which facilitates analysis and valid comparisons with established criteria, among time periods, and with other governmental units;
 - (b) for evaluating the efficiency and economy of operations of organisational units, programs, activities, and functions;

3 A.R. Drebin, J.L. Chan and L.C. Ferguson, Objectives of Accounting and Financial Reporting for Governmental Units: A Research Study, N.C.G.A., Volume One.

(c) for evaluating the results of programs, activities, and functions and their effectiveness in achieving their goals and objectives; and

(d) for evaluating the equity with which the burden of providing resources for governmental operations is imposed.

3.9 The Committee will discuss the last mentioned objective of the equity of resources financing at length in Chapter Four.

3.10 These objectives move outside the realm of strictly financial reporting except to the extent that budgets, established criteria for evaluating the efficiency and effectiveness of operations, and questions of equity can be portrayed in financial terms. Doubts must be expressed about the ability of the conventional financial reporting framework to absorb this needed information in a meaningful way. Certain legal and financial compliance aspects of accountability are covered by the traditional form of statements. However publication of wealth and income statements alone falls far short of meeting the major information needs of users concerned with the efficiency and effectiveness of these governmental units. It would seem clear that to meet these information needs for efficiency and effectiveness (5b and 5c above) some form of performance reporting in documents separate from, but related to, the financial statements is needed.

3.11 The difficulties in using reported profit figures in a government business organization as a measure of efficiency will be discussed later. If the financial dealings of statutory organizations are guaranteed by the Commonwealth, and the authorities do not operate in conventional markets so that profit may be taken as an indication of efficiency, then the major thrust of their reporting would not appear to be served by the conventional financial reporting framework. It would appear that program statements are also needed. This aspect will be discussed further in Chapter Six.

3.12 Thus efforts should be made to produce a reporting framework which has the capacity to deal with matters of efficiency and effectiveness. As the Auditor-General has the power to conduct efficiency audits of statutory authorities it would seem reasonable to assume that these bodies should make available statements of their efficiency which could be subject to audit. It would also seem reasonable that statutory authorities report measures of effectiveness to enable their activities to be better reviewed.

3.13 The exposure draft of the United States General Accounting Office on the Objectives of Accounting and Financial Reporting in the Federal Government considers that:

The primary objective of accounting and financial reporting in the Federal Government is to provide useful information for assessing management's performance and stewardship. Assessing this basically involves determining what an entity has achieved and what it can achieve in the future. In assessing past performance, information must provide indications on:

- financial viability (the ability of the entity to provide the same level of resources);
- program activity (the degree of activity under various programs including costs of inputs and value of outputs);
- fiscal compliance (whether financial and related laws and regulations were followed);

Information, which indicates how efficient and effective management operates, helps users assess stewardship and performance.⁴

3.14 The statement makes the point that in order to provide information useful for determining resource allocations based upon financial viability and future levels of service, financial reports should reflect an entity's current position, past performance and future expectations⁵:

Planned program activity refers to anticipated distribution of resources based upon anticipated levels of costs. By its very nature planned activity data is goal and attainment oriented. Information on the cost of resources, distribution of resources, and planned program activity is necessary for users to assess management's stewardship and performance, both past and expected⁶.

3.15 These views are much stronger than those of most writers in the area of non-business reporting generally. They stress the added accountability of managers in government agencies. Thus the scope of reports extends beyond legal and financial compliance, short-term liquidity determination, long-term maintenance of capital and the costs of rendering the services provided. The dimensions of adequate planning and forecasting together with the evaluation of efficiency and effectiveness of operations are subsumed into a formal reporting framework.

4 United States General Accounting Office, Exposure Draft, Objectives of Accounting and Financial Reporting in the Federal Government, February 1980, p. 24.

5 ibid., pp. 28-29.

6 ibid.

3.16 William Holder⁷ disagrees with the views of those who advocate a form of budgetary disclosure for governmental units. However, he notes the present mandatory requirements of the National Council on Governmental Accountants (NCGA Statement No. 1):

- (1) An annual budget should be adopted by every governmental unit.
- (2) The accounting system should provide the basis for appropriate budgetary control.
- (3) Budgetary comparisons should be included in the appropriate financial statements and schedules for governmental funds for which an annual budget has been adopted.

3.17 This Committee notes the view of Holder and others that the preparation of financial statements which compare actual with budgeted figures may mislead users. Arguments that extra costs would be involved are not compelling because most organisations use budgets for internal management purposes. While disagreement on the issue exists, the comparison of actual with budgeted information is the fundamental pivot of financial control in public sector affairs. The Committee's view is that this procedure should be extended to the external reporting function of statutory authorities.

Efficiency and Effectiveness Measurements

3.18 William J. Vatter has examined the issue of how to achieve efficiency and effectiveness of government organisations. He states:

The major difficulty lies in motivation: the business firm is motivated by the hope of augmenting its capital to produce growth from profits; the typical non-business firm has no such motivation, because its capital (indeed, practically all of its inflows except service charges) is supplied by asking for it, or having a legislature appropriate it. The basic point (usually presented) is that there is no other way to provide motivation for governmental cost reduction except to limit the supply of resources. Perhaps there is a way to control motivations in non-business organisations.⁸

7 William W. Holder, A Study of Selected Concepts for Government Financial Accounting and Reporting, National Council on Governmental Accounting, Chicago, Illinois, 1980, pp. 22-23.

8 William J. Vatter, 'State of the Art - Non-Business Accounting', The Accounting Review, July 1979, p. 575.

3.19 However, this Committee believes that a formal framework for public reporting of efficiency and effectiveness could provide such motivation. As previously mentioned the traditional frameworks based upon receipts/payments; surplus/deficiency; profit/loss; and wealth determination may not be adequate unless operations are performed in competitive market places. The traditional framework is restricted to concepts of legal and financial compliance although, with necessary accrual procedures, it may disclose full costs of services (historical) and financial viability. Both of these measurements are useful.

3.20 The Committee believes that the usefulness and value of conventional type financial reporting is reduced if it is made to stand as a surrogate for more dynamic processes such as efficiency and effectiveness reporting. Furthermore, if no need exists for statutory authorities to identify efficiency and effectiveness criteria for external reporting purposes, then managements might not feel pressured to develop critical criteria, standards and norms of efficiency and effectiveness for internal management purposes. For efficiency measurement this might be left in abeyance until the Auditor-General comments unfavourably on such deficiencies during his efficiency auditing inspections. This process is clearly illustrated by Mr Steele Craik:

Although in many areas of performance auditing the criteria are implicit and ill-defined, it is often possible for the auditor and management to reach agreement on the nature and specification of criteria (of efficiency). Also, it may be possible for the auditor to synthesise criteria on the basis of accepted theory and practice, or perhaps on observations of similar operations elsewhere. Where this is so, audits may be undertaken of economic, administrative, financial and technical decision-making affecting the efficiency of operations.⁹

3.21 Additionally Committees of the Parliament could directly evaluate efficiency on a regular basis where formal efficiency auditing reports are regularly published by management and audited by the Auditor-General against established criteria of efficiency. This Committee made the point in the discussion paper, Internal Audit in the Australian Public Service,¹⁰ that internal auditors should report on progress made by management through the use of

9 D.R. Steele Craik, A Perspective of Government Auditing - Past, Present and Future, 1980 Research Lecture of the Australian Society of Accountants (Victorian Division) and the University of Melbourne, October 1980.

10 Joint Parliamentary Committee of Public Accounts, Internal Audit in the Australian Public Service - A Discussion Paper, A.G.P.S., March 1981, Parliamentary Paper No. 1/1981.

operations research and other technical facilities, of developing criteria for the evaluation of efficiency in operating and administrative areas.

3.22 The Auditor-General is not empowered to carry out effectiveness audits. Reviews of effectiveness are carried out by the Department of the Prime Minister and Cabinet but are not made public. However in some overseas countries the scope of external audit does extend to effectiveness reviews (eg the USA Comptroller-General) and standards and criteria for effectiveness measurement have been developed. The Committee sees the publication of such effectiveness information as forming the basis for improved external review by Parliamentary Committees and others.

User Decisions and Environmental Factors

3.23 The Financial Accounting Standards Board (FASB) of the United States of America has published a statement of accounting concepts in which the objectives of financial reporting by non-business organisations are developed. The statement identifies the following user groups of financial statements:

- (a) Resource providers who may or may not be directly compensated, eg. lenders, suppliers, employers and taxpayers.
- (b) Constituents who use and benefit from the services provided.
- (c) Governing and oversighting bodies who set policies and evaluate performance.
- (d) Managers who direct and carry out the policy mandates of the governing bodies.

3.24 However the FASB view that the objectives of financial statements overrule the requirements of users in decision making roles points to the weaknesses of conventional financial reporting for public sector purposes. If those objectives of financial statements become embodied in the conventional reporting framework then the objectives will relate to fiscal compliance, financial viability and perhaps full historical costs of services provided. While important these do not necessarily reflect efficiency in non-competitive market places.

3.25 Thus interpretations of a surplus or deficit in a government organisation may be little more than knee-jerk reactions by evaluators who are familiar with the profit/loss

criterion of the private sector. This possibility is referred to by the United States General Accounting Office:¹¹

Perhaps the most important environmental factor affecting the objectives is the way the Federal Government is regulated. In the private sector built-in controls in the form of the free market system necessitate the need to operate economically. Without alternative controls there are no objective assurances that Government will operate efficiently, effectively and economically since there often exists:

1. the absence of the need to operate profitably;
2. the lack of an open market test of the value of the organisation's output;
3. the remote and indirect relationship, if any, between the resources contributor and the goods or services recipient; and
4. the ability to force resource contribution via taxation.

3.26 Operations in the Federal Government are consequently subject to considerable legal and regulatory controls over organisational structures, personnel policies and procedures, and sources and uses of resources. Further, reported profit figures in government business entities are affected by both financial advantages and disadvantages compared with private sector companies which apply to such entities because of government policies or directives.¹²

3.27 An obvious response to these environmental factors has been to leave policy laden institutions on a cash basis and to require trading type operations to prepare business type accrual accounts and then to enforce a profitability or 'user pays' dictum. Unfortunately, however, in the absence of much relevant and needed information and competition in markets this can lead to gross subsidisation of some consumers on the one hand, and victimisation or unjust specific consumer taxation on the other under the conventional private sector reporting framework. Parliamentarians simply do not have the information to enable rational determination of these issues to be made.

- 11 United States General Accounting Office, Exposure Draft, Objectives of Accounting and Financial Reporting in the Federal Government, February 1980, pp. 11-12.
- 12 D.A. Shand, The Financial Structure and Objectives of Commonwealth Trading Organisations - A Review. Australian Journal of Public Administration, March 1982.

3.28 Thus, while it may be true as the FASB statement indicates 'that information indicating that an inefficient entity is efficient is not likely to meet the broader objectives of financial reporting', answers to the problem are not likely to be forthcoming from the use of either cash based or accrual accounts within the conventional reporting framework.

3.29 Whilst the objectives of financial reporting in the public sector will not be achieved by showing an inefficient operation as efficient, they will not be accomplished either by showing an efficient producer to be inefficient. This could occur for example if a reported poor profit performance was used without considering the limitations of its relevance and other factors needed to consider efficiency in non-competitive organisations. Relevant reports supplementing the financial statements based upon efficiency criteria must be provided to avoid this problem. Even in the private sector profit is a blunt measure of efficiency and traditional accounting practices often provide only a rough guide of the financial viability of large companies. This explains why so much attention is given by analysts to the additional information provided by the Chairman's Report over and above that given in the financial statements of private sector firms.

Conclusions

3.30 The Committee is not convinced that meaningful progress in providing adequate disclosure and control over statutory authorities of the Commonwealth can be achieved by fitting objectives of financial statements into a relatively conventional framework of financial reporting adopted from the private sector. This has been tried for a considerable number of years and found to be deficient in many respects. Additional information in the form of statements based on criteria for administrative and operating efficiency are required, as are planned program activity reports showing expected costs and distribution of resources. For trading authorities these may take the form of budgets and forecasts prepared in accordance with the financial statements to be produced.

3.31 The Committee considers that most statements of accounting objectives sponsored by accounting bodies are deficient when applied in the public sector. In their efforts to promote full accrual or business accounting they do not comprehend that the surplus/deficit or profit/loss determination for operations of the period will be interpreted widely as if the figure occurred in the private sector. Thus traditional accounting procedures rather than sound economic analysis may determine a government's pricing policies for widespread community service needs and be used to evaluate efficiency.

3.32 This Committee does not deny that financial statements should be prepared which enable assessments to be made of legal and financial compliance, financial viability and the costs of services provided. These matters will be dealt with thoroughly in later discussion. The provision of statements to show these characteristics of performance will invariably lead to private sector type evaluations which may or may not be correct in assessing the quality of performance.

Recommendations

3.33 The Committee recommends that:

3. The process of standard setting in the public sector should be cognisant of the following features of financial accountability:
 - a) legal, contractual and fiduciary constraints;
 - b) budgeting and prediction for resources allocation and control in authorities and programs;
 - c) determination of full costs of services and programs and formulation of efficiency criteria for performance evaluation;
 - d) equitable calculation of the burden of financing resources for governmental operations;
 - e) the relevance of concepts of capital to be maintained under full cost calculations and 'user to pay' policies.
4. Reports on efficiency and effectiveness should be published and, where criteria are available, be audited.

CHAPTER FOUR

FINANCIAL REPORTING FOR FISCAL COMPLIANCE, FINANCIAL VIABILITY AND COST OF SERVICES

An identification is undertaken of material issues which can confuse users of traditional form financial statements or make the statements inadequate or misleading. Matters examined include accountability and the use of cash accounting, modified accrual accounting and full accrual accounting. Traditional concepts relating to the matching principle and especially the use of depreciation of non-saleable infrastructures in times of inflation and technological change are challenged. The accounting profession is asked to research the area of capital maintenance to determine a suitable concept for measuring financial viability and full costs of services provided in the public sector. A total resources as distinct from a working capital concept of funds is supported as the basis of funds statements in the public sector.

4.1 The primary objective of financial reporting as stated by the United States General Accounting Office stresses both management's performance and stewardship.¹ This requires assessment of fiscal compliance, program activity and financial viability.

4.2 Fiscal compliance in the public sector is the extent to which an organisation complies with the financial and related laws and regulations or even policy directions established by government. Adherence to budget limits is one aspect of fiscal compliance. This compliance may in some cases require organisations to provide services at charges which do not cover operating costs, and which would not be financially viable or efficient in a normal commercial sense. Government decisions, for example, require Australia Post to deliver a standard letter anywhere in Australia for 27 cents. In remote areas the cost of delivery can often exceed \$2.00.

4.3 Program activity information provides an indication of the efficiency and effectiveness of specific programs administered by an undertaking, including the costs of inputs and the value of outputs. Program statements, which will be discussed later in this Report, are a means of providing this information to managers.

1 U.S. General Accounting Office, Objectives of Accounting and Financial Reporting in the Federal Government, op. cit., p. 22.

4.4 The concept of financial viability is the capacity of an organisation to provide the same level of resources as in the past or as is expected to be provided in the future. Criteria for evaluating financial viability are:

- resources available to management
- obligations
- changes in resources and obligations
- resource flows
- liquidity

4.5 On the basis of information given about fiscal compliance, financial viability, operating and administrative efficiency including the costs of services provided and the effectiveness of programs, resource allocation decisions by governing bodies may be made in an informed manner. There may be many social and political elements of a resources allocation decision. This in no way diminishes the importance of economic and technical measures of performance provided in financial statements.

Cash vs. Accrual Accounting

4.6 In attempting this appraisal it is necessary to discuss basic concepts of accounting and the nature of diverse governmental bodies in conjunction with the accountability of their managements. An evaluation of Governmental Accounting and financial reporting principles of the NCGA (1979)² is useful for this purpose.

4.7 In its discussion of basic accounting the NCGA looks at the cash and accrual bases:

The accrual basis is the superior method of accounting for the economic resources of any organisation. It results in accounting measurements based on the substance of transactions and events, rather than merely when cash is received and disbursed, and thus enhances their relevance, neutrality, timeliness, completeness and comparability. Accordingly, the Council recommends use of the accrual basis to the fullest extent practicable in the government environment. ... The cash basis of accounting is not appropriate.³

2 The National Council on Governmental Accounting, Governmental Accounting and Financial Reporting Principles, Chicago, Illinois, March 1979.

3 National Council on Governmental Accounts op.cit., page 11.

4.8 Under the accrual system items are recorded as they occur when goods or services are supplied or received. There is no delay waiting for cash to be received or disbursed and thus financial statements are more timely and also more representative of the results of operations and the state of affairs of the organisation. However, accrual accounting and even modified accrual accounting have inherent properties which impose certain responsibilities upon management. In extreme agency situations, where authorities are little more than the agent of a parent department rather than autonomous entities, the cash basis of reporting may more fairly reflect the operations under management's control. Cash accounting may thus provide a superior basis for evaluation of performance of managers in terms of relevant accountability even though the statements themselves provide inferior measures of performance and stewardship in terms of government programs.

4.9 Arguments against use of accrual accounting and favouring the cash basis are usually based on claims that additional expenditures are required and that accrual accounting is not cost effective. These arguments can be largely discounted as the correct extent of accrual accounting will usually be determined by the financial information needed for effectively managing the organisation. The real argument relates to the collection of information for full costs of services, much of which may lie within responsibility areas of departments rather than the particular organisation under review. Thus collection of such information seems to lack cost effectiveness in the eyes of management.

4.10 The cash based system of the Commonwealth with its basis of appropriations and constitutional and parliamentary checks and balances is designed to protect the rights of taxpayers and citizens generally. This is recognised as fiscal compliance. Many authorities are set up to increase administrative efficiency and the effectiveness of services provided in discrete areas. Nevertheless, they see themselves as extensions of departments of state and thus conceive a cash basis of financial reporting to be legitimate in view of the structure of the financial system for the Commonwealth as a whole. This notion is misconceived.

4.11 The financial system of the Commonwealth is based for reasons mentioned above on legal and financial or fiscal compliance. This is a legally oriented financial concept. It relates to the collection, holding and disbursement of public monies in a statutory current environment which is the result of past planning. Attained performance by the government in the form of a cash surplus or deficit for the financial year reflects governmental policies and the state of international and domestic affairs. It is the reflection of a government's response to a whole variety of economic and social criteria as indicators of events.

4.12 However, given the electoral system and a history of rationality, in the mix of cash surplus/ deficit budget results, it is more useful to view the financial system as a constitutional control which produces accurate periodic results of the effects of a government's financial policies. Cash based accounting provides essentially an immediate and very short-term portrayal of operations in financial terms. These results may be used as inputs in financial planning for future viability. The cash based system of accounting is not in itself an indicator of future viability, but immediate viability. A funds statement which embodies a modified accrual approach, provides an indication of short to medium term viability. Full accrual accounting was designed to provide an indication of longer term viability and, when used in conjunction with market forces, of economic efficiency.

4.13 The arguments for cash based financial statements put forward by authorities are really arguments against assigning reporting responsibilities which are not compatible and go beyond fair representation of the accountability of management. This transgresses the first cardinal precept of fairness in financial reporting.

4.14 Furthermore, it creates anxieties for management who might be asked to report on a full or substantial accrual basis knowing full well that aspects of operations reflected by the amounts to be incorporated in the financial statements lie outside, and sometimes far outside, the assigned levels of authority and powers of management.

4.15 For example, suppose management of a national cultural institution is responsible for the orderly running of tours, canteen and cleaning. It may have no powers of decision relating to the treasures displayed, the maintenance and upgrading of major facilities or setting staff ceilings and selection of permanent staff. In these circumstances the adoption of accrual accounting must be carefully investigated. It could be that the amounts involved under the accountability of management could be quite large and the temptation arises for the Department of Finance to require a form of financial statements which attempts to determine full costs of services (with or without depreciation of long lived assets) on the accrual basis. This could be regarded as unfair to management and misleading to the public.

4.16 However a problem with not using full accrual accounting is that the full costs relating to the particular organisation (but not necessarily controllable by its management) would not be shown. Such information may be needed to assess the overall efficiency and effectiveness of the organisation and to decide whether it should continue operations, as opposed to reviewing the performance of management based on those items management is responsible for. This raises a common accounting problem - whether to report

costs controllable by management or whether to report all costs relating to or caused by a particular organisation.

4.17 The Committee supports an approach under which full costs are shown but unfairness to management is avoided by clearly distinguishing between those items which are controllable by management and those which are not. This might be done by footnote disclosure, but appropriate arrangement of the items in the financial statements would be a better approach. In this respect the Committee supports the concept of an activity statement suggested by the Joint Working Party for non-business units. This involves the separating of provisions and unfunded items most of which would be non-controllable by management from those expenses which require funds. Examples of provisions and unfunded items would include depreciation of exhaustible assets and provision for long service leave. The suggested activity statements may require a little modification to meet the purposes suggested by the Committee and this should be further examined by the Joint Working Party.

4.18 Under this approach complementary financial statements would also be prepared by the parent department in its annual report where appropriate. These statements would deal with full costs of services including valuation of the treasures, maintenance and depreciation charges (if appropriate) of long lived facilities and items such as provision for long service leave, in these cases where they are the responsibility of the parent department. The permanent head thus assumes full responsibility for cost control rather than merely cash management. These financial statements would incorporate the necessary information on operations obtained from the financial statements prepared by the organisation's operating management and both sets of financial statements would carry notations to this effect for adequate disclosure to the public.

Accountability of Non-business Units and the Form of Financial Statements

4.19 The Committee has accepted arguments against the use of cash based accounting for statutory authorities unless it can be shown that accrual accounting lacks cost effectiveness in terms of time taken to produce accrual based statements and that the difference between using cash and accrual accounting would not be material. The argument that accrual accounting is not cost effective is seen to be weak as the accountability of management may in many cases indicate accruals only to a very limited extent, e.g. for wages, debtors, creditors and miscellaneous expenses (i.e. modified accrual). This information is already needed for effective management control.

4.20 We are thus left with two bases for the preparation of financial statements for statutory authorities. These are full accrual or business type financial statements and modified accrual statements which reflect a source and disposition of funds approach rather than a full cost measurement approach. Both are geared to assessment of future financial viability, with the business type accounts incorporating provision for depreciation having the longer-term connotations. Modified accrual accounting incorporates future contractual amounts for long service leave and other similar commitments but does not show depreciation.

4.21 The Committee considers that activity statements as suggested by the Joint Working Party can be appropriately modified to show full cost information, but avoid unfairness to management by distinguishing those costs controllable by management from those which are not. At the same time the principal, i.e. the parent department, should provide full accrual accounting for the full costs of all non-business agencies (statutory authorities) under its control, i.e. those items for which the department is responsible.

Accountability of Business Undertakings and the Form of Financial Statements

4.22 The financial statements prepared for business undertakings of the Commonwealth should have many of the features of statements prepared by commercial institutions in the private sector. It is necessary, however, to note dissimilarities as well as common features in order to reach conclusions about the form and content of financial statements for public sector business enterprises.

4.23 For reasons of policy a government may decide to provide services on a business basis to consumers, or determine that a large organisation may be a more efficient unit if it is forced to account as a fully autonomous entity by charging for its services. Another reason for full accrual accounting may be to isolate a manufacturing or trading entity within a department for cost determination of goods and services made available by the entity to the department or to other governmental units.

4.24 The reasons for insisting on full accrual accounting for profit/loss or surplus/deficit determination are usually associated with the promotion of administrative and operating efficiency and the determination of full costs of services provided. The private sector accounting and reporting model, modified as necessary, is therefore seen to be appropriate.

4.25 On the full accrual basis revenues will be recognised in the accounting period in which they are earned and become measurable, and expenses are recognized in the period when

incurred. These include the expiration of original cost (depreciation), allowing for wear and obsolescence of long-lived assets during the period. The National Council on Governmental Accounting quotes the conventional wisdom when referring to proprietary funds or funds receiving user charges:

*Revenues earned and expenses incurred are recognized in a government's proprietary funds in essentially the same manner as in commercial accounting. Only minor adaptations are involved in applying the revenue realisation and expense recognition principles in the government environment.*⁴

4.26 While this thought might have application in the United States where private sector financial reporting is heavily regulated through the Securities and Exchange Commission, its acceptance in Australia must be carefully watched. It may have a severe impact on consumers and may allow such bodies to operate in a manner not compatible with a government's economic and social policies. This is so, notwithstanding that many statutory authorities have reported to the Parliament for many years using the principles and standards of the private sector.

4.27 Problems caused by the application of the private sector accounting/reporting model in the public sector are not new phenomena. Writing nearly thirty years ago Sir Alexander Fitzgerald, one of the most respected accountants of his day, made the following comment about Australian Government trading organisations' financial statements:

*...in the great majority of instances, it appears that whether depreciation is accounted for, and if so to what extent and in what way, is made to depend upon the ease or difficulty with which depreciation charges, along with other costs, can be recovered from users of public services - which is surely a negation of the accounting concept of depreciation.*⁵

4.28 Thus he suggests that such costs may be used as the basis for determining revenue, through a cost based pricing system.

Public Sector Matching of Full Costs and Pricing Policies

4.29 During the three decades since Fitzgerald's comment the private sector financial accounting model has been under

4 National Council on Governmental Accounting, *op. cit.*, p.12.

5 A.A. Fitzgerald: Accounting and the Public Accounts, Proceedings of the Australian Society of Accountants Convention on Accounting, Adelaide, 1954.

continuous and increasing assault by unprecedented inflation and, perhaps more importantly, technological change and development which is proceeding unabated. In this environment the temptation to set prices based on costs derived under a variety of accepted practices of questionable relevance is almost irresistible when a 'user pays' policy is enforced.

4.30 This practice is the opposite of tailoring costs to allow for an acceptable rate of profits after calculating expected revenues in competitive market places. Revenues, of course, are determined by price fixing directions, not market places, for many community goods and services provided by statutory authorities. While price fixing of this type also occurs in the private sector, the essential nature of public schemes and difficulties of substitution are important issues requiring serious study, particularly as receipts become public monies.

4.31 The breakdown of the traditional financial accounting model, statutory requirements for full accrual accounting, and supervision and enforcement of modified private sector accounting standards by the Auditor-General have all contributed to reporting by statutory trading authorities which satisfies superficially the principles and recommendations for external financial reporting. The questions which must be asked are - at what price to the consumer; and at what cost in terms of deviation from financial and economic policies of government?

4.32 The use of such principles for determining accountability for the supply of needed community services and for controlling public monies may be quite ineffective without additional stringent regulations and standards. For example, by following these principles in a non-competitive environment, an authority may generate profits available for distribution and large cash flows with little restraint from the economic environment. This practice may fuel inflation by raising prices to cover "costs" and also by providing funds for expansionary activities even when government policies are directed towards restraint.

4.33 It is not certain that surveillance by the Department of Finance and the Treasury would be effective. Under the 'user pays' dictum officials would be concerned that authorities cover their costs. However the determination of 'costs' may be left as a matter for accountants within the authorities. It is uncertain as to whether such accountants and their managers and commissioners are themselves aware of the effects of using profit determination as a basis for revenue determination under conventional accounting practices. The Committee is not saying that authorities use full accrual accounting to generate small or politically acceptable profits and large cash flows. It is saying that there is a weakness in the private sector financial accounting model which might be exploited in the public sector.

4.34 Neither is the Committee necessarily advocating the use of price change accounting for the public sector. The further one moves from historical cost in times of inflation the more pronounced become the problems of consumers. Thus the present current cost valuation models are likely to cause greater inequities in using the model than strict adherence to historical cost. Current cost accounting is likely to aggravate the situation more than the current historical cost model. This is because of the doubtful validity of capital maintenance concepts adapted from the private sector. In times of inflation costs of asset expiration (depreciation charges) will be larger under current cost than under historical cost. If the concept of depreciation used is in error, especially in regard to a large scale infrastructure and specialised assets, then the distortion under current cost accounting will be the greater.⁶

4.35 The Committee is aware that these remarks challenge the very basis of conventional financial reporting by public sector business organisations. Yet there is a requirement to provide evidence of financial viability and full relevant costs of operations in a relatively conventional framework. It is therefore necessary to provide information about financial viability and full relevant costs in a form which the community understands, or thinks it understands. However, use of the framework should be properly restrained so as not to damage society.

4.36 The incidence of inflation and the pace of technological change has caused profound damage to the credibility of the financial accounting model. In the United States and the European Economic Community inflation accounting and strengthened regulations are being used to counter the problem. This is especially so in England, the original home of the 'true and fair' view of financial reporting. The accounting profession in Australia is working to follow International Accounting Standards and to produce more effective standards to reflect local conditions. It is also producing new standards to cover past omissions.

4.37 However, when compared to other developed countries the profession is seen to be at a point of indecision, waiting to see the nature and extent of change in North America and the EEC and knowing that management in Australia might not

6 M.E. Aiken, 'The Relevance of Current Cost Accounting to Commonwealth Government Accounting', Australian Society of Accountants Bulletin No. 1979, and

M.C. Wells, 'Current Cost Accounting and Public Sector Bodies', The Australian Accountant, Vol 51, No 7, August 1981, pp. 511-15.

take kindly to restrictions on present reporting flexibility. This Committee sees the role of the recently established National Companies and Securities Commission as being influential in these matters.

4.38 In the meantime, the Committee believes that urgent research and remedial action should be directed to financial reporting by public sector bodies. This research must include study of the correct basis of expressing financial targets for government business undertakings and determining their pricing policies and on the appropriate measurement of costs.

Depreciation and Capital Maintenance in Commonwealth Business Entities

4.39 The adoption of accounting procedures for Commonwealth Government authorities has in many ways paralleled the ad hoc thinking and haphazard planning which originally characterised the formation and retention of many of these bodies.⁷ A lack of clarity in specification of the financial objectives of many bodies and failure to determine effective principles and theories for governmental accounting has led to a wide variety of practices, particularly with regard to the treatment of depreciation. Professor Louis Goldberg observed this before the period of growth in the number of statutory authorities.

Such diversity of treatments suggests that the question of depreciation in relation to government-owned assets has not been considered consistently with reference to any underlying philosophy of government.⁸

4.40 Depreciation charges adopted by most statutory authorities can affect consolidated revenue by diminishing or increasing profits or surplus available for "dividends". Few, if any, Commonwealth authorities are completely divorced from the Budget because of the mechanism for transfers of funds between the budget and non-budget sub-sectors as illustrated by Budget Paper No. 10.

4.41 Criticisms of public financial reporting such as that by Sir Alexander Fitzgerald when noting that accounting for depreciation was very entangled with legal requirements for debt redemption, may not be so much a criticism of government accountants as an indication that the purposes of performance measurement in the public sector are different, or should be different. As Levy says:

7 Gerald E. Caiden, The Commonwealth Bureaucracy, Melbourne University Press, 1967, Chapter 4.

8 Louis Goldberg, Concepts of Depreciation, Sydney, Law Book Co., 1960, p. 79.

... it is clear that the depreciation of fixed assets in the context of governmental accounting should not be an analogy with, or direct adoption from, that applied in relation to ordinary business enterprises, since the role and purpose of much of government accounting differs radically from that of the private sector.⁹

4.42 Of course the enforcement of private sector accounting standards by the Commonwealth Auditor-General, as appropriate, has had the effect through AAS 4, Depreciation of Non-Current Assets, of bringing depreciation accounting in Commonwealth business institutions in line with private sector practices, particularly in the last ten years.

4.43 In order to determine whether or not this has been of benefit to the community it is necessary to first examine the use of depreciation in private sector accounting and then relate areas of usefulness and incompatibility to governmental business units. At this stage it is convenient to state that the Committee's concern about business depreciation concepts applies primarily to the large infrastructure assets of government business entities rather than to resources which are available, in terms of management's decisions, for purchase or sale in market places.

4.44 Government always has the option in terms of its policies of buying or selling business institutions including their infrastructure either lock, stock and barrel or in major segments. However prices in such situations would depend upon social needs policies and economic analysis relating to expected returns, rather than upon accounting entries. We shall not, therefore, dwell further on the possibility of sale or purchase of the enterprise as a whole by government.

4.45 Before the substantial weakening of the effectiveness of the traditional private sector financial accounting model through the incidence of inflation and technological change the purpose of depreciation seemed clear. Funds were to be kept in the business to maintain capital intact in the face of expiration of asset values through wear and tear in productive or service processes and/or obsolescence. If replacement was considered then a special sinking fund could be established for that specific purpose. Depreciation expense was included with other expenses to be matched against revenues in the determination of periodic profit. Its purpose is maintenance of capital to continue operations at present levels, not to provide funds for expansion.

4.46 The conventional theory is stated in AAS 4, Statement of Accounting Standards - Depreciation of Non Current Assets:

⁹ V.M. Levy, Public Financial Administration, (2nd Edit.), Sydney, The Law Book Co., 1981, pp. 143-146.

- Depreciation charges should be made consistently from period to period, depending neither on the profit or loss for any one period, nor on the amount that may be claimed as an allowable deduction when computing taxable income for any one period, and irrespective of whether any of the assets have been revalued.
- The basis and methods for calculating depreciation charges should be appropriate to the nature of the respective assets and their expected use in the operations of the business entity.
- Depreciation rates should be reviewed annually, and, if necessary, adjusted so that they will reflect the most recent estimates of the useful lives of the respective assets.
- When a depreciable asset has been revalued, with a corresponding adjustment of the amount at which the asset is earned in the accounting records, depreciation charges subsequent to the date of revaluation should be related to the adjusted amount.

4.47 The Committee questions whether these private sector standards are applicable to the public sector. While providing constraints on inconsistency in the application of methods, they permit management subjectivity in the form of non-market and non-cost based asset revaluations to determine in a material way the profits of the organisation, and thus amounts available for distribution to shareholders. This is done without any objective clarification of the nature of capital to be maintained for financial viability through the use of depreciation accounting.

4.48 In a non-competitive market pricing situation it is not difficult to comprehend a management revaluation of assets leading to price increases in services provided. Depreciation charges rise and revenues are simply matched against costs. However the concept of capital maintenance applicable to public sector business institutions is another question.

Depreciation and the Infrastructure of Government Business

4.49 The Committee will not examine in depth the question of depreciation procedures to be used with respect to fixed assets which can be bought and sold on the market. Management has, to a large extent, discretionary power to buy, sell, hold, operate and replace or substitute such services and operating capacity. It is noted, however, that the selection of a valuation basis to improve the effectiveness of the financial accounting concept of capital maintenance continues to be a subject of much controversy and anxiety in the private sectors of most developed countries. When agreement is reached on methods of price change accounting in the private

sector, its applicability to public business enterprises should be closely researched.

4.50 The position may be quite different as regards the specialised infrastructure or network of services provided by government utilities. Procedures to be adopted for measurement purposes depend heavily on the philosophy of government business institutions and policies of governments themselves. The nature of the procedures is directly related to the question of setting prices of government services under a 'user payers' concept.

4.51 Those who would argue against depreciating long-lived non-saleable assets of public utilities generally regard such structures as community or governmental assets even though for legal and administrative purposes they are assigned to a utility. Management's only power of decision over such networks once assembled relates to use or non-use and the extent of maintenance to be applied. From the point of view of realization of value through sale (except as an operating unit as a whole) they are 'sunk costs'.

4.52 Under this philosophy, management is accountable in the private sector as lessee of assets with the government as lessor. Thus the entity receives a loan, as distinct from an asset in the usual leasing situation and uses its skills to create the asset. Accountability is discharged by paying the rate of interest on the loan appropriate to the government's cost of capital (possibly the interest rate on semi-government securities) and ensuring that a zero balance on the asset account is achieved by the time the loan is redeemed. The loan repayment could be achieved by appropriating moneys to a loan redemption reserve fund according to the legal requirements for repayment. No depreciation charge is necessary or appropriate under this concept.

4.53 If the loan redemption was based on reasonable assessments of consumers' capacity to pay, then the effect of the philosophy and accounting procedures was to match user payments with the services they actually received i.e. 'user pay' was achieved through needing to cover loan redemption payments. Other accounting treatments can result in users paying for benefits received by past generations (historical depreciation over many years of asset life) or users paying for expansion and benefits to be used by future generations (depreciation based on current costs or management valuations over shorter periods). If pricing policies on a 'user pays' basis are determined by matching revenues with total costs (as distinct from matching costs to expected revenues in competitive private sector market places) this traditional concept of loan redemption is an exercise in relevant accounting. However, because of inflationary effects there would need to be some modification. Interest rates should reflect current opportunities for investment and the value of loans for redemption would need to be indexed. An equitable

solution would ensure that neither the Commonwealth nor present consumers are disadvantaged. The Government, as principal, has the funds advanced to the agency maintained in real terms.¹⁰

4.54 Those who support depreciation in the conventional sense of business financial reporting as embodied in AAS 4 Statement of Accounting Standards-Depreciation of Non-Current Assets, do so on the grounds that depreciation expense is an integral element of the 'full cost' of services provided. The limitations of this concept are well known and have been publicly acknowledged by the accounting profession. Statement of Accounting Practice D1.1, Presentation of Balance Sheet, first issued in 1963, states:

(4) A true and fair view also implies the consistent application of generally accepted principles. Assets are normally shown at cost less amounts charged against revenues to amortize expenditure over the effective lives of the assets or to provide for diminutions in their value. A balance sheet is therefore an historical document which does not purport to show the realisable value of assets such as goodwill, land and buildings, plant and machinery; nor does it normally purport to show the realisable value of assets such as stock-in-trade. Thus a balance sheet is not a statement of the net worth of the undertaking and this is normally so even when there has been a revaluation of assets and the balance sheet amounts are based on the revaluation instead of cost.

4.55 This statement remains representative of the nature of the private sector balance sheet at the present time. The concept of capital maintenance which it depicts is unknown. It is certainly not historical financial capacity nor current financial capacity. Depreciation accounting is now an area of managerial policy incorporating variations in asset values and changes to estimates of useful asset life. The Committee believes that necessary restraints over and above that of showing a true or fair view in terms of conventional accounting as contained in Statement of Accounting Practice D1.1 are required if the depreciation concept is to have acceptance as an element of financial reporting by government bodies with respect to long lived infrastructure assets.

Funds Statements

4.56 The structure of funds statements which are required by listing requirements for public companies in the private sector and which are usually provided by public utilities using accrual based accounting has led to much confusion. The

10 M.E. Aiken, op.cit; p. 58.

Australian Accounting Research Foundation is attempting to rectify the matter by the issue of an exposure draft of a proposed statement of accounting standards.¹¹ This Committee is impressed with the suggested emphasis on the 'total resources' concept of funds rather than the purely 'working capital' concept.

4.57 It is generally agreed that financial statements of public sector bodies are required to provide information on resource flows. This information is relevant to both fiscal compliance and financial viability. In addressing this problem for accounting practices as a whole, McMahon and Mitchell make the following point:

In a broad sense, there are three types of external transactions in which a firm can engage:

- (1) Those in which the components of working capital are affected, but the net amount of the working capital is unaffected (for example, the purchase of stock with cash);
- (2) Those in which the net amount of working capital is changed and also one or more of the non-working capital accounts is affected (for example, the purchase of fixed assets with cash) and;
- (3) Those in which no working capital accounts are affected (for example, the acquisition of a subsidiary through a share exchange).¹²

4.58 The Proposed Statement of Accounting Standards envisages an audited statement of sources and applications of funds as an integral part of the financial statements, and that it is prepared on the accrual basis for the same period as is covered by the profit and loss statement and balance sheet. The point is made that the cash and working capital bases are narrow concepts of funds which can only provide information about specific aspects of the entity. The proposed standard on form and content is:

36. The statement of sources and applications of funds should be presented in a form whereby gross inflows and gross outflows are shown to be equal. Funds from operations (showing separately gross operating fund

inflows and gross operating fund outflows) and the gross inflows and gross outflows of funds relating to other items should be separately disclosed. If changes in individual working capital items (that is, those working capital items disclosed separately in the balance sheet or notes thereto) are not shown in the body of the funds statement they should be shown in supplementary information.

39. Additional Disclosures

Gross inflows and outflows of funds should also be disclosed in the statement of sources and applications of funds for the following items:

- (1) any funds flows resulting from transactions or events which give rise to extraordinary items in the profit and loss statement;
- (4) ...the acquisition of non-current assets - by class of assets;
- (5) the disposal of non-current assets - by class of assets;
- (6) interim dividends and final dividends proposed;
- (7) the proceeds of any share issue or call;
- (8) the amount of any debt refinancing; and
- (9) the amount of any increase or decrease in long term liabilities.¹³

4.59 This statement of proposed accounting standards when modified to reflect governmental sources of financing is appropriate to increased Parliamentary control over autonomous bodies, particularly business undertakings. The total resources format incorporates the effects of all external financing transactions whether or not working capital is involved. Furthermore, the separation of gross inflows and outflows relating to operations from those with respect to other items, particularly longer term items is important. So are the additional disclosures and meaningful classifications. Such funds statements would reflect significant financial policy issues such as the source of funds for acquisition of fixed assets, debt redemption and the utilisation of funds generated by profit in the operations. The Committee recommends that the Proposed Statement of Accounting Standards - Statement of Sources and Applications of Funds be adopted by all governmental business institutions.

11 Australian Accounting Research Foundation, Exposure Draft - Proposed Statement of Accounting Standards Statement of Sources and Applications of Funds, Melbourne, August 1980.
12 R. McMahon and G. Mitchell, 'Funds Statements - The Relationship between the Total Resources and Working Capital Approaches', The Australian Accountant, November 1981, p. 702.

13 Australian Accounting Research Foundation, ibid.

Recommendations

- 4.60 The Committee recommends that:
5. Financial reports of government authorities should reveal:
 - a) resources available to the authority
 - b) obligations
 - c) changes in resources and obligations
 - d) resource flows
 - e) liquidity
 - f) budget forecasts of operations
 - g) commitments and contractual arrangements
 6. Cash based accounting should be eliminated as the primary focus for financial reporting by authorities except for extremely small agency situations. Accrual accounting should be adopted.
 7. For non-business undertakings, to avoid unfairness to management but to also show full costs relating to the organisation, a modified form of the activity statement proposed by the Joint Working Party should be developed, distinguishing between those items which are controllable by management and those which are not. Complementary full accrual financial statements for the responsible department would also show those costs relating to the undertaking for which the department assumes responsibility.
 8. The validity of the concept of depreciation to government owned infrastructures should be carefully considered in relation to both government policies for cost determination and aversion and the economic and physical nature of the resources.
 9. Funds Statements of Commonwealth authorities are to adopt a total resources rather than a working capital or cash basis of funds and are to be published as part of the formal financial statements. The proposed Statement of Accounting Standards - Statement of Sources and Application of Funds should be adopted by all governmental business institutions.

CHAPTER FIVE

EVALUATION OF THE REPORT OF THE JOINT

WORKING PARTY ON FINANCIAL STATEMENTS OF

COMMONWEALTH UNDERTAKINGS

A critical appraisal is presented of the Exposure Draft by the Joint Working Party of the Department of Finance and Office of the Commonwealth Auditor-General on the 'Form and Standard of Financial Statements of Commonwealth Undertakings'. Strengths of the philosophy and content of the document as perceived by this Committee are discussed. The Committee recognises the professionalism of the document but is concerned to a greater extent with the economic consequences of the recommendations of the Joint Working Party. The determination of the Joint Working Party to resist claims for the retention of cash based statements on pragmatic grounds is supported. Answers by the Joint Working Party to responses relating to the Exposure Draft and provided in a Progress Report (December, 1981) are reviewed, and matters needing further research are identified. Finally, answers to a questionnaire circulated by the Joint Committee of Public Accounts to interested accountants are provided in an appendix to this Report.

5.1 In June 1980 a Joint Working Party of the Department of Finance and Office of the Commonwealth Auditor-General produced an Exposure Draft suggesting guidelines for the 'Form and Standard of Financial Statements of Commonwealth Undertakings' in the following terms:

The broad aim of the working party was to develop a viable set of practical guidelines for financial statements of statutory authorities and departmental business undertakings and to permit Audit and Finance to employ a common approach to financial reporting consistent with contemporary accounting practices.¹

5.2 The strength of the document lies in its structure and objectivity in the context of modifying private sector standards for public sector use initiating new proposals where necessary. Further, it aims to provide guidelines for

¹ Department of Finance and Auditor-General's Office - Exposure Draft on the Form and Standard of Financial Statements of Commonwealth Undertakings, June 1980, p. 9.

facilitating required formal financial and auditing arrangements.

5.3 This Committee acknowledges the need for guidelines which will enhance the effectiveness of the appraisal process for the form and content of financial statements by the Department of Finance and of the audit function. It also supports the Joint Working Party's search for formal criteria for a relevant, logical, consistent and verifiable reporting model which addresses observable features of public operations.

5.4 A statement by Maurice Moonitz is used by the Joint Working Party as it begins its advocacy of full conventional accrual accounting for public sector bodies as a significant although not completely general aim:

The function of accounting is (1) to measure the resources held by specific entities; (2) to reflect the claims against and the interests in those entities; (3) to measure the changes in those resources, claims and interests; (4) to assign the changes to specifiable periods of time; and (5) to express the foregoing in terms of money as a common denominator.²

5.5 This statement is representative of financial accounting measurement in private sector market places where features of voluntary capital subscription, competition and the going concern convention apply. After two decades of significant inflation money is now usually defined as the medium of exchange rather than a store of value or a common denominator but the statement has merit for private sector purposes.

5.6 The Report uses this definition as a basis for the following statement:

By concentrating on the resources entrusted to undertakings, on the costs incurred and the flow of financial resources Parliament would be informed and in a position to safeguard, to encourage efficiency and to clarify value criteria necessary to establish priorities and policies.³

While this goal is highly desirable the ability of conventional style statements to satisfy its needs as

2 Maurice Moonitz, The Basic Postulates of Accounting: A.I.C.P.A. Accounting Research Study No. 1. New York, 1961.

3 Department of Finance and Auditor-General's Office - op.cit. p. 17.

expressed above must be questioned. Historical costs do not provide full costs in the sense of current operations. They provide financial control but are not reliable indicators of efficiency. The conventional structure is based upon efficiency generated by competitive market places. Where operations are not constrained in this way and revenues may be matched with costs to achieve a desired result then the policies and priorities which may determine value criteria may not be evident.⁴ Furthermore, efficiency might not be capable of evaluation in such situations and additional statements to be proposed by this Committee may be needed.

5.7 The Report of the Joint Working Party makes the following observations:

The working party considers that the most practical way to define 'costs' is to consider each undertaking as if it were an independent corporation functioning in the private sector. The Commonwealth would then be regarded in the same way as an equity holder in a company. 'Costs' reported would extend to all those directly associable with the principal activities of that undertaking but would exclude those which might reasonably be deemed to be incurred by the Commonwealth in its role as equity holder or as central government.⁵

5.8 The strength of the statement is that the working party realises that because government managers may be subject to varying degrees of Ministerial and other control total accountability does not pass entirely to the management of a government organisation as it does to company directors. Also, there is an acknowledgement that the degree of accountability passing from government departments may vary as between different undertakings, which will affect the extent of costs to be accrued among different authorities. This most persuasive assumption makes the document more meaningful than most competing recent overseas pronouncements on the objectives, form and content of public sector financial statements and is strongly supported by this Committee.

5.9 Identification of government as capital subscriber defines the role of the Commonwealth in too narrow a sense in relation to statutory authorities. This is common to most literature and therefore is not intended as a criticism of the document. The Commonwealth may be seen in both the roles of equity holder and policy maker through the powers reserved for Ministers. However, it should also be seen to have powers and duties commonly associated with creditors and lessors where such assumptions are relevant.

4 See also Chapter 4, pp. 39-41 for further discussion.

5 Department of Finance and Auditor-General's Office, op.cit. p. 20.

5.10 The notion of all advances from the Commonwealth being of an equity capital nature is inadequate as a basis for relevant accounting, given the complexity of operations of authorities and the nature and accountability constraints associated with the infrastructure of public sector services. Moreover, political considerations and policy issues are often at variance with usual private sector ideas of entrepreneurship, maximisation of profits and capital maintenance.

5.11 This Committee has argued that the construction of long-lived assets for specialised community services should often be seen as a series of projects for which those consumers who gain most benefits pay. For example, a generation of citizens should not be subsidised by future generations and one locality should not subsidise another except as a matter of consensus governmental policy. Consumer equity will not be achieved by simply emphasising the entrepreneurial role of government through statutory authorities operating in highly imperfect market places, quite apart from the fact that Government policy may in some cases require such 'cross subsidisation'.

5.12 Cost determinations under full accrual accounting have the capacity to influence prices. It is essential therefore to ensure that cost maximisation without proper bona fides is not used in conjunction with pricing to consumers in order to screen inefficiencies, generate heavy cash flows and predetermine 'community acceptable' profits available for dividends through management valuations and subsequent depreciation calculations. This issue is not adequately addressed by the Joint Working Party Report.

5.13 Questions concerning the 'ownership' of the infrastructure and matching its 'deterioration' under vague concepts of capital maintenance are particularly at issue. Problems of efficiency and the equitable pricing of needed government services are too important to be left to cost determination processes based upon managerial discretion or historical costs. Also, the amounts involved may be sufficiently large to affect basic governmental policies for future economic management. Prices of government services invariably find their way into 'baskets of commodities' used for establishing changes in price indices.

Effects of the Proposed Guidelines

5.14 The Joint Working Party has exhibited a considerable degree of skill in identifying existing practices and recommendations from both the public and private sectors and in constructing the reporting model in a cohesive way. A difficulty is that the model embodies conventional modes of thought as well as initiatives and pragmatic considerations for facilitating accounting and auditing procedures. The economic and social consequences of the procedures advocated

appear to be considered by the Joint Working Party as a secondary purpose of the document.

1.8. Principal effects of the guidelines would be to require:

(a) use of full accrual accounting by all undertakings except where reporting objectives could reasonably be deemed to be achieved by 'cash' based statements;

(b) preparation of a Statement of Changes in Financial Position ('funds statement') by all undertakings;

(c) modification of Income and Expenditure Statements prepared by non-trading bodies to a 'Statement of Activity' which more clearly distinguishes between funded and unfunded liabilities (depreciation and long service leave);

(d) improved segmental reporting by trading bodies; and

(e) improved disclosure of leasing arrangements.⁶

5.15 Except for item (a), which emphasises conventional accrual accounting to measure the 'full cost' of services, the effects of the Joint Working Party Proposals are very desirable. This might also be the case with full accrual accounting but the Joint Working Party should be supported by research from the profession on this issue.

Joint Working Party Progress Report - December 1981

5.16 The Joint Working Party from the Department of Finance and Office of the Auditor-General has responded to a variety of comments on the Exposure Draft issued in June 1980. Furthermore, its Progress Report notes assertions of a number of committees made since the original presentation.

5.17 Overall the Joint Working Party maintains its position of presenting a modification of private sector standards in a professional manner. A concession to the variability of managerial authority in the public sector is given in the form of an activity statement which modifies the full accrual concept but captures important events which may materially effect an organisation's viability, for example, provision for superannuation and provision for long service leave.

5.18 Reports of inquiries examined by the Joint Working Party comprise:

6 Department of Finance and Auditor-General's Office, op.cit., p. 7.

- Victorian Public Bodies Review Committee 'Report on a Study of the Audit and Reporting responsibilities of Public Bodies in Victoria'.
- Victorian Public Accounts and Expenditure Review Committee Discussion Paper, 'Review of the Audit Act'.
- The 'Jamieson' Commission of Inquiry into the Efficiency and Administration of Hospitals.
- The 'Dix' Committee of Review of the Australian Broadcasting Commission.
- The Senate Standing Committee on Finance and Government Operations Inquiry into the Australian Dairy Corporation and its Asian Subsidiaries.

5.19 The last mentioned inquiry is important in that it clearly identifies the need for adequate standards of disclosure where statutory bodies or their agents enter into joint ventures. The Joint Working Party gives credit for initiatives made by the above bodies and the development of useful ideas where these are apparent. However, where dogmatic claims for adopting private sector practices are evident the Joint Working Party criticises such arguments.

5.20 Many respondents to the Exposure Draft attempted to dismiss calls for full accrual accounting on pragmatic grounds of the additional costs involved. This Committee supports the Joint Working Party in rejecting this argument. Disclosure of the use of public resources cannot generally be attained using a cash basis of accounting.

5.21 The problem for this Committee in fully supporting the Joint Working Party is not related to the use of cash based systems by government authorities. It is the Joint Working Party's lack of emphasis on examination of environmental factors specific to governmental operations. An events approach which captures all material aspects of periodic operations as they occur is very much needed. However, whether or not such an approach can be reconciled in a meaningful way with conventional accrual accounting from the private sector is a matter for research.

5.22 The Joint Working Party feels that the proposed guidelines should not have any material impact on the pricing of goods and services because the authorities concerned are already using commercial type accrual accounting. This misinterprets the thrust of this Committee's concern. We are worried about the effects of such full cost entity type valuations as practiced at present on pricing to consumers.

If there are inequities the proposed guidelines will entrench these under professional standardisation.

5.23 A second point made by the Joint Working Party is that product costing is somehow not directly linked to the content and quality of disclosure in external financial statements. The Committee understands that user to pay pricing policies are addressed at the macro level of accountability, i.e. for the organisation as a whole which is ultimately revealed by surplus/deficit, profit/loss determinations in the financial statements. Costing at the product or individual service or micro level will be intimately influenced by the need for acceptable performance in terms of overall financial accountability under user to pay policies.

5.24 Again the Committee wishes to point out that differences in views between itself and the Joint Working Party are not concerned with any support for cash based as against comprehensive accrual accounting systems. They are concerned with underlying doubts of the Committee about the validity of private sector financial reporting objectives when applied in the public sector. This matter is seen as deserving adequate research before conventional financial models are accepted as an article of faith and enshrined by standardisation.

Conclusions

5.25 The Report of the Joint Working Party has provided a highly professional initiative and frame of reference for further work in the area. The provision of guidelines for public sector financial reporting is a matter of the utmost importance and urgency.

5.26 Areas of debate which need intensive research and which have not been addressed by the Joint Working Party Report include:

- the inclusion and reporting of large scale financial commitments.
- determination of the relevance of historical cost and price change accounting models for full cost determination in the public sector (The Comptroller General of the United States has attacked historical cost as irrelevant).
- analysis of the extent to which separate entities, the subject of accounting models based on entry prices (historical or replacement), as distinct from agencies exist in the public sector given reserve powers of Ministers.

- identification of other methods not generally used or proposed in the private sector for measuring full costs in government agencies rather than treating each authority as a separate entity for this purpose.
- determination of the effect of using entity based accounting models or pricing policies in the public sector where the objective may be to maintain the financial amounts of government funding in real terms and cover opportunity costs of such funding to an agency, rather than to maintain an entity's 'wealth'.
- identification of a set of objectives for public sector reporting which are relevant in terms of economic planning; accountability and stewardship realities; full cost determination as a legitimate economic concept; and the needs of governing bodies to evaluate managerial budgets, commitments, economy, efficiency and program effectiveness.

5.27 The Public Accounts Committee, whilst supporting the general thrust of the Report and Exposure Draft considers that, prior to implementation, the matter should receive wide circulation, informed discussion and general acceptance throughout the Commonwealth. To this end, the Committee in association with the Australian Society of Accountants has conducted seminars in all State Capitals to evaluate the Joint Working Party's Report. These seminars were well attended, which indicated that there was a high level of interest in the subject by government accountants. A questionnaire, written by the Public Accounts Committee, was distributed and answered by interested contributors from the accounting profession.

5.28 The Committee notes that almost all respondents to the questionnaire accepted the need for improved disclosure and accountability standards for public sector authorities at all levels of government. In particular, the Committee notes that respondents supported the principles outlined in the Exposure Draft and believed that if they were adopted the standards of public sector accountability and reporting would equal or surpass those currently used in the private sector. Respondents in general agreed with the approach adopted by the Joint Working Party in drawing upon the Ninth Schedule of the Companies Act, but considered that public sector organisations should provide a funds statement with their annual financial reports.

5.29 There was also general support for the use of full accrual accounting in government organisations, including the requirement that the value of resources provided free of charge should be disclosed in the financial reports. Most respondents did not consider that there were any inherent problems in producing a general standard specifically for

government accounting in the Australian Public Service. An analysis of the responses to the questionnaire together with selected comments are presented at Appendix B.

5.30 The Committee supports the aim of the Joint Working Party from the Department of Finance and Office of the Auditor-General to develop a viable set of practical guidelines for financial statements, but in a broader framework, discounting emphasis on contemporary commercial accounting practice.

Recommendations

5.31 The Committee recommends that:

10. The Statements of Activity suggested by the Joint Working Party for agencies with less than full autonomy and management accountability in the commercial sense should be evaluated for early implementation in place of cash based financial reporting.
11. The Joint Working Party should join with accounting and other interested groups to further evaluate the nature of financial reporting by public sector bodies. Government financial support at Commonwealth and State levels should be sought by a suitably organised proposal from the accounting profession.

CHAPTER SIX

ADDITIONAL DISCLOSURE REQUIREMENTS

FOR PUBLIC SECTOR REPORTING

An overview and re-emphasis of issues addressed earlier in the Discussion Paper relating to monopoly pricing and consumer equity; efficiency reporting by government authorities within the financial reporting framework; budgetary control and disclosure; and the elements of accounting for financial commitments.

Economic Efficiency and Consumer Equity

6.1 Many statutory authorities hold a monopolistic position in relation to the provision of needed goods and services to the public. Monopolies generally exist where large scale production leads to decreasing costs over a wide range of output. Monopolists generally face two constraints in relation to profit determination. Firstly, every product has some substitutes if its price becomes unacceptably high. Secondly, the larger the profits made, the greater is the chance of a competitor entering the industry despite very high costs and risks.

6.2 Where an authority has a public franchise then substitution is the major cause of concern. Thus public resistance to the postage service when prices of stamps rose by over 60% and to short-haul domestic air flights when pricing was adjusted to emphasise 'flag fall' indicate that franchised authorities are to an extent constrained by economic forces.

6.3 The difference between these two examples is that the first relates to a monopoly situation and the second to duopoly. Research has not proved conclusively that duopoly is effective in causing privileged utilities to reduce costs and introduce technical improvements when compared to the relative performance of monopolists.

6.4 For the monopolist, as a price maker, there will be an economic goal to produce to a point where marginal revenue is equal to marginal cost. However, as distinct from producers in many competitive markets the monopolist may be a

utility which provides the same price to most consumers. Thus if price is lowered to sell more services then it is lowered to most customers.

6.5 The natural tendency of monopoly is to provide too few services at too great a price.

6.6 An answer to this problem when greater output is required from a public body is to subsidise the utility for profits lost when output exceeds that indicated by equating marginal revenue and marginal cost. However, such a proposal would no doubt meet with community resentment. The practical answer usually adopted is to ask the utility to meet public demand as far as possible and to charge the lowest price providing a 'fair return on investment'.

6.7 Four major concerns are associated with this widespread solution to the problem:

- How should the return on investment be calculated?
- What is a fair return on investment?
- How is investment to be measured?
- How are efficiencies introduced so that costs are minimised without the stimulus offered by competition?

6.8 These questions are fundamental to the efficiency of resources allocation and, thus, to the effectiveness of accounting and financial reporting which attempt to provide information on the subject.

6.9 Issues on the calculation of the return on investment have been discussed earlier in Chapter 4. The determination of a fair rate of return could conceivably be the subject of disputation and arbitrary judgement. However, if one looks for a guide to the cost of capital of government, the going market rate for semi government securities provides one possible answer. Of more importance than precise estimation of a fair rate of return on investment is measurement of the investment itself. This question has been addressed by Professor George L. Bach of Stanford University:

...the investment figure varies greatly during inflation; depending on whether we use the original cost of the investment less depreciation or the higher replacement cost (because of the inflation). Most economists consider replacement cost the more meaningful and flexible figure, but many commissions drag their feet because replacement cost implies higher rates in inflationary times like now.

1 W.J. Primaux, 'A Recommendation of the Monopoly Market Structure for Electrical Utilities' in A. Phillips, eds. Promoting Competition in Regulated Markets, Washington, The Brookings Institution, 1975.

2 George L. Bach, Economics - An Introduction to Analysis and Policy, Prentice-Hall, New Jersey 1980, p. 346.

The reason why many economists would be advocating current cost depreciation is that they see as do most accountants, the government in a purely entrepreneurial role as equity holder. Under this concept there is a need to maintain invested entity capital in current terms, including capital directed towards the construction of non-saleable long-lived assets and infrastructure. This Committee has maintained throughout that pricing policies must not be tied to managerial discretion relating to revaluation of the infrastructure and subsequent depreciation calculations if equity to consumers is a goal under the notion of 'user pays'. The government's contribution to long-lived projects can be maintained in real terms by adjusting advances for inflation and paying current interest rates thereon. This procedure is more objectively relevant, and fair in application given the absence of market forces for price determination.

6.10 The government is thus seen as a creditor or lessor who provides the infrastructure under the control of the authority and retains residual ownership once the terms of the lease agreement have been met. The assets have no market price as such even though in use. The operating costs of the agency include the costs of maintenance. The amount to be repaid to the government (excluding interest) is a capital redemption and advances are indexed so that Government as the principal maintains its funds advanced to the agency in real terms.

6.11 Professor Bach himself points out the danger if Government is seen as solely an equity holder and profit taker with respect to the long-lived non-saleable asset systems of public utilities.

...inefficiency is one of the greatest dangers for regulated monopolies. The danger is compounded by the fact that by increasing its scale of investment wastefully, a regulated utility can increase the size of the 'rate base' on which its 'fair return' is calculated, if the regulators don't catch on to what it is doing.³

6.12 This Committee's concern is that full accrual accounting from the private sector provides an instrument for implementing such inequitable conduct. We suspect that the practice is widespread in Australian Government businesses even if accountants and managers are not conversant with the implications. They probably feel that they are simply meeting the requirements of modern accounting practice as required by the Department of Finance and the Commonwealth Auditor-General. They also realise that bigger cash flows are better than small cash flows and that such systems are good for them, at least under present conventions and doctrines. In the

absence of any meaningful concept of capital maintenance or expense relating to the infrastructure, the use of depreciation accounting can move prices either up or down for consumers - past, present or future, depending upon the situation and the arbitrary calculations involved. The Committee has proposed a method for promoting equity among different generations of consumers. However, the evaluation of efficiency leading to effective resource allocation in the absence of market dominated pressures is also a problem to be addressed by financial statements.

Efficiency Reporting⁴

6.13 Where one wishes to maximise monopoly profits, as has been stated, it is possible to compare total cost and total revenue at each different level of output to find where the variation is largest. This can be more easily calculated by equating marginal cost and marginal revenue, that is, to produce to a point where revenue from selling an additional unit remains greater than the marginal cost of producing the unit. This is the point of greatest economic efficiency in the sense of profit maximisation.

6.14 However this does not necessarily imply that the goods or service has been produced at the lowest possible unit cost for that level of output. Waste or inefficient methods and procedures may be present, particularly in the absence of competition.

6.15 If an authority is franchised and asked to produce required output at the lowest price giving 'a fair rate of return on investment' then a statement of unit costs may be helpful in evaluating efficiency. It is accepted that policies relating to community needs will not accept production at the point of greatest economic efficiency or profit maximisation. Although many aspects of the efficiency of an authority must be subjected to project type efficiency audits and be the focus of a special ad hoc report in their own right, there are general efficiency indicators which may be modified for inclusion in financial statements. If the major products and services are identified and a comparative statement of the unit cost, or cost per standard parcel of units (eg 100,000 units) for, say, the last five years is prepared, then information on efficiency not contained in conventional statements is available. These are unit costs of outputs, and may be regarded as akin to productivity measures.

4 See also p. 24.

3 George L. Bach, ibid.

6.16 This may be done according to relevant classifications of types of products produced or services provided on appropriate geographical and other bases of social and community need. If properly audited such information can be accepted as reliable and may be used by Parliamentarians to pinpoint areas of efficiency and, also, costs associated with the fulfilment of social needs. For instance, overall profits might be declining but unit costs in areas unaffected by political decisions might also be declining or at least growing more slowly than costs generally in similar areas.

6.17 This Committee believes that presentation of appropriately classified comparative statements of unit costs of products and services should be a mandatory element of financial reporting by public sector organisations. This requires the development of adequate and meaningful measures of output which reflect the goods and services provided by each organisation.

6.18 It is recognised that efficiency auditing extends beyond possible modifications and extensions of financial statements. This is supported by the nature and content of efficiency auditing reports of the Auditor-General, a number of which have already been tabled in the Parliament. This Committee noted in Chapter One that much attention in the private sector is now being given to the 'Chairman's Report', which usually comments upon key performance indicators and contains information additional to that supplied by financial statements.

6.19 There would appear to be a role for Commissioners to report on the efficiency of operations, and this is already occurring in many Annual Reports of statutory authorities. Indeed, one would expect organisations to develop such measures for their own internal evaluation purposes. This Committee proposes that consideration be given by the Auditor-General to applying his efficiency auditing powers to an evaluation of such management statements. He would report on the adequacy, (in the sense of adequacy as a measure of the organisation's activity) validity and accuracy of the reported performance measures. Rhetoric and advocacy by Commissioners would be balanced against a critical audit appraisal of major effectiveness and efficiency indicators of the issues involved.

Program Statements and Effectiveness Reporting

6.20 However, achievement of financial objectives is only part of the issue. Most organisations, particularly those of a non-trading nature have service objectives in the sense of providing goods or services to achieve a particular objective. Evaluating the extent to which these objectives are achieved is generally described as evaluating effectiveness. This is a different concept from efficiency which relates to unit costs

of goods or services. Effectiveness relates to the appropriateness of the resources used to achieve the organisation's objectives.

6.21 The budgets and financial statements of all departments and most authorities are prepared on an inputs basis - i.e. the accounts summarise expenses on salaries, overtime, office expenses et cetera for the whole organisation. No information is however provided on the full cost of individual programs. A program is best regarded as an activity or a series of activities related to a particular objective of the organisation. The purpose of a program statement is to provide this information on program costs which can then be used in effectiveness and efficiency reviews.

6.22 In 1979 the House of Representatives Standing Committee on Expenditure considered that a program statement has four main features.

- it identifies specific government policy objectives;
- it specifies the activities that contribute to the objectives;
- it identifies the resources and costs required to achieve the objectives; and
- it contains measurements or assessments of outputs.

6.23 Thus, program statements would form the basis for assessing the organisations effectiveness. The House of Representatives Expenditure Committee recommended that the government should encourage the development of program statements by all Departments, and that these should be published soon after the Budget is presented to the Parliament. The Government in response has decided that work is to be commenced on the development of Program Statements, and that as a first step the Department of Finance will prepare guidelines for departments with a view to maintaining consistency and comparability of presentation. The Government has commented, however, that significant costs can be involved in producing program statements. The Department of Finance is also currently preparing a paper on the advantages of changing the appropriation bills to a program format.

6.24 In the light of this response, this Committee considers that the managements of statutory authorities and other government undertakings should also prepare program statements, except where the costs of doing so would be substantial, or where a statement would, of necessity, disclose necessarily confidential commercial information. However the Committee would envisage such instances to be comparatively rare, as program information should already be extensively used by internal management for expenditure control and pricing policies, so the costs of public disclosure would be relatively low, and the commercial-

in-confidence criteria should only apply to isolated sections of the larger trading authorities.

6.25 The Committee considers that there should be a cyclical review of all government undertakings to determine their effectiveness and efficiency and need for continued existence. It is considered that these reviews can be accommodated within the framework of the current Parliamentary Committee system. The Committee sees the development of program statements and efficiency and effectiveness criteria for all government organisations as a more effective area of effort than sunset legislation under which organisations automatically cease to exist after a specific time unless Parliament acts to continue it.

Budgetary Control and Disclosure

6.26 It has long been symptomatic of a lack of accountability in various aspects of public sector activities that little effort is made to establish clearly defined objectives against which management performance can be measured. Of course estimates and budgets relating to cash receipts and outlays provide for a limited scope evaluation, based on legal and financial compliance for the governmental financial system as a whole. One method of assessing management's capacity to meet clearly defined objectives is enforcement of disclosure of the organisation's financial goals, as these are formulated for internal purposes by the organisation's budgeting system.

6.27 Most statutory authorities currently operate on the basis of clearly established goals and forecasts in the public sector. Also it may be assumed that such budgets are flexible so that variations in demand flowing from changes in economic conditions and alterations of government policy are accommodated as they occur. The Committee believes that accountability is closely related to these procedures in the public sector.

6.28 Budgets and operating standards provide criteria against which the actual performance of the entity can be assessed. For any authorities who are not fully meeting their responsibilities for adequate planning, the disclosure of budgets with related criteria for performance assessment would provide discipline in progressive management. The publication of key elements of the budgetary process and related performance criteria by those authorities whose planning and forecasting capabilities are already great, would not seem to impose any unnecessary hardship or unfair restraint upon managements unless performances are materially affected by market forces and competition.

Annual Reports and Notes to the Accounts

6.29 It is now widely accepted practice for the management of government organisations to provide significant non-financial information in annual reports to the Parliament. The Committee welcomes this development. Such information provides users with additional details on the objects and achievements of the organisation over the previous year. In 1979 the Senate Standing Committee on Finance and Government Operations recommended that the following basic non-financial information should be included in all Annual Reports.

- the Minister through which the authority reports to the Parliament;
- the members of the authority and the terms of their appointment;
- the executive officers of the authority;
- the statutory powers (including the power of direction) which the Minister has over the authority and details of the exercise of any such powers;
- the statutory functions and purposes of the authority;
- a description of the principal activities of the authority;
- a description of major problems which have arisen in the authority's activities, including details of requisite Governmental action to overcome such problems (e.g. the amendment of the enabling Act);
- the plans of the authority for major future activities;
- a list of any documents prepared by the authority which are of public interest; and
- a description (including the results) of research by the authority, in the context of other research being undertaken elsewhere on the same subject.

6.30 It also recommended the passing of an Annual Reports Act to ensure compliance.

6.31 The Public Accounts Committee while supporting the above recommendations considers that the information provided in annual reports should be complete but concise, and presented in a style which should not confuse readers. As the annual report is the primary instrument for the organisation to communicate with both the Parliament and the community,

detailed consideration should be given by management to its preparation. Parliament, in turn, should also more clearly express its requirements. Annual reports should not be viewed simply as a public relations document, nor should they merely be a repetition of the previous years report, with the figures updated.

6.32 Notes to the financial statements contained in annual reports should be used where appropriate to clarify individual items or to meet the appropriate disclosure standards. In cases where the organisation has changed any aspect of its accounting procedures during the preceding year an explanatory footnote should be used.

6.33 On 16 September 1982 the Senate Standing Committee on Finance and Government Operations tabled its Fifth Report on Statutory Authorities of the Commonwealth. This Report contains a categorisation of authorities, which can be used as a basis for determining the functions, independence and financial accountability of particular organisations. In terms of financial accountability the Senate Committee generally concurs with the Joint Working Party's proposals, and considers that the proposals should form the regulations under an annual Reports Act. Additionally the Report examined in detail the relationship between Ministers and statutory authorities, particularly with regard to the concept of ministerial responsibility. The economic impact and financial behaviour of statutory authorities is also considered. The Public Accounts Committee supports the work of the Senate Standing Committee on Finance and Government Operations and considers that its six Reports on statutory authorities have been significant in improving the the accountability of many government organisations.

Commitment Accounting

6.34 Under the guise of certainty and the resulting 'realisation principle', conventional accounting disregards many major contractual arrangements and commitments which may vary an organisation's financial capacity in a material and significant manner. Commitment accounting is essentially important in two ways. Firstly, a commitment may exist in terms of operations and related revenues which ensures, usually through contractual arrangements, that a new market will certainly open up or an existing market will be expanded. Under the realisation principle such opportunities are usually regarded as 'uncertain' until the actual point of sale and thus no benefits are recorded or necessarily disclosed. Of course if conditions occur which make contractual obligations unfavourable, then a 'contingent' liability will be raised.

6.35 This is a major defect of financial reporting in both the public and private sectors and can lead to much confusion

about an organisation's true economic position. It is possibly more important than failures of the conventional reporting framework to deal with either inflationary effects or forecasting needs of economic decision makers who use financial statements.

6.36 The Committee's view of this matter is that as a minimum, significant arrangements which will have a material bearing on an authority's operations should be incorporated into forecasts and be the subject of an announcement in the Commissioner's (or Chairman's) Report.

6.37 The second area where additional disclosure requirements for accountability exist is in the area of capital expenditure. Constraints on the availability of capital for general use occasioned by existing contracts for large scale capital expenditure projects are not always made clear by financial statements and their accompanying notes. Parliamentary scrutiny of the progress of large scale ventures and projects of this kind is essential. This requires a progress statement of contractual costs, costs incurred to date and variations from original estimates and obligations, and a forecast of costs to completion and likely variations from original estimates. Parliamentary scrutiny of performance requires financial budgets and costs to be incorporated in such statements of capital expenditure.

Recommendations

6.38 The Committee recommends that:

12. Measurement of the investment base on which a fair rate of return is expected should be a major objective of research in public sector accounting under the 'user to pay' philosophy.
13. The presentation of unit costs of different goods and services into a multiple period comparative statement should be an integral feature of all financial reporting requirements for governmental bodies. Such reported information should be subject to audit.
14. Budgeted and actual performance should be shown where possible in published financial reports of governmental authorities.
15. Where problems exist in determining evaluation criteria the matter should be addressed in the organisation's Annual Report.
16. Annual Reports should provide non-financial information about key performance indicators and adequate explanations of what these predict for the future operations of the authority.

17. Program statements should be prepared by all Government undertakings except where such a statement would disclose necessarily confidential information.
18. Commitment accounting should be implemented with respect to:
 - (a) large scale contracts in respect of operations, and related revenues, and
 - (b) capital expenditure control.

CHAPTER 7

OTHER ISSUES

Delays in the Submission of Financial Reports to Parliament

7.1 For some years the Parliament and the Auditor-General have expressed concern over the length of time it takes for some government authorities to prepare their financial statements and submit them for audit and presentation to the Parliament.

7.2 The Companies Acts provide severe penalties for private sector firms which do not produce their financial statements to shareholders within 6 months of the close of the financial year to which they relate. The Committee believes that similar requirements should apply to the managers of public sector authorities. In this regard the Committee concurs with the recommendations of the Senate Standing Committee on Finance and Government Operations which says in effect, that the audited financial statements of all public sector authorities should be presented to Parliament as soon as practicable, and certainly no later than 6 months after the close of the financial year.

Accountability to Parliament

7.3 The growth in the number and size of organisations established by and reporting to the Commonwealth Parliament has resulted in a considerable increase in the amount of information. Consequently, the time that the Parliament and its Committees can devote to considering the annual reports of individual organisations, including their financial statements is extremely limited. This means that if Parliamentarians are effectively to fulfil their responsibility to the community and ensure that public monies are spent efficiently, then the financial reports presented for scrutiny must be intelligible to a reader who has little or no knowledge of the organisation's functions.

7.4 To ensure full accountability to the Parliament, the financial statements must show relevant resource costs and also explain sources and disposition of funds. This envisages the departmental head as a cost manager as well as a cash manager. A Commissioners' Report is also required to develop a reader's understanding of how events (past, present and future) have shaped the authorities present condition.

Government Accounting Research

7.5 Paragraph 4.4 of the Progress Report of the Joint Working Party on Financial Statements of Commonwealth Undertakings draws attention to the paucity of the Australian

research into government accounting. This discussion paper also identifies a number of government accounting matters needing further detailed research (see Chapter 5). In 1981 the Australian Accounting Research Foundation decided to commence investigating the issue of accounting standards for government. In December 1980, the United States Financial Accounting Standards Board released conceptual statements on government accounting.

7.6 In the private sector, the National Companies and Securities Commission has recommended that an Accounting Standards Review Board consisting of both business and professional representatives, be established. The major functions of this board would be to approve priorities proposed by accounting bodies for the formulation and review of standards, and to organise the authorisation and implementation of accepted proposals.

7.7 The Committee recommends that Governments provide support for necessary research which will lead to the development of a comprehensive set of accounting standards for the public sector.

7.8 In this regard the Committee further recommends that an Accounting Standards Review Committee be established, with its secretariat being located within the Department of Finance. This Committee's membership could be drawn from representatives of the following organisations.

- . the Department of Finance
- . the Auditor-General's Office
- . the Public Service Board
- . the Finance Committees of Parliament
- . the Australian Accounting Research Foundation
- . the Australian Society of Accountants
- . the Institute of Chartered Accountants in Australia

7.9 The role of the Review Committee would be to examine government accounting and reporting standards and to make recommendations for improvements in the light of current research and experience. An independent Chairman for the Accounting Standards Review Committee should be appointed by the Minister for Finance.

7.10 The establishment of an Accounting Standards Review Committee should help to refine standards and provide a powerful incentive for the managements of all government undertakings to improve and standardise their financial reports.

Professional Status of Government Accountants

7.11 The Public Accounts Committee has for many years been concerned that the number of qualified accountants employed in

the public sector is very low. For example in 1980/81, there were less than 2,000 qualified accountants employed by all public service departments throughout Australia. Additionally, the Committee has been concerned that the status of qualified accountants within the public sector is not sufficiently defined or recognised.

7.12 The Committee therefore supports the founding of Government Accountants Groups within Branches of the Australian Society of Accountants in all States. These groups have been active in promoting seminars and discussions on all aspects of public sector accountability and management issues. The work of these groups has, in part, contributed to the current debate on the adequacy of government accounting standards. It is also noted that the Public Service Board has been associated with government accountants on internal audit and ADP issues. The Committee hopes that this trend will continue, and believes that the use of appropriately qualified accountants at senior levels of the Public Service should improve the quality of the financial administration generally.

Private Sector Involvement

7.13 Private sector involvement in the formulation and review of government accounting standards can relate to the provision of internal and external audit services to departments and authorities.

7.14 The Auditor-General should be the external auditor for all Government organisations. Should it be necessary to employ private sector firms because of insufficient resources in the Auditor-General's Office, such firms should be employed by and be responsible to the Auditor-General. The Auditor-General would remain responsible for such audit work. This approach retains the advantage of Parliament having one national Auditor to work with. It should also help maintain consistency of auditing standards while still significantly enhancing staff development and training through the interchange of ideas and procedures used in both sectors.

7.15 In Canada, private firms are assisting the Auditor-General to scrutinise government departments. The Canadian Auditor-General is personally involved in the selection of private sector firms for government audit work. The Committee also notes that the Northern Territory Government has instituted a similar scheme for contracting external audits from July 1 1982.

7.16 The Joint Implementation Committee on Internal Audit (JIC) considered that in some circumstances the use of properly controlled and organised resources from outside an organisation's own establishment could help to make internal audit more efficient and effective. A copy of the JIC's conclusions are at Appendix C.

7.17 The Public Accounts Committee supports the JIC's recommendations. There may also be the need for private sector management consultancy services to be provided in specialised instances.

Comparability of Federal and State Accounting and Budgeting Systems

7.18 In 1939 the Commonwealth Grants Commission recommended that a move be made towards uniformity in systems of public accounting. This view was again reaffirmed in 1981. A common set of standards for accounting and budgeting systems of government would enable amounts raised and spent to be compared as between the various levels of government.

7.19 A further matter of concern is the inability of auditors to cross state or federal boundaries in order to trace the disposition of funds. This becomes a question of sovereignty of government versus effective control and verification of public monies. The matter can only be resolved by discussion at the highest levels of government. Adequate and comprehensive audit trails are necessary for financial control, especially using modern computer technology.

7.20 The Committee believes that discussions should be held between relevant Commonwealth and State government ministers and officials on the desirability of introducing a uniform set of accounting standards and procedures for public sector authorities at all levels of government throughout Australia. An appropriate mechanism for this issue to be considered would be for a working party to be established by the Premiers Conference.

Use of Free Assets and National Treasures

7.21 The Committee has noted a growing incidence of the use of donated and other 'free' assets by public bodies. It is considered appropriate for these resources to be brought to account at a valuation reflecting economic realities and transactions.

7.22 The Committee previously recommended in this Report that responsible Departments list materials and objects of national importance in their consolidated accrual based financial statements. The authorities themselves should list items of significant value such as the national art collection in a footnote or in the Commissioner's Report. Such references should ideally indicate original costs of acquisition and current costs of replacement, if possible.

Conclusions

7.23 Much has been said about the commonality of standardisation requirements in the public and private sectors. Less has been said about the differences which are substantial. Of particular importance is the tendency of the community to assign responsibility for financial and operating conditions to the appropriate Minister. The position of management in such a situation is more restricted than in the private sector where directors are fully accountable for all operations of their organisation.

7.24 The diversity of financial accountability in government needs to be considered as a basic frame of reference for the development of the reporting framework and accounting standards. Progress will be limited until accounting standards recognise that unlike situations demand special reporting consideration. These will emphasise the purposes of management in essentially different stewardship and cost determination situations.

Recommendations

7.25 The Committee recommends that:

19. The audited financial statements of all government organisations should be presented to Parliament within six months of the close of the financial year to which they relate.
20. An Accounting Standards Review Committee should be established to examine government accounting and reporting standards, and to make recommendations for improvement. This Committee should consist of representatives from the Parliament, the Public Service and the Accounting Profession.
21. Federal and State Governments should provide financial support for necessary research to develop a comprehensive set of accounting standards for the public sector.
22. Discussions should be held between relevant Commonwealth and State government ministers and officials on the desirability of introducing a uniform set of accounting standards and procedures for public sector authorities at all levels of government throughout Australia. An appropriate mechanism for this issue to be considered would be for a working party to be established by the Premiers Conference.
23. The use of donated and other 'free' assets by public bodies should be brought to account in the financial statements at a realistic valuation. An inventory of items of national importance owned by departments or authorities should also be included in annual reports.

APPENDIX A

**REPORT OF THE JOINT WORKING
PARTY ON FINANCIAL STATEMENTS
OF COMMONWEALTH UNDERTAKINGS
(Abridged Edition)**

**Department of
Finance**

**Auditor-General's
Office**

JUNE 1980

OUTLINE

This condensed edition of the Joint Working Party's report is intended for use with the Exposure Draft on Guidelines for the Form and Standard of Financial Statements of Commonwealth Undertakings.

The report endeavours to:

- (a) set out basic objectives (or functions) to be served by financial statements of Commonwealth statutory authorities;
- (b) establish a General Accounting Standard, dealing with minimum disclosure requirements and basic techniques which would be applicable to all such bodies;
- (c) identify specific pronouncements of professional accounting bodies which could be associated with particular categories of authorities either as mandatory standards or as persuasive guides to accepted accounting practice.

In doing so a number of accounting issues of particular concern to Commonwealth undertakings are discussed. These include fund accounting, tax effect accounting and problems experienced when using conventional accrual based reports in non trading bodies. Broad implications for the adoption of the Guidelines contained in the Exposure Draft are also examined.

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CHAPTER 1 - SUMMARY AND RECOMMENDATIONS

- 1.1 The working party was set up to develop a viable set of practical guidelines for the form and standard of financial statements of Commonwealth statutory authorities and departmental business undertakings which would have the backing of both the Auditor-General's Office and the Department of Finance.
- 1.2 The task was undertaken by:
 - (a) identifying the general information needs of users of such financial statements;
 - (b) formulating a set of basic objectives for such statements;
 - (c) developing a General Accounting Standard applicable to all bodies;
 - (d) categorising all known reporting bodies into six broad groups; and
 - (e) identifying specific professional accounting standards and other authoritative pronouncements which could be associated with each group.
- 1.3 The study did not extend to the evaluation of novel or polemical issues in contemporary accounting such as Current Cost Accounting or the Value Added Statement. Instead it has concentrated on identifying a body of orthodox practices which would enable statements to be prepared to the highest conventional standards.
- 1.4 The working party recommends (3.34) that as a matter of general policy the published financial statements of Commonwealth undertakings should indicate to readers the:
 - (a) cost to the taxpayer of operations of the undertaking over the reporting period and preceding periods;
 - (b) net resources currently devoted to the undertaking's activities;
 - (c) solvency of the undertaking;
 - (d) change in the level of net resources held since previous reporting date and the manner in which that change came about.

- 1.5 The working party recommends the adoption of accounting standards and pronouncements of the professional accounting bodies where they can reasonably be considered to assist in achieving the above objectives (4.13, 4.14).
- 1.6 The working party recommends endorsement of the enclosed "Recommended Guidelines". These comprise:
- (a) a General Accounting Standard applicable to all undertakings; and
 - (b) specific standards and "Guides to Accepted Accounting Practice" applicable to particular categories of undertakings.
- 1.7 The General Accounting Standard is drawn largely from companies legislation and deals principally with valuation practices and disclosure requirements presently applicable to the bulk of profit and non-profit bodies in the private sector. Specific standards are taken from Australian Accounting Standards and International Accounting Standards. The Guidelines also refer to a separate group of pronouncements of US origin which deal with specialised areas of accounting (eg museums, broadcasting). The working party recommends that these be recognized as persuasive "Guides to Accepted Accounting Practice".
- 1.8 Principal effects of the Guidelines would be to require:
- (a) use of full accrual accounting by all undertakings except where reporting objectives could reasonably be deemed to be achieved by "cash" based statements;
 - (b) preparation of a Statement of Changes in Financial Position ("funds statement") by all undertakings;
 - (c) modification of Income and Expenditure Statements prepared by non-trading bodies to a "Statement of Activity" which more clearly distinguishes between funded and unfunded liabilities (eg depreciation and long service leave);
 - (d) improved segmental reporting by trading bodies; and
 - (e) improved disclosure of leasing arrangements.
- 1.9 Stemming from consideration of particular accounting issues the working party also recommends that:
- (a) if the accounting profession is unable to produce a standard relating to the translation of foreign currency, action be undertaken to develop a consistent interim standard for Commonwealth undertakings (6.11);

- (b) the form and nature of the Canberra Municipal Accounts be reviewed in terms of their ability to service basic reporting objectives and that pending such a review cash based statements complying with the disclosure requirements of the General Accounting Standard, be prepared (6.85);
 - (c) the implications of the use of tax-effect accounting by business undertakings merits further study in terms of consistency with basic reporting objectives. (7.9-7.16);
 - (d) further study be undertaken into the required characteristics of the Statement of Changes in Financial Position with a view to servicing both the general reader's information needs and the preparation of the national accounts (3.28).
- 1.10 Introduction of a Statement of Changes in Financial Position aside, implementation of the Guidelines would involve changes to the statements of more than half the undertakings covered (8.4). These would occur mainly in connection with depreciation charges and the Statement of Activity. However some nine bodies would be required to convert totally from cash based to accrual accounting. Only a handful of undertakings presently prepare a Statement of Changes in Financial Positions (however described). In no case is the form approved by the responsible Minister. Data needed for preparing a Statement of Changes in Financial Position is readily available where accrual based statements are prepared. Consequently the new requirement for such statements is not considered onerous.
- 1.11 To permit the ongoing development of a corpus of accounting standards and pronouncements applicable to Commonwealth undertakings the working party recommends (8.10) that the present Steering Committee should continue in the capacity of a committee of review:
- (a) allocating new undertakings to appropriate categories and amending the classification of existing bodies as functions alter;
 - (b) examining and endorsing the applicability to Commonwealth bodies of standards promulgated by the accounting profession;
 - (c) commissioning appropriate research into matters not adequately covered by professional accounting standards; and,
 - (d) coordinating Audit/Finance participation in the development activities of the Australian Accounting Research Foundation, particularly in the area of Exposure Drafts.
- 1.12 Finally the working party recommends that, consistent with the proposed Guidelines, simplified accounting formats should be approved where financial statements of undertakings are presently grossly in arrears. This would enable technical resources to be concentrated on the production of full accounts for the most recent accounting period (8.13).

CHAPTER 2 - AIMS AND APPROACH

- 2.1 The Joint Working Party on Financial Statements of Commonwealth Undertakings was established to respond to an increasingly evident need for consistent reporting and financial disclosure practices by Commonwealth undertakings operating or identifiable as discrete entities apart from normal departmental activities.
- 2.2 The broad aim of the working party was to develop a viable set of practical guidelines for financial statements of Commonwealth statutory authorities and departmental business undertakings and to permit Audit and Finance to employ a common approach to financial reporting consistent with contemporary accounting practice.
- 2.3 Specific terms of reference were to:
- (a) Establish basic objectives for financial statements (particularly those required to be approved by the Minister for Finance).
 - (b) Develop a practical categorisation of undertakings and broad formats for financial statements for each category.
 - (c) Examine present accounting standards and pronouncements of professional accounting bodies with the aim of identifying:
 - (i) those standards suitable for adoption, and
 - (ii) areas requiring further development.
 - (d) Make recommendations for the adoption of accounting standards and means for overcoming identified deficiencies.
- 2.4 The study entailed consideration of:
- (a) express and implied users' needs (particularly those of Parliament);
 - (b) the number and diversity of reporting bodies and the manner in which their statements were approved;
 - (c) the "state of the art" of accounting with respect to the very wide range of bodies concerned; and
 - (d) potential categorisation models which would permit acceptable accounting standards to be associated with particular groups of undertakings.

- 2.5 Resources available to the working party (from the Management Accounting Section, Department of Finance and the Audit Research Section, Auditor-General's Office) were very limited. The relatively short period of some two months, in which the bulk of research and report writing has been undertaken precluded the usual solicitation of views from potentially interested parties. However the recommendations put forward by the working party are not considered to depart from orthodox accounting practice, nor by comparison with reporting practices elsewhere are they considered to impose an undue administrative burden on undertakings.
- 2.6 Although the terms of reference of the working party refer specifically to statements approved by the Minister for Finance an effort has been made to establish the broadest possible base for the development of a consistent body of accounting standards applicable to all Commonwealth undertakings (other than Departments of State).

CHAPTER 3 - OBJECTIVES FOR FINANCIAL STATEMENTS

- 3.1 Rational development of a framework of standards for financial statements entails first a decision as to what such documents are to achieve. The term "objective" has been favoured by accounting researchers to describe such goals. The dictionary meaning is:

"something towards which effort is directed, an aim or end of action".

The definition seems doubly apposite in the accounting context, connoting both the immediate aim of producing information and the ultimate one of influencing the actions of readers of financial statements.

- 3.2 This chapter examines the objectives to be achieved by financial statements in the light of the express and implied information needs of prospective users. It begins by considering certain underlying assumptions about the nature of accounting and closes with a recommended set of practical objectives. These provide a basis for the prescription in a later chapter of the types of report that should be expected from particular authorities.

THE PURPOSE OF ACCOUNTING

- 3.3 To develop a framework of objectives for financial statements it is of advantage first to put issues into perspective by asking what is commonly expected of the accounting process and what priorities ought to apply to it?
- 3.4 In the simplest terms accounting could be said to consist of a record keeping function and an information-communication or reporting function. Accountants in the government sector seem often to emphasise the former and view financial statements (particularly those for public consumption) as merely a by-product of the accounting process.
- 3.5 A contrary point of view is one expressed by the American Accounting Association and the professional accounting bodies generally viz that:

"the primary function of accounting is to accumulate and communicate information essential to an understanding of the activities of an enterprise."⁽¹⁾

- * Cf the GAO requirement that "Federal agency accounting systems shall be designed to enable the prompt preparation of all needed financial reports. Financial reports should be prepared to clearly disclose significant financial facts about agency operations and activities" (52).

- 3.6 The working party favours the latter view and considers that the starting point both for this study and any subsequent implementation of guidelines is to affirm the primacy of the reporting function in the accounting process. Unless reporting bodies accept that the primary output of their accounting systems ought to be the financial statements, failure to disclose material information or to observe standards will invariably be excused on the grounds of administrative expediency (- "inadequate records", "insufficient resources" etc).

RELEVANCE AND FACTUALITY-KEY CONSIDERATIONS

- 3.7 Accepting that the main purpose of accounting is to provide essential information about undertakings it is appropriate to establish what sort of information, for whom? Indeed it is well to go the whole way and ask what is information? Information is commonly taken to consist of a communication of facts relevant to the decisions of an intended user. If a communication consists of suppositions, expectations or of facts not relevant to the users needs it cannot reasonably be described as information. More likely it will interfere with the transmission of "essential information" in the same way as "static" distorts and interrupts a wireless broadcast.
- 3.8 While this discussion may at first sight appear academic it does point to areas that are quite critical if practical reporting standards are to be achieved. Without a clear conception of the need for relevance, statements (particularly appended notes) could well be expected to grow at an exponential rate until essential information becomes buried in superfluous detail. Similarly unless statements are conceived as factual documents dealing with present and past situations, neutral to the interests of various user groups their value to the community as a whole could be expected to disappear as they become part of the propaganda apparatus of particular interest group.
- 3.9 To develop objectives for financial statements further elaboration of the concept of relevance is needed. It is possible to distinguish between information which is relevant (or useful) to the needs of particular users of reports and that which is relevant to all potential users of a report. Clearly, published financial statements are not intended to satisfy all the financial information needs of all interest groups. Rather they are supposed to meet the common needs of the bulk of interested parties. As indicated earlier if information is provided which is relevant only to a specific user it could, to the detriment of other users, obscure information which is of general relevance. The premise that information contained in financial statements ought to be "generally relevant" is a vital one if statements are to be balanced and of enduring effectiveness. Whether such a criterion can be acted upon depends on consideration of the needs of present and prospective users of statements.

USER GROUPS

- 3.10 Research seems to indicate that the variety of actual and potential users of published financial statements both in the private and public sectors has grown significantly in recent years. With regard to the private sector the NSW Government's Accounting Standards Review Committee (38) acknowledges that although the Companies Acts' disclosure provisions were initially designed to protect investors and creditors, financial statements published in accordance with the legislation are used by many other interest groups (eg trade unions and government departments). In the public sector the intended audience for published reports has perhaps been less explicitly defined. It does however seem apparent from parliamentary comment that statements produced by Commonwealth bodies are expected to service the community at all levels (of 3.19).
- 3.11 As Exhibit 3.1 shows, similarities in interest groups are apparent when potential users of financial statements in the public and private sectors are compared. It might be noted that two other external users who have interests in each type of body have been omitted from Exhibit 3.1. These are the auditors and the media (representing that rather vaguely defined group the "general public").
- 3.12 The similarity in interest groups for bodies having widely differing purposes is hardly surprising when the nature of financial information and the character of organisations generally is taken into account. Whatever the objects of their common endeavour, groups of people working together within a legally defined association, are usually involved from a financial viewpoint in the same kinds of activity. They obtain working and fixed capital, enter into credit arrangements, deal with employees, consumers and governments. The financial transactions involved are essentially the same. Whether or not it is a matter of soliciting subscriptions, appropriations and grants or selling services and goods, if an organisation is to continue to exist it must ensure that revenues eventually at least match expenses/that capital is maintained intact.
- 3.13 By utilising the notion of generally relevant information the working party considers that a basis exists for establishing a common set of reporting objectives for all varieties of Commonwealth undertakings which can be deemed to have a discrete existence apart from the activities of central government. That basis is to be found in the definition put forward by Moonitz in AICPA Accounting Research Study No. 1 (36) viz that:

"The function of accounting is (1) to measure the resources held by specific entities; (2) to reflect the claims against and the interests in those entities; (3) to measure the changes in those resources, claims and interests; (4) to assign the changes to specifiable periods of time; and (5) to express the foregoing in terms of money as a common denominator".

EXHIBIT 3.1 POTENTIAL EXTERNAL USER GROUPS

	Companies	Private Non-Profit Bodies	Local Government	Commonwealth Authorities
INVESTORS				
Shareholders	X			
Electorate (incl Parliament)				X
Subscribers		X		
Ratepayers			X	
CREDITORS				
Banks	X	X	X	X
Other lenders	X	X	X	X
Suppliers	X	X	X	X
EMPLOYEES				
Trade Unions	X	X	X	X
Superannuation Funds	X	X	X	X
CONSUMERS				
Buyers	X			
Taxpayers			X	X
GOVERNMENT				
Taxation Authorities	X			
Regulatory bodies		X	X	X

- 3.14 The working party sought to validate this prescription by reference to the express statements of users of financial statements and contemporary investigations and inquiries by governments and professional bodies in Australia and overseas.

USER NEEDS

- 3.15 Both direct and indirect means were used to gain an insight into the information needs of potential users of financial statements. The former included:
- (a) examination of Australian parliamentary comment over the last three years; and
 - (b) a survey of the use of published statements by officials of the Auditor-General's Office and the Department of Finance.
- 3.16 Indirect means employed involved the appraisal of reports prepared by official inquiries elsewhere and of developments within the accounting profession in Australia and overseas.

PARLIAMENTARY INFORMATION NEEDS

- 3.17 Apart from the Reports of the Senate Standing Committee on Finance and Government Operations on "Statutory Authorities of the Commonwealth" (20) there appears to have been relatively little in the last three years by the way of parliamentary comment relating to the role of historical financial data in the scrutiny of undertakings.
- 3.18 A certain amount of discussion of parliamentary information needs has occurred in the context of the estimates examination process. For example the Senate Estimates Committee's "Guidelines for Explanatory Notes" mention the need for an annual report and comparative details of actual expenditure (and revenue) in the previous period. This theme was taken up in the recent report of the Joint Committee on Publications which envisaged the inclusion in reports of

"a statement of the budget allocation of funds (if appropriate) together with a note on actual expenditure for the period." (14)

- 3.19 There would however seem reasonable evidence to suppose that parliamentarians view themselves in the role of the "shareholders" (taxpayer's) representative, dealing with Commonwealth undertakings as though they were private corporations. Their attitude towards the accounting responsibilities of statutory corporations and undertakings could be described as follows:

"It is not good for any governmental corporation to hide behind its legal position, its position of power as a governmental corporation to avoid meeting the requirements that an ordinary corporation would have to meet" (19).

- 3.20 In the case of "business undertakings" there seems to be a common expectation that such bodies observe at least the minimum disclosure standards of the companies legislation.* Although many are probably not fully aware of the degree of non-compliance with Australian Accounting Standards that in fact occurs in the private sector (as indicated by the Reports of the various Corporate Affairs Commissioners (39)).
- 3.21 The reporting obligations imposed on private corporations (by the various Companies Acts and Associations Incorporation legislation) broadly entail the preparation of a statement indicating the results of operations during the reporting period and one indicating financial position at reporting date. (It should be noted that private corporations include many non-profit organisations and are not all "business" entities). Many private bodies (particularly those subject to stock-exchange regulations) also produce statements indicating the sources and use of finance. Support for the general use of each of these reports is apparent in Parliamentary debates and reports.
- 3.22 In reporting to the Parliament on its inquiries into Northern Territory forestry programmes the House of Representatives Standing Committee on Expenditure (hereafter the "Expenditure Committee") did make a significant point regarding information needs when the Chairman stated:

"Economic and accounting practices which do not record accurately the total cost of such programmes or which do not allow the total cost to be readily available, do not enable proper evaluation and decisions based on adequate economic criteria to be made by the Parliament." (18)

* The Auditor-General's Office and the Department of Finance have, of course, since January 1977 agreed that such standards should apply.

- 3.23 This point was echoed by the Senate Standing Committee on Finance and Government Operations in its report on the Capital Territory Health Commission when it expressed dismay that full costs of services (including depreciation and interest) were not disclosed. This concern led the Committee to undertake an examination of the merits of accrual vs cash accounting leading to the endorsement that:

"...prima facie accrual accounting is superior to cash accounting from a Parliamentary viewpoint because accrual accounting provides the greater disclosure of the financial affairs of an authority". (16)

- 3.24 While such comments clearly support the use of an operating statement and statement of financial position, support for a statement indicating the source and use of funds has been expressed by the Joint Committee on Publications (14).
- 3.25 The working party has been unable to locate any direct Government comment regarding the financial information needs of Parliament, other than concern expressed at delays in the production of reports. The Government would seem, however, unlikely to disagree with the Expenditure Committees' statement that:

"the broad objectives of financial scrutiny are to safeguard expenditure of the taxpayer's money, to promote and encourage efficiency in administration and to influence priorities and policies. The end purpose of this work of scrutiny is "influence" not direct power; advise, not command, criticism not obstruction ... and publicity not secrecy". (17)

- 3.26 Interpreted in the light of these objectives, the direct comments of parliamentarians on types of statement, accrual accounting etc would seem to lend support to the Moonitz description of the function of accounting referred to earlier (3.13). By concentrating on the resources entrusted to undertakings, on the costs incurred and the flow of financial resources Parliament would be informed and in a position to safeguard, to encourage efficiency and to clarify value criteria necessary to establish priorities and policies.

OFFICIALS' INFORMATION NEEDS

- 3.27 In addition to parliamentary scrutiny Commonwealth undertakings are generally subject to a level of monitoring by departmental officials. To establish information needs a survey was conducted of senior Third Division officers in the Department of Finance and the Auditor-General's Office.

- 3.28 Generally responses appeared to reflect a prevailing conventional wisdom. Information on financial position and operating results was generally considered useful for "business undertakings", but not quite so useful for "non-trading" bodies. However a marked degree of interest was shown in the possible use of funds statements which in the working party's view could well be followed up.

- 3.29 There seems to be a general lack of awareness of the possible uses of financial information for non-trading bodies. Government, it may be contended is concerned that these bodies remain solvent; it is concerned that they do not accrue extraordinary unfunded liabilities; that they do not absorb excessive capital resources; and that they are managed in a financially prudent manner. Accordingly the working party considers financial statements for non-trading bodies ought to provide information on such matters for the use of officials.

FINDINGS OF OTHER INQUIRIES

- 3.30 In examining issues related to the aims of this study the working party considered the findings of NSW, US, Canadian and British inquiries and also standards and norms set by the accounting profession overseas. It also considered work in the accounting standards field undertaken by the UN (51), OECD (40) and the EEC (24).
- 3.31 Reports and publications of particular relevance were:
- (a) "Government Accounting and Financial Reporting Principles" (GAAPFR) issued by the US National Council on Governmental Accounting (37).
 - (b) "Statements of Position" and various "Industry Audit Guides" dealing with the accounts of non-business organisations issued by the American Institute of Certified Public Accountants (AICPA) (3) to (11).
 - (c) "The Reports and Accounts of Nationalised Industries" produced by the UK Civil Service College (32).
 - (d) "Accounting Principles and Standards for Federal Agencies" issued by the Comptroller-General of the United States (52).
 - (e) "Company Accounting Standards", the report of the NSW Government Accounting Standards Review Committee (38).
 - (f) Australian Institute of Management Annual Report awards suggested criteria for entries in Division B (Public Administration and Public Authorities).
- 3.32 Although these documents do not all explicitly deal with broad accounting objectives the approach adopted to financial statements in each case is consistent with that proposed in para 3.13 of this report.

RECOMMENDED OBJECTIVES FOR INCLUSION IN GUIDELINES

- 3.33 The working party considers that there is sufficient evidence both from the expressed needs of parliamentarians and the approach to financial reporting for statutory bodies adopted by overseas authorities to support the prescription of objectives for statements in a manner similar to Moonitz's definition of the accounting function (3.13).
- 3.34 It is proposed that the following statement of objectives be adopted for financial statements of all Commonwealth undertakings:
- "Financial statements should provide information that is useful or relevant to the needs of users in general, and should permit the reader to establish as a matter of fact the:
- (a) cost to the taxpayer of the operations of the undertaking over the reporting period and preceding periods;
 - (b) net resources currently devoted to its activities;
 - (c) solvency of the undertaking; and,
 - (d) the change in the level of net resources held since the previous reporting date and the manner in which that change came about."
- 3.35 The need to prescribe a "cost" reporting objective (3.34(a)) is apparent both analytically and empirically. From a purely theoretical stance few would deny that one of the primary concerns of readers of the financial reports of government undertakings is with the extent of cash outlays and obligations incurred. Such an assumption is amply borne out by the actual comments of report users.
- 3.36 However it is scarcely sufficient for purposes of calculation simply to state that an objective of financial statements is to report "costs of operations", "total costs incurred" etc. The term "cost" has several connotations which differ significantly from one another. Unless the particular usage of the term is carefully defined author and reader of the Guidelines may readily place different interpretations on what it is that is to be reported.
- 3.37 For example, when parliamentarians speak of "costs" it is often in the sense of overall obligations and expenditures incurred in achieving a particular government program. In operational terms this differs markedly from the use of the word when, say, the management of an undertaking talks of the costs of operating a particular facility. Interpreted in the

former manner we could assume that the "costs of operating" an undertaking should include expenses incurred by co-ordinating departments such as Finance in administrative and financial oversight. Yet if we adopted the second approach to "costs" the figure finally arrived at would relate only to expenditures made by the undertaking (excluding expenses directly associated with the operations of that body such as maintenance and depreciation). Neither concept of "cost" would seem entirely suitable for establishing reporting objectives.

- 3.38 The working party considers that the most practical way to define "costs" is to consider each undertaking as if it were an independent corporation functioning in the private sector. The Commonwealth could then be regarded in the same way as an equity holder in a company (of 3.19). "Costs" reported would extend to all those directly associable with the principal activities of that undertaking but would exclude those which might reasonably be deemed to be incurred by the Commonwealth in its role as equity holder or as central government. The statement of objectives contained in the Recommended Guidelines has been qualified accordingly (see A5).
- 3.39 Whereas the "cost" objective deals with "flows" of resources consumed the second "resources" objective (3.34(b)) deals with "stocks" held by an undertaking at a point in time. The need for such information is again apparent from the comments of parliamentarians. Indeed it may be argued that such information is necessary if "costs" referred to earlier are to properly be placed in context. Again in identifying resource "stocks" associable with an undertaking's activities the working party recommends that the "independent private corporation" approach discussed in 3.38 be used.
- 3.40 Less readily apparent from public comment is the need for statements to indicate the solvency of an undertaking. (It could be claimed that such considerations are secondary since the Commonwealth is morally (if not legally) committed to bailing out a failing statutory body.) The working party, however, considers that solvency is a primary concern for financial statements on the following grounds:
- (a) Financial statements are able not only to indicate the wealth of an entity and the increase or decrease resulting from its operations but also the quality of financial management.
 - (b) The quality of financial management of government undertakings is no less a concern of the taxpayer than the quality of operational management.

- (c) If an undertaking is experiencing liquidity or working capital problems statements should indicate that situation before disaster occurs so that remedial action can be taken.

3.41 The fourth objective proposed (3.34(d)) is necessary if statements are to present a complete picture of what has occurred with the overall resources of an undertaking.

CHAPTER 4 - ACCOUNTING STANDARDS GENERALLY

4.1 The term "objectives" has been used to describe the functions to be served by financial statements in providing information of use to potential readers generally. Accounting procedures are concerned with means of obtaining information. Linking the two are accounting standards which are concerned with the quality of information generated by those procedures. This chapter examines the nature, sources and sufficiency of accepted accounting standards preparatory to exploring in subsequent chapters a general codification of standards for Commonwealth undertakings.

WHAT ARE STANDARDS?

4.2 Perhaps the best starting point is to define what accounting standards are not. Early writers on the subject have made the point that:

"...standards should deal more with fundamental conceptions and general approaches to the presentation of accounting facts than with questions of precise captions ... Although accounting standards are not in themselves procedures they point towards accounting procedures, that is, towards rules which cover details of specific situations." (41)

4.3 Standards also differ from "objectives" since they are more concerned with means to achieve given ends than in the legitimacy of those ends. Nevertheless they are intimately linked to "objectives". For example if an objective of financial statements is to indicate the solvency of an entity an essential qualitative aspect of that information is that it give a balanced view of the situation by not omitting facts pertinent to the readers appreciation of matters.

4.4 The rather enigmatic relationship of standards to objectives is somewhat clarified by distinguishing between "product quality" standards for statements as a whole and input and processing standards.* The distinction between the two types of standards is best outlined by an analogy to engineering standards.

4.5 Standards Associations of Australia standards prescribe uniform minimum properties for certain engineering assemblies (eg electrical motors). These standards do not determine the designer's objectives but do set a product quality level for basic features of an assembly to which he may refer. In turn components of that assembly may be subject to input or processing standards relating, for example, to the ductility of

* This distinction is drawn in the NSW Accounting Standards Review Committee Report (38).

wire used, the hardness of castings etc. Again these input/processing standards do not prescribe objectives but define acceptable quality characteristics of material used for certain purposes.

- 4.6 Financial statements may be considered the product of a corporation just as much as the goods and services it provides. A general product quality standard can be set in relation to financial statements which stipulates what is expected of information contained in those statements. Input/processing standards may be determined regarding the quality of procedures that in aggregate, produce the information contained in financial statements.

PRODUCT QUALITY STANDARDS

- 4.7 The fundamental quality requirement for financial statements is that they provide a "true and fair view" of what they purport to be about. Section 162 of the various Companies Acts requires published accounts to give "a true and fair view of the profit or loss of the company" for the preceding financial year and a balance sheet "giving a true and fair view of the state of affairs of the company as at the end of the financial year".

- 4.8 The NSW Accounting Standards Review Committee makes the point that:

"The references (of the Companies Act) to the profit or loss and the state of affairs of a company can only be taken as referring to some real features of the company. They cannot have reference merely to some features of the accounting records such as the balances remaining in the accounts at the end of a year".

Hence "true and fair" cannot simply be taken to apply to the correctness of data processed to produce statements or to the volume of information disclosed but rather it must be a judgement on the serviceability of the final product to the reader.

- 4.9 In the context of the proposed objectives for the statements of Commonwealth undertakings (3.34) the concern is whether they give a "true and fair view" of the cost to the taxpayer, the solvency of the reporting entity etc. Correct figures may readily be processed to give a false view of the level of resources used, and those processed figures even when "true" may be arranged to present an unfair picture of what has happened. The touchstone of whether a report is "true and fair" is ultimately the probability of that report misleading the reader.

- 4.10 This raises once more the crucial role of the notion that statements must be relevant to users. Reports can be considered unfair and potentially misleading if they either do not provide all information that is relevant to users in general or they become cluttered with so much generally irrelevant detail as to prevent the reader from "seeing the wood for the trees".

- 4.11 Australian Accounting Standard AAS6 seemingly takes note of those possibilities by requiring statements to be timely, consistent, comparable, material, prepared with prudence and take notice of financial realities. These characteristics are part and parcel of the broader notion of relevance. Statements cannot be relevant if they are not timely, consistent, and realistic.

- 4.12 The foregoing matters are considered by the working party to constitute a basis for a general quality standard to apply to all financial statements of Commonwealth undertakings. Input/processing standards are more closely related to particular characteristics of various types of authority.

INPUT AND PROCESSING STANDARDS

- 4.13 While it is the prerogative of the consumer to specify objectives and quality standards for a product, the question of input and processing standards is one which of necessity belongs to the professional bodies. Strong practical arguments exist for the adoption of existing professional accounting standards wherever appropriate:

- (a) the effort required to develop a comprehensive range of input/processing standards is beyond resources currently available;
- (b) lead times would be extensive;
- (c) the final outcome would be unlikely to diverge greatly from what exists;
- (d) the effort would better be directed towards filling gaps in existing standards; and
- (e) a "credibility gap" could emerge if standards developed diverged markedly from those used in the private sector.

- 4.14 This is not to suggest that professional accounting standards should receive uncritical acceptance. The majority of extant standards in Australia and overseas have been specifically developed for "business" enterprises. Many concepts used may be validly transferred to the public sector others are questionable (eg is it appropriate for an authority to employ tax-effect accounting to retain funds which otherwise would go to the Commonwealth as dividends on the grounds that the undertaking has a deferred tax liability?)

4.15 Adoption of existing professional standards does not solve the problem of input/processing standards entirely. Two important gaps remain:

- (a) Standards relating to businesses are incomplete;
- (b) No standards specifically for non-business undertakings exist in Australia.

STANDARDS FOR BUSINESS ENTERPRISES

4.16 Gaps in Australian Accounting Standards for business enterprises exist inter alia in the following important areas:

- (a) foreign currency translation;
- (b) leasing;
- (c) joint ventures and consolidations; and
- (d) segmental reporting.

Such gaps have a major effect on the overall consistency of accounting practices in the Commonwealth sphere. Three major authorities involved in major overseas purchases have three entirely different accounting policies for dealing with the translation of foreign currency, yet basically, are supposed to be relating the same type of information to readers of their reports. Lack of professional standards would seem insufficient reason for permitting such diversity and there would seem good cause for the adoption of some interim position on important accounting practices if the process of endorsing standards is not to become one of simply "double-bolting the front door while leaving the back open".

4.17 Interim standards could readily be developed by reference to the prevailing practice within an industry, or to standards existing overseas. The US Financial Accounting Standards Board (FASB) has some 36 standards compared to the 9 endorsed by the Australian professional bodies, whilst the International Accounting Standards Committee has 13.

4.18 Given the acknowledgement by the Australian profession of the latter body's role^{*}, it would seem appropriate to utilise International Accounting Standards (IAS) verbatim in the "business" context until such time as specific Australian standards are developed. Those which presently cover areas not touched by Australian Accounting Standards are:

- IAS3 Consolidated Financial Statements (and Equity Accounting)
- IAS7 Statements of Changes in Financial Position

^{*} See ASA and ICAA statement APS3 "Compatibility of Australian Accounting Standards and International Accounting Standards".

- IAS9 Accounting for Research and Development Activities
- IAS11 Accounting for Construction Contracts
- IAS13 Presentation of Current Assets and Current Liabilities.

4.19 FASB standards while frequently directed to peculiarly American situations and employing American technical terminology nevertheless may be deemed to provide compelling evidence of what constitutes good accounting practice in many instances. Together with empirical evidence of industry practice they would seem to provide a sound basis for determining appropriate accounting practice in a number of critical areas.

4.20 An essential feature of interim standards would be their effect in countering "creative accounting" directed towards exploiting gaps in present Australian standards. It would no longer be possible for undertakings to claim that a practice is "accepted" or used by the business community; it would be necessary to demonstrate that the technique reflects prevailing practice. A similar situation would apply to non-trading bodies.

STANDARDS FOR NON-BUSINESS UNDERTAKINGS

4.21 Where non-trading bodies are concerned it would seem appropriate to take note of the large body of de-facto standards existing particularly in the United States. While they do not bear the title "standard" they do have the endorsement of authoritative bodies^{*} and are considered guides to good practice. Included in this category are:

- various "Statements of Position" and "Industry Audit Guides" promulgated by the AICPA;
- pronouncements of the National Council on Governmental Accounting;
- regulations of the US Comptroller-General (ie the General Accounting Office).

4.22 If anything these pronouncements tend to be more explicit in their requirements than Australian Accounting Standards and would provide a ready basis for interim standards after appropriate "translation". Areas particularly well served by them include:

- Hospitals and Health institutions;
- Universities and Educational bodies;
- Museums, Libraries and Art Galleries;
- Cultural and Performing Arts bodies;

^{*} Statement of Financial Accounting Standard 32 issued by the FASB recognises the AICPA Industry Audit Guides and Statements of Position discussed in this report as containing "preferable accounting principles".

OTHER SOURCES OF ACCOUNTING STANDARDS IN AUSTRALIA

- 4.23 In addition to standards jointly promulgated by the Institute of Chartered Accountants in Australia and the Australian Society of Accountants there are three other important sources of input/processing standards:
- (a) The Companies and Securities legislation;
 - (b) Australian Associated Stock Exchanges (AASE) Official List requirements;
 - (c) Specialised legislation (eg Banking Acts, Insurance Acts).
- 4.24 These standards deal principally with matters of disclosure. The Ninth Schedule to the Companies Acts, for example, lists an extensive number of items that are required to be included in a company's annual accounts. The required disclosures are of interest to all potential readers of those statements and are readily transferable to the context of public undertakings.
- 4.25 Given the common objectives for statements of all Commonwealth undertakings it could be considered that certain Ninth Schedule requirements could, with appropriate editing (to exclude requirements solely of application to business corporations) serve as a general disclosure standard for all such statements. Businesses, as a specific category of undertaking would be required to conform to those requirements in full and be subject to specialised legislation (eg Banking Acts) as appropriate. It is of interest to note that a similar approach has been taken in the Canadian Crown Corporations Bill, introduced to the Canadian Parliament in December 1979.
- 4.26 The general disclosure standard proposed by the working party appears in paragraphs A15 to A30 (inclusive) of the Recommended Guidelines.

RECOMMENDED APPROACH TO STANDARDS

- 4.27 The working party recommends that:
- The general disclosure standard described above apply to all undertakings.
 - Companies Acts and nominated AASE requirements apply to all business type undertakings in addition to all existing mandatory standards issued by the Australian accounting profession.

• Appropriate overseas standards and pronouncements be adopted as interim measures until such times as Australian Accounting Standards are issued.

• Such overseas publications be styled "Guides to Accepted Accounting Practice" and that they be highly persuasive in establishing appropriate accounting methods.

Arrangements for updating the Guidelines and associated standards are discussed in Chapter 8.

CHAPTER 5 CATEGORISATION OF UNDERTAKINGS

CATEGORISATION - A MEANS OF REDUCING DIVERSITY

- 5.1 The problem of achieving consistency in reporting is highlighted by the diverse nature of statutory bodies; it is a multifaceted problem because it is necessary to identify the basis or bases on which consistency may or may not exist or on which it should be established.
- 5.2 Ultimately it may be possible to develop a single, coordinated, consistent, conceptual framework for general purpose financial statements for all types of organisations. At the macro level all financial statements should be relevant to the users' needs, understandable, verifiable, neutral, timely, comparable, complete and reliable. Clearly, the accrual basis of accounting is essential if the statements are to achieve proposed reporting objectives (3.34).
- 5.3 At the more detailed levels of the conceptual model, variations in application may be necessary to recognise special needs but "convergence" rather than "divergence" should be the underlying theme. In the immediate future consistency is conceived - and more likely to be achieved - as applying within subsets of entities with common features.

BASES FOR CATEGORISING UNDERTAKINGS

- 5.4 The Senate Standing Committee on Finance and Government Operations (20), canvassed several bases for categorisation and eventually selected a functional classification which in broad terms makes the distinction between "business" and "non-business" undertakings. The five categories used by the Senate Committee are:
- Business Authorities
 - Primary Industry Authorities
 - Administrative, Advisory and Adjudicative Authorities
 - International Organisations; and
 - Non-Statutory Authorities.
- 5.5 Likewise, a measure of an entity's size may reflect important differences which might lead to the adoption of differing accounting standards/principles or their application. An approach along these lines was mooted in a UK "Green Paper" on company accounting and disclosure (49) which to a large extent was inspired by the EEC Fourth Directive on company accounts (24).

- 5.6 The "Green Paper" proposed a "three tier" disclosure structure which it was hoped would provide an appropriate framework within which the law relating to company accounts could be developed. Different accounting and disclosure requirements are proposed for large, medium and small companies.

- 5.7 Briefly the criteria for each category are:

- Top Tier - All companies listed on the stock exchange and all other companies which exceed two of the following criteria:
 - (a) turnover 5 million pounds
 - (b) balance sheet total 2.5 million pounds
 - (c) average number of employees, 250
- Middle Tier - All public companies not in the top tier and all private companies which do not fall within either the top or bottom tiers.
- Bottom Tier - Small private companies which do not exceed two of the following criteria:
 - (a) turnover 1.3 million pounds
 - (b) balance sheet total 0.65 million pounds
 - (c) average number of employees, 50

- 5.8 A third type of commonality is linked to the source of the entity's financial resources - FASB Research Report, Financial Accounting in Non Business Organisations, R.N. Anthony (12). This concept is based on a bifurcation between those entities which are "self funding" and those funded from the budget.

- 5.9 This was an attempt to identify and treat those accounting problems unique to entities funded by gifts, taxes etc recognising the fact that the amount of "goods and services" produced by these entities during a period cannot be measured. In general terms the two categories are defined thus:

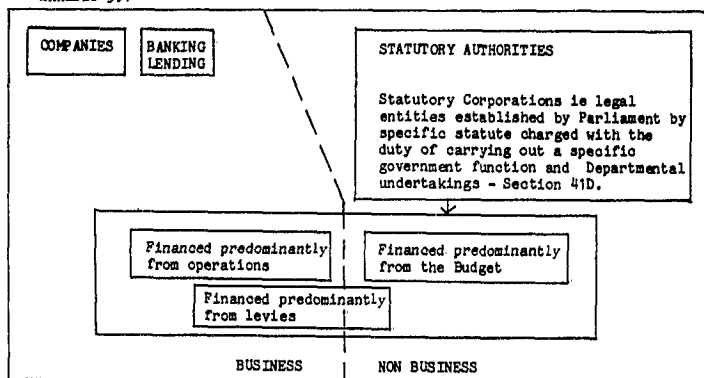
- TYPE 1 - an organisation whose financial resources are obtained mainly from the sale of goods and services (or levies). Although the initial acquisition of fixed assets may have been financed by debt or equity capital this is viewed as an advance to be recovered by subsequent productive use of the asset.
- TYPE 2 - an organisation where a significant amount of the financial resources is provided from the Budget

- 5.10 Clearly, most of the accounting problems that are particular to statutory authorities arise in Type 2 organisations.

5.11 Other bases for categorisation is profit/non-profit and fund accounting were considered inappropriate. The business/non-business concept is rejected as the sole basis for categorisation - it does not provide that general element of commonality need to reflect important differences which might lead to the adoption of different accounting standards or to differences in their application. As always we are drawn back to the fundamental question - why draw the conceptual distinction between the two?

5.12 The classification model developed for this report initially draws the distinction between companies (incorporated under State legislation/Territory Ordinances), banking and lending institutions and statutory authorities. Statutory bodies are then subdivided depending on the source of their financial resources. An overview of the model is presented below (Exhibit 5.1).

EXHIBIT 5.1



In broad terms some distinction can be made between business/non-business (illustrated above), however the model developed here tries to recognise the special needs of particular sub-sets of government bodies. The model also has regard to materiality considerations - the use of a cash basis may be justified in some cases on grounds of materiality rather than on conceptual grounds.

5.13 Clearly, some problems may arise with a model based on sources of operating funds because authorities are dynamic entities and there may be a shift in categories. A body funded predominantly from the budget may gradually obtain revenue from the sale of goods and services (eg the ABC) and this may require an upgrading of disclosure depending on materiality.

5.14 Alternatively it could be argued that no authority is really "self funding" as deficits, if any, are funded by government advances. However the model developed by the working party is based on the concept of financial resources provided from the revenue generated by the sale of goods and services.

THE CLASSIFICATION MODEL FOR GOVERNMENT UNDERTAKINGS

5.15 The model favoured by the working party has the following broad categories:

- Category 1 - Statutory bodies that are predominantly self financing ie financial resources derived from operations or levies.
- Category 2 - Statutory bodies (other than included in Categories 3, 5 and 6) that are predominantly financed from the Budget.
- Category 3 - Statutory bodies engaged in research/advisory activities financed from the budget or levies.
- Category 4 - Companies incorporated under State legislation or Territory Ordinances.
- Category 5 - Banking and lending institutions.
- Category 6 - Municipal activities.

5.16 Subsets of categories 1 and 2 are identified and categorised in the following manner:

CATEGORY 1 (PREDOMINANTLY SELF FINANCING)

- 1.1 Financial Resources from operations
- 1.2 Financial Resources from levies

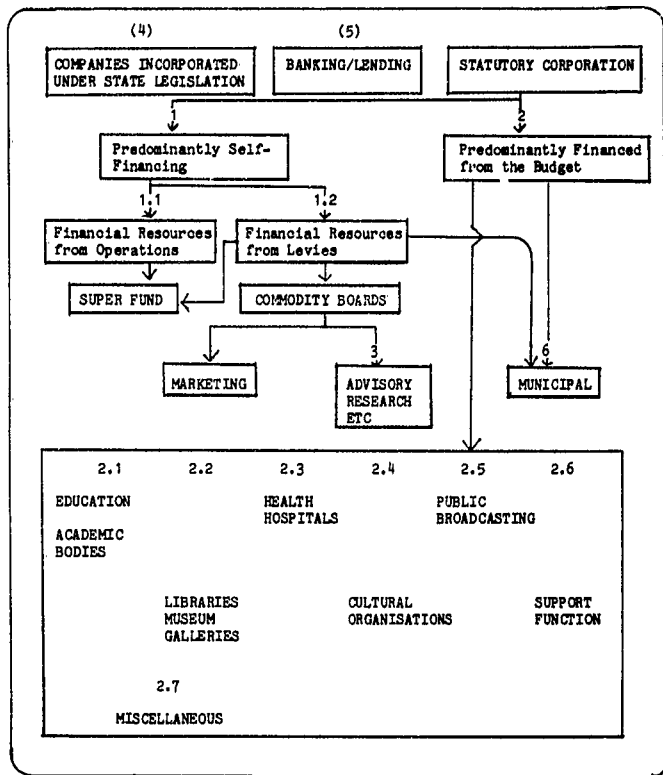
Commodity Boards (i) Marketing
(ii) Advisory/Research

CATEGORY 2 (PREDOMINANTLY FINANCED FROM THE BUDGET)

- 2.1 Education - Academic Bodies
- 2.2 Libraries, Museums, Galleries
- 2.3 Health/Hospitals
- 2.4 Cultural Organisations
- 2.5 Public Broadcasting
- 2.6 Support Functions
- 2.7 Miscellaneous

5.17 These categories and their relationships are represented in Exhibit 5.2 below. Lists of undertakings belonging to each category appear in Attachment A2 to the Recommended Guidelines.

EXHIBIT 5.2



CHAPTER 6 SPECIFIC ACCOUNTING STANDARDS FOR CATEGORIES OF AUTHORITIES

6.1 Following on from the discussion of input/processing standards in 4.13-4.26, this chapter discusses specific standards applicable to the particular categories of Commonwealth undertakings previously identified.

COMPANIES AND UNDERTAKINGS PREDOMINANTLY FINANCED FROM OPERATIONS

6.2 These comprise Categories 1.1 and 4 in the model set out in Exhibit 5.2, and may loosely be described as "business enterprises". Such bodies are normally required by legislation to conform to "accounting principles generally applied in commercial practice". In accordance with the joint policy of the Auditor-General's Office and the Department of Finance that requirement is interpreted to mean the principles inherent in the requirements of the Companies Acts and Ordinances and the practices prescribed by that legislation, and the Australian Accounting Standards.

6.3 The Companies Acts and Australian Accounting Standards however do not represent the totality of requirements to which most public companies are required to conform. The Australian Associated Stock Exchange Official List requirements also prescribe additional disclosures and the provision of a Statement of Changes in Financial Position. These requirements are, in turn, given the tacit backing of the Securities Industries Acts. There would seem no reason why "business undertakings" in the Commonwealth sector should not meet pertinent sections of these requirements, in particular Sections 3C(2), 3C(3)(a), (b) and (c) and 3C(4).

6.4 These sections of the Official List Requirements entail, inter alia, disclosure of:

- (a) whether the company is taxed as a private company;
- (b) the maximum contingent liability of the company and its subsidiaries (or other undertakings) for termination benefits under service agreements with directors and persons who take part in the management of the company (or undertaking);
- (c) turnover;
- (d) particulars of material contracts involving directors' interests either still subsisting at the end of the financial year or, if not then subsisting, entered into since the end of the previous financial year; and
- (e) the increase or decrease in profits, losses and the amount of assets and revenues resulting from the adoption of equity accounting.

- 6.5 As mentioned in 4.16 significant gaps exist in Australian Accounting Standards at present. Considerable effort is being devoted to that problem by the Australian Accounting Research Foundation. However, issue of standards to cover important areas cannot be expected for some years. Unlike the USA there is no written body of pronouncements similar to the AICPA "GAAP Guide" (34) which can serve as an indication of recognised accounting practices until necessary standards are established. To fill that gap the working party recommends the adoption of certain International Accounting Standards and Standards of the US Financial Accounting Standards Board until such time as Australian standards are promulgated. The standards selected are considered to reflect orthodox accounting practices and to be consistent with Australian conditions.
- 6.6 It is proposed, as a matter of general policy, that International Accounting Standards which are not manifestly contrary to Australian practices should be considered mandatory for undertakings in this group until they are replaced by an Australian Accounting Standard dealing with the same subject.
- 6.7 Supporting mandatory standards (comprising Ninth Schedule, AASE requirements and Australian and International Accounting Standards) it is recommended that there be a recognised body of preferred accounting techniques composed of appropriate FASB standards and styled as "Guides to Accepted Accounting Practice".
- 6.8 International Accounting Standards required to supplement Australian Standards with respect to "business" categories of Commonwealth undertakings are as follows:
- International Accounting Standard (IAS) 3 - dealing with Consolidated Financial Statements and the equity method of accounting.
 - IAS7 dealing with Statements of Changes in Financial Position.
 - IAS9 dealing with Research and Development activities.
 - IAS11 dealing with accounting for Construction Contracts.
 - IAS13 dealing with the presentation of Current Assets and Liabilities.
- 6.9 The following Statements of Financial Accounting Standards issued by the US FASB are recommended as persuasive "Guides to Accepted Accounting Practice":

- SFAS5 - Accounting for Contingencies
 - SFAS7 - Accounting for Development Stage Enterprises
 - SFAS13 - Accounting for Leases
 - SFAS14 - Segmental Reporting
 - SFAS30 - Major Customers
 - SFAS34 - Capitalization of Interest Cost
- 6.10 The main impact of these requirements will be to introduce:
- equity accounting,
 - a new statement (the Statement of Changes in Financial Position),
 - valuable disclosures concerning lease commitments.
- 6.11 The working party declines to recommend an interim standard for foreign currency translation in view of the stated intention of AARF to issue an Australian Accounting Standard on this subject in April 1980. Should that standard be delayed the working party recommends that a thorough investigation of contemporary Australian practice be undertaken in order to compile an interim standard.
- 6.12 Where non-business undertakings operate auxiliary trading activities (eg student residences in universities and colleges) the working party recommends that they be required to produce statements in respect of those operations which conform to endorsed "business" standards. This requirement is subject to considerations of materiality. Materiality will depend on whether or not statements prepared on an alternative (eg "cash" basis) could be considered to effectively achieve a similar level of disclosure. Such cases will be confined to relatively small scale auxiliary operations.
- COMMODITY MARKETING BOARDS
- 6.13 Commodity boards are established for the benefit of particular rural industries and are financed mainly from levies. These authorities lend themselves to a natural bifurcation between marketing type entities and research/advisory type entities; this division is reflected in the classification model discussed in chapter 5 of the Report.
- 6.14 Commodity marketing boards, listed in Category 1.2 of Exhibit 5.2, in terms of regulatory powers and trading powers vary one from another, however their financial provisions (outlined in the relevant enabling legislation) are similar to those applying to business type authorities. This category includes three authorities which have wholly owned or a controlling interest in companies incorporated in Australia and overseas.
- 6.15 Currently all authorities in this category use (or are required to use) accrual accounting and keep their accounts and records in accordance with the accounting principles generally applied in commercial practice. In broad terms the working party considers that this group should continue to provide normal commercial accounts and supplementary accounts of pooling operations.

Commercial Accounts

- 6.16 These accounts relate to recording and reporting the normal administrative functions and responsibilities of the entity under the relevant act. The accounts may be segmented (where appropriate or where required by legislation) into separate funds.
- 6.17 The appropriate statements for the "commercial accounts" are:
- . Statement of Income and Expenditure;
 - . Balance Sheet (consolidated);
 - . Notes to and forming part of the accounts; and
 - . Statement of Changes in Financial Position (where the balance sheet is consolidated).

Pool Accounts

- 6.18 Pool Accounts relate to the recording and reporting of levies collected from producers, expenses and proceeds relating to the disposal of a product and advances made to growers. Enabling legislation usually provides for an authority to conduct pooling operations therefore the requirement to produce "Pool Accounts" is on a "where applicable" basis.
- 6.19 Pool accounting would normally be based on a "production period" and until such time as all the product for a certain period was sold, its pool would remain open until a final return was declared and paid to the industry. In the event that there is a deficiency in the pool this is usually underwritten by the Commonwealth.
- 6.20 The working party considers that Pool Accounts should provide:
- (1) Statement of Account for the year at balance date; and
 - (2) Statement of Assets and liabilities at balance date.
- 6.21 As a general principle the financial statements of commodity marketing boards should be prepared on a similar basis to trading bodies. The working party recommends that Accounting Standards and "Guides to Accounting Practice" discussed in para 6.3 to 6.9 should apply to this category of undertakings.

EDUCATIONAL INSTITUTIONS

- 6.22 These are bodies comprising Category 2.1 in Exhibit 5.2. With one or two exceptions they presently report in a consistent pattern using statements based partially on fund accounting concepts. Many have auxiliary trading activities (eg student residences) which are dealt with in supplementary statements. Generally the level of disclosure achieved by such statements is high. The principal role of standards in this context is to provide guidance in areas of accounting technique.

- 6.23 There are no Australian Accounting Standards or pronouncements dealing with the subject of educational institutions and none are likely to issue in the next five years. The working party understands that a part-time study group within the Victorian Division of the Australian Society of Accountants is considering the matter of uniform practice for tertiary level bodies. Time and lack of resources have prevented the working party establishing contact with that group.
- 6.24 The chief publication available dealing with accounting methods and techniques in this area is the AICPA Industry Audit Guide "Audits of Colleges and Universities". In common with other AICPA pronouncements applicable to non-profit bodies the Guide leans rather heavily on fund accounting. This approach, consistently applied by the AICPA to non-business undertakings, has drawn criticism from US commentators on the grounds of complexity and the difficulty readers have in comprehending such statements.
- 6.25 In the context of Commonwealth undertakings it would also seem inappropriate to advocate the adoption of fund accounting on the lines of the Industry Audit Guide, particularly as we are dealing with government funded bodies rather than bodies drawing their principal income from a variety of state and private sources. For this reason the working party recommends that fund accounting be confined to "restricted" and "trust and agency" funds", according to the same broad format presently used by most Commonwealth tertiary institutions.
- 6.26 However the working party considers that the Industry Audit Guide should be recognised as a "Guide to Accepted Accounting Practice" in respect of accounting techniques.
- 6.27 To satisfactorily achieve the "cost" measurement objectives set out in paragraph 3.34 the working party considers that educational institutions should record depreciation charges in their statements in accordance with Australian Accounting Standard AAS4. This requirement would be subject to the proviso that depreciation charges should not be recorded in respect of non-exhaustible assets such as works of art, historical artifacts etc.
- 6.28 In addition the working party considers that the following Accounting Standards dealing with matters of general concern should apply to educational institutions:

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- * This matter is discussed further in 7.2-7.8.

AAS5 - Materiality in Financial Statements
 AAS6 - Accounting Policies, Determination, Application and Disclosure
 AAS8 - Events Occurring After Balance Date
 AAS9 - Expenditure Carried Forward to Subsequent Accounting Periods
 IAS7 - Statements of Changes in Financial Position

6.29 Adoption of these proposals would result in the following changes to the status quo:

- Preparation of a Statement of Changes in Financial Position.
- Inclusion of depreciation in the statements (as opposed to notes).
- Redesign of the Statement of Income or Expenditure to "Statement of Activity" (see discussion 7.26).

MUSEUMS, LIBRARIES AND GALLERIES

6.30 These comprise Category 2.2 in Exhibit 5.2. Presently both "modified accrual" and "cash" based statements are used. Each institution in this category uses substantial fixed assets, has major investments in irreplaceable assets and performs a curatorial function.

6.31 No Australian standards have been specifically developed for such bodies and it is unlikely that any will be issued in the foreseeable future. However, as with educational bodies the working party sees no reason why they should not be subject to Australian Accounting Standards listed in 6.28 above and recommends accordingly.

6.32 Guidance as to specific accounting techniques applicable to these institutions may be obtained from two sources:

- AICPA "Statement of Position 78-10 - Accounting Principles and Reporting Practices for Certain Non-profit Organisations" and
- "Museum Accounting Guidelines" promulgated by the American Association of Museums and the Association of Science-Technology Centers.

Subject to the caveats regarding fund accounting made earlier (6.25) the working party recommends that these two statements be regarded as authoritative "Guides to Accepted Accounting Practice".

6.33 Arguments regarding the need for depreciation to be included in statements if they are to fully disclose costs apply with equal force in the Museums, Libraries and Galleries context. However the working party concurs with the case made out in SOP78-10 and the "Museum Accounting Guidelines" that depreciation should apply to exhaustible assets only (ie excluding Collections). Consequently it is recommended that AAS4 apply to these bodies with respect to exhaustible assets only.

6.34 Implementation of these standards will require major changes (from a cash to accrual basis) for certain bodies in this category.

HOSPITALS AND HEALTH INSTITUTIONS

6.35 Although there is presently only one body included in Category 2.3 creation of a separate category is warranted both because of the intrinsic nature of the body concerned and the possibility of future expansion of reporting requirements in this area.

6.36 Presently the Capital Territory Health Commission adopts a cash accounting basis of reporting, but at the behest of the Senate Standing Committee on Finance and Government Operations is intending to prepare accounts on an accrual basis.

6.37 The working party considers that such accounts should endeavour to meet the objectives set out in 3.34 for financial statements generally. To do so it will be necessary for the accounts to disclose:

- all fixed assets (whether donated or purchased)
- associated depreciation
- sources and application of funds.

To that end it is recommended that AAS4 and IAS7 apply to this category of undertakings. Similarly there would seem no reason to exclude this category from the provisions of AAS5, AAS6, AAS8 and AAS9.

6.38 No pronouncements by the Australian accounting profession exist for undertakings of this type. However an AICPA Industry Audit Guide, the "Hospital Audit Guide" provides rules for the treatment of certain accounting issues particularly related to hospitals (eg Patient Service Revenues). These rules reflect orthodox accounting practice and are consonant, at a theoretical plane, with those recommended for other categories. Consequently the working party recommends that the Hospital Audit Guide be recognised as an authoritative "Guide to Accepted Accounting Practice".

CULTURAL ORGANISATIONS

- 6.39 These are Category 2.4 in Exhibit 5.2. Statements presently used vary from those based on "modified-accrual" concepts to those of a purely cash nature. Some bodies are heavily dependent on Commonwealth Departments for administrative support, others are quite independent. Certain own key assets in their own right, others have the use of key assets (eg buildings) yet ownership remains with the Commonwealth. The diversity of administrative and proprietorial arrangements encountered poses serious difficulties for achieving the basic objectives for financial statements set out in 3.34.
- 6.40 Where a body utilises assets owned by the Commonwealth, it is desirable, in order to indicate resources used by it, to disclose the amount of assets used but not owned in the financial statements of that body. To do so, however, could distort the picture given of the solvency of the body concerned since solvency reflects a relationship between legal ownership and legal indebtedness.
- 6.41 Similarly where a body draws significant operational support from departments (without a charge being made by the supplier) it would be appropriate to include amounts representing direct outlays by the supplier on such support in the statements. Nevertheless reporting bodies could be reluctant to include such data since:
- legally the outlays involved are not theirs, and
 - often they have little control over the extent and quality of departmental backup (whether or not the department supplying services is efficient is beyond the control of the undertaking).
- 6.42 To partially remedy these situations the working party recommends that, where they meet criteria set out in 7.20 resources provided to an undertaking free of charge be disclosed in notes to the accounts on supplementary statements.
- 6.43 No Australian Accounting Standard or pronouncements exist for bodies of this type in either the public or private sector. Subject to the reservations regarding fund accounting contained in 6.25 and 7.2-7.8 the working party does consider that AICPA Statement of Position 78-10 provides a good guide to orthodox accounting practice and recommends that it be used as an authoritative reference. In line with SOP78-10 and the discussion in 6.33 the working party also considers that statements ought to disclose depreciation in respect of exhaustible assets, using AAS4 as a basis.

- 6.44 Similarly the working party recommends that Australian Accounting Standards AAS5, AAS6, AAS8 and AAS9 and International Accounting Standard IAS7 should apply to these bodies.

- 6.45 The effects of these recommendations would range from, in the case of bodies presently using cash based statements, a wholesale revamping of accounts; to, in the case of larger bodies presently employing accrual techniques, the:

- preparation of a Statement of Changes in Financial Position;
- inclusion of depreciation charges;
- disclosure of support provided free of charge;
- redesign of the Statement of Income and Expenditure to "Statement of Activity" (of 7.26).

PUBLIC BROADCASTING

- 6.46 These consist of undertakings listed in Category 2.5. Reporting bases presently used range from pure cash to full accrual. The largest, the ABC, having extensive assets (and liabilities) reports only on a cash basis. A feature of certain undertakings are material trading "side-lines" (eg ABC receipts from publications sales to the private sector exceeds those of AGPS by more than a million dollars).
- 6.47 In line with the approach adopted for all other significant undertakings in order to achieve reporting objectives established earlier the working party considers it essential that bodies in this category produce statements based on full accrual concepts. To this extent AAS4, AAS5, AAS6, AAS8, AAS9 and IAS7 should apply.
- 6.48 In dealing with accounting problems peculiar to the broadcasting industry (eg movie rights) the working party considers that the following pronouncements issued by the American Institute of Certified Public Accountants, may, after making due allowance for Australian conditions, serve as authoritative "Guides to Accepted Accounting Practice":
- SOP75-5 Accounting Practices in the Broadcasting Industry
 - SOP78-10 Accounting Principles and Reporting Practices for Certain Non-profit Organisations
 - SOP76-1 Accounting Practices in the Record/Music Industry
 - SOP 79-4 Accounting for Motion Picture Films.

6.49 Similarly it is considered that in common with the accounts of other undertakings on an accrual basis the following Statements of Financial Accounting Standards should serve as references to accepted accounting practice:

- . SFAS5 Accounting for Contingencies
- . SFAS7 Development Stage Enterprises
- . SFAS13 Accounting for Leases
- . SFAS34 Capitalization of Interest Costs

6.50 Where an entity has significant auxiliary trading activities it is recommended that they be required to prepare supplementary trading statements indicating both the contribution made to the finances of the entity and the resources devoted to that activity. In general such statements should comply with standards applicable to accounts of bodies in category 1.1 (ie "commercial" requirements).

ADMINISTRATIVE, PLANNING AND SUPPORT FUNCTIONS

6.51 The undertakings listed in Category 2.6 are broadly concerned with planning and administration. They report mainly on a cash basis. Of all categories they may be considered the closest to purely departmental activities and it may be argued, by analogy, that they should report in a manner similar to departments of government.

6.52 The working party takes an alternative view. As legal entities distinct from the Commonwealth, not subject to central government controls and somewhat less under immediate ministerial direction than government departments, such bodies ought to provide statements which account for the totality of resources invested in them. There would seem no reason why these bodies should not be expected to meet reporting objectives listed in 3.34, to do so it would be necessary for statements to be prepared on an accrual basis. Such requirements are imposed on similar governmental agencies in the USA (Cf GAO "Accounting Principles and Standards for Federal Agencies") and would not seem out of place in the Australian context.

6.53 An appropriate guide to accounting procedures for such bodies would seem to be provided by AICPA Statement of Position 78-10.

MISCELLANEOUS BODIES PREDOMINANTLY FINANCED FROM THE BUDGET

6.54 As can be expected to occur with most categorization schemes a residue of bodies which do not conveniently fit any of the particular categories set up will remain. These comprise bodies listed in Category 2.7 of Exhibit 5.2.

6.55 The working party recommends that a flexible approach be adopted to the choice of standards/guides for these bodies, but that they be subject to reporting objectives set out in 3.34 and associated provisions regarding the use of accrual accounting.

6.56 In these circumstances AAS4, AAS5, AAS6, AAS8, AAS9, IAS7 and IAS13 should apply. Guidance as to acceptable practices could be expected to be drawn largely from Statement of Position 78-10.

COMMODITY BOARDS (ADVISORY/RESEARCH)

6.57 These comprise bodies listed in Category 3.1 of Exhibit 5.2. In addition to the three bodies shown there as publishing financial statements there are numerous s62A trust accounts (financed by levies) which support primary industry research. These trust accounts have not been included in this review.

6.58 Two of the three bodies included in this category presently report on an accrual basis, the other on a cash basis. Assets and transactions of all bodies are relatively small. Nevertheless the working party sees no reason why these bodies should report on any basis other than full accrual - the general reporting objectives set out in 3.34 would not in these cases be achieved by other methods of reporting.

6.59 In line with the approach adopted for other authorities it is recommended that these bodies be subject to the provisions of AAS4, AAS5, AAS6, AAS8, AAS9, IAS7, IAS9 and IAS13. Guidance as to acceptable accounting practices may also, if required be obtained from SFAS5 (Contingencies) and SFAS34 (Capitalization of Interest Cost).

OTHER ADVISORY/RESEARCH BODIES

6.60 These comprise bodies listed in Category 3.2 of Exhibit 5.2. Included in this group are several very large organisations which report solely on a cash basis, certain which utilize a hybrid of cash and accrual accounting and others on a modified accrual basis. None would seem sufficiently minor that cash based statements could reasonably be considered to achieve reporting objectives set down in 3.34.

6.61 By comparison with local and overseas counterparts the quality of financial reporting in this group is rather poor. The United Kingdom Atomic Energy Authority and the Standards Association of Australia, to mention but two examples, both produce financial statements on a full accrual basis. There would seem to be no evidence to suggest that the public needs to know less about the financial position and transactions of semi-autonomous Commonwealth bodies engaged in research type activities than it does about other undertakings. To the contrary where large amounts of public funds are handled at arms length to the central government there would seem to be added reason to require that the quality of financial management exercised by such bodies be made apparent. Estimates and cash based historical reports do not do that.

- 6.62 Accordingly the working party recommends that these bodies should report on a full accrual basis, observing the requirements of AAS4, AAS5, AAS6, AAS8, AAS9, IAS7, IAS9 and IAS13. Guidance on acceptable accounting practices may be obtained from SFAS5, SFAS34 and Statement of Position 78-10.

BANKING AND LENDING INSTITUTIONS

Banks

- 6.63 The central issue in the financial reporting of banks is whether they should fall outside normal accounting conventions, and to what degree they should be treated differently from other entities.
- 6.64 The form of Australian trading and savings banks' published financial statements is prescribed in the Banking Act 1959. In complying with legislative requirements in relation to published financial statements (ie Banking Act 1959 and Commonwealth Banks Act 1959), banks are exempt from the relevant Companies Act provisions.
- 6.65 The prescribed forms for reporting are currently being reviewed; this review appears to be proceeding on the basis that the banking institutions will not be required to disclose publicly the levels of, and appropriations to, provisions for bad and doubtful debts. The banking industry feels that this disclosure would be undesirable because of what they perceive as probable implications for the stability of the banking system.
- 6.66 The working party cannot support the practice of each bank making an undisclosed provision for bad and doubtful debts before striking its operating profit. The working party considers that it is important that as well as disclosing the basis on which provision for loan losses is made, statements ought to disclose movements in the provision and the amount of the provision at the balance sheet date. These measures are necessary to give a proper understanding of the impact which loan losses can have on the results of a bank and its financial position.
- 6.67 The banking industry have traditionally resisted disclosure in two other areas:
- (a) interest paid; and
 - (b) provisions for long service leave.

The industry argues that Companies Act's requirements are not tailored to banking companies. However although interest paid is a major item of banks' expenditure, the same can be said for other financial intermediaries who are required to disclose this information. There is ample overseas precedent where "interest paid" is disclosed by banks in UK, USA and Canada.

- 6.68 Disclosure could aid efficiency in financing; and it would make banks' profit and loss statements more meaningful. Banks in the UK, US and Canada disclose this information in their accounts, which generally contain more detail regarding income and expenditure than do local banks.

- 6.69 As a general principle the preferred disclosure by banks should be on the same basis as other Companies required to prepare accounts under the provisions of the Companies Act, including information relating to bad and doubtful debts. Disclosure by the banks on the same basis as other companies should be regarded as desirable in principle, and departures from it should be permitted to occur only when there is an overwhelming case for doing so.
- 6.70 One such case is the "current: non-current" distinction for assets and liabilities. The working party believes that this lack of segregation is appropriate in view of the nature of a bank's assets and liabilities. Except for bank premises and equipment, the assets and liabilities are generally not susceptible to the "current: non-current" classification. It is the working party's view that assets and liabilities should be listed in their approximate order of liquidity.
- 6.71 The "general principle" developed in 6.69 has been a pervasive consideration in determining the standards for banks. As well as complying with the proposed General Accounting Standard the following standards and recommended accounting practices are seen to be applicable to banks:
- (a) Ninth Schedule of the Companies Acts
 - (b) Australian Accounting Standards ie AAS1, AAS4 - AAS6, AAS8 and AAS9
 - (c) Recommended "Guides to Accepted Accounting Practices".
 - (i) SFAS 5, 7, 13, 14, 34
 - (ii) AICPA Industry Guide: "Audit of Banks"

- 6.72 The financial statements considered appropriate for banks are:
- . Balance Sheet
 - . Profit and Loss
 - . Changes in Financial Position

Borrowing Corporations

- 6.73 The accounts of borrowing corporations (and guarantor corporations) incorporated in a State or Territory must comply with the general requirements of the Companies Act (including the Ninth Schedule). The balance sheet, by way of additional disclosure, must include a schedule setting out separately estimates of the amounts payable by, and the debts payable to, the company:

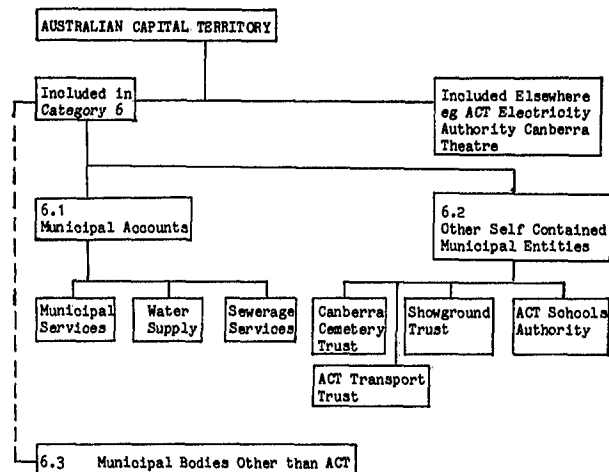
- (i) not later than 2 years;
- (ii) later than 2 years but not later than 5 years; and
- (iii) later than 5 years, after the end of the financial year.
- 6.74 A borrowing corporation that has issued debentures must prepare half yearly accounts and lodge them with the Commission and the trustee for debenture holders. The half-yearly accounts should comply with the general requirements of the Act but they need not be audited provided that written consent is obtained from the trustee.
- 6.75 The Act does not make specific reference to the content of the half-yearly accounts but the NSW Commissioner for Corporate Affairs has indicated that the most appropriate comparative figures would be:
- (i) in the half-yearly balance sheet - the balance at the end of the corresponding half year in the preceding financial year; and
- (ii) in the half year Profit and Loss Statement - the results of the corresponding 6 months in the preceding financial year.
- 6.76 The working party believes that borrowing corporations, in addition to the legal requirements detailed above, should conform to the standards and recommended accounting practices for Category 4. (See 5.5-5.9). The AICPA Industry Audit Guides "Audits of Finance Companies" is cited as a "Guide to Accepted Accounting Practice".

MUNICIPAL ACTIVITIES

- 6.77 These comprise bodies listed in Category 6 of Exhibit 5.2.
- 6.78 Canberra's municipal accounts were intended to portray expenditure and revenue associated with the provision of municipal services, water supply and sewerage services. Amounts shown in the accounts are derived from financial records of those Commonwealth Departments and the National Capital Development Commission which provide municipal services.
- 6.79 Problems of a practical and conceptual nature beset the present accounts. These stem mainly from the lack of a clearly defined legal or operational entity. Canberra is, of course, not legally a municipality, although the accounts are drawn up as though it is in order to obtain some comparison with other bodies. Several Commonwealth agencies are involved in providing "municipal services", however each of these has significant other activities of a non-municipal type. This gives rise to particularly difficult problems of cost collection and cost apportionment. Much of data contained in the accounts is necessarily subjective giving rise to a general criticism of the current arrangements that they are unable to produce "true" accrual based data that will allow the determination of total organisational expenses or costs by functions or activity.

- 6.80 While differing environmental factors prevent the United States accounting methods to be readily transposed to the Australian context, some themes developed in the AICPA Industry Guide can provide the basis of an interim standard. The working party prefers the concept of an interim standard because this is one area where more work should be done than was possible in the present exercise.
- 6.81 The working party developed a basic model for Canberra's Municipal Activities (Exhibit 6.1).

EXHIBIT 6.1



The model was derived from the fund concept of municipal accounting used in the United States. It must be stressed however that the working party is not advocating fund accounting as such (see paras 7.2-7.8) but rather aligning ACT municipal activities with the functions of the various funds with the aim of adopting (where possible) relevant standards applicable to each fund.

6.82 Entities shown above in the "Included Elsewhere" sub-category are similar to those activities grouped under the AICPA's, "Enterprise Fund", ie self-supporting activities of a municipality which render services on a user-charge basis. These entities would normally appear in category 1.1 of the General Classification Model and be subject to full accrual accounting.

6.83 Activities in Category 6 are similar to those activities grouped under the AICPA's "General Fund", "Special Revenue Fund" and "Special Assessment Fund". The distinguishing characteristic of entries classified under the Special Revenue Fund is that most of the revenue involved in the operation comes from rates as opposed to the Enterprise Fund where revenues are derived from direct charges.

6.84 The following relationships have been developed:

(a) Municipal Accounts

- (i) Municipal Services - General Fund
- Special Assessment Fund
- (ii) Water Supply - Special Revenue Fund
- (iii) Sewerage Services - Special Revenue Fund

(b) Other Self-Contained Activities

This sub-category comprises separate discernible entities that provide specific municipal services. Some activities may charge users for services provided but a significant part of their revenue comes from the Budget.

Accounting Basis

6.85 As an interim measure the working party considers that sub-category 6.1 should adopt a cash accounting convention. The working party feels that the present notional accounts do not meet the criteria of relevance and factuality. Clearly, meaningful accrual based accounts are impractical at this stage and in any event, the AICPA Guide only recommends a modified accrual system for this category together with the optional disclosure of assets other than buildings (including depreciation thereon).

6.86 As a general principle sub-category 6.2 should adopt a full accrual basis as there are identifiable entities from which relevant and factual data can be produced. Principal financial statements required for adequate reporting of overall municipal finances are shown in Exhibit 6.2.

EXHIBIT 6.2

	RECEIPTS/ PAYMENTS	INCOME/ EXPENDITURE	BALANCE SHEET	FUNDS STATEMENT	STATEMENT OF CAPITAL EXPENDITURE
Category 6.1					
(i) Municipal	X				X
(ii) Water	X				X
(iii) Sewerage	X				X
Category 6.2		X	X	X	
Category 6.3	X				

Accounting Standards

6.87 The working party considers the following standards should apply to Category 6.

(a) Sub-Category 6.1

- (i) The disclosure requirements of the General Standard
- (ii) The Australian Accounting Standards: AAS5, AAS6, AAS8

(b) Sub-Category 6.2

- (i) The General Accounting Standard
- (ii) Australian Accounting Standards: AAS2, AAS5, AAS6, AAS8, AAS9.
- (iii) International Accounting Standards: IAS7
- (iv) Recommended Guides (US Standards) SFAS5, SFAS34

(c) Sub-category 6.3 - As for 6.1

CHAPTER 7 - SPECIAL ISSUES IN ACCOUNTING FOR COMMONWEALTH UNDERTAKINGS

- 7.1 In dealing with reporting requirements for various categories of undertakings a number of issues, common to several types of entity, were identified where customary practices seemed deficient. These concerned:

- Fund accounting.
- Tax effect accounting.
- Accounting for resources supplied/owned by other parties.
- Annual reporting by bodies predominantly financed from the Budget.

This chapter examines each problem area and possible solutions, providing recommendations which are consistent with reporting objectives established in Chapter 3.

FUND ACCOUNTING

- 7.2 The United States National Council on Governmental Accounting (NCGA) Statement 1 asserts that:

"Governmental accounting systems should be organized and operated on a fund basis"

A similar approach is endorsed in the various AICPA statements for non-business entities.

- 7.3 The NCGA defines a fund as:

"a fiscal and accounting entity with a self balancing set of accounts recording costs and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations."

- 7.4 Typically a fund is an accounting abstraction rather than a legal entity (although funds, of course, may be established as such). Fund accounting reports focus on discrete aspects of an organization's affairs rather than on the totality of operations. Concepts of revenue and expense tend to differ from that usually encountered in so called "commercial" accounting. Flows to and from funds are frequently matters of management discretion rather than legal necessity.

- 7.5 Both NCGA and AICPA pronouncements endorse the use of multiple funds in the accounts of non-profit and Government entities.

These are reported in financial statements in a columnar format which permits aggregation to show overall effects. With the exception of Trust and Agency Funds (which reflect legal obligations) none of the eight types of funds espoused by the NCGA seems appropriate for use in Commonwealth undertakings. However where fund accounting is necessitated by legal requirements the working party considers that the "restricted/unrestricted" categories provided as an alternative in SOP78-10 should be used.

- 7.6 The working party's principal objection to multiple fund accounting can be summed up in the words of an American commentator:

"A person familiar only with commercial accounting may find fund accounting a bewildering experience. Instead of one set of financial reports covering the entire entity, there are separate reports for each fund... The rationale for segregating funds in this manner is to assure that specific sources of funds will be used to finance specific governmental activities. This may be well suited for internal control and accountability on a custodial basis; however, it does not provide an overall view of fund flows. Fund accounting is so fragmented that it discourages comprehension by external users of financial reports." (46)

- 7.7 If statements are to consist of relevant, factual data it is imperative that they be restricted to essentials (so that the reader may readily grasp what they report) and that they not mislead by inducing the reader to think of managerial appropriations as expenses in the conventional sense. Multicolumnar fund reports commit both errors and are not considered suitable for use in Commonwealth undertakings.

- 7.8 Where funds exist by legal requirement the working party recommends that they be reported as follows:

- Funds vesting in the reporting body which are subject to restrictions on use should appear separately in the balance sheet identified as "Restricted Funds". A supplementary statement setting out transactions in "Restricted Funds" during the reporting period should also be provided.
- Funds held on a trustee and/or agency basis should be reported in a supplementary statement to the accounts as "trust and agency funds", except where conditions in trust deeds or commercial privacy prohibit it.

TAX-EFFECT ACCOUNTING

- 7.9 AAS3 requires the use of the "liability method of tax-effect accounting" by businesses. The method assumes that a liability for future income taxes arises whenever tax rules allow deductions at a faster rate than the business charges in calculating pre-tax accounting profit or when those rules bring in revenues at a later date than when the business credits them to the profit and loss account.
- 7.10 The efficacy of this technique as applied to the accounts of companies in the private sector has been repudiated by the NSW Government's Accounting Standards Review Committee on the following grounds:
 - The "deferred tax - liability" computed is not moneys owed to anyone, hence cannot be considered a liability.
 - It is not necessarily recoverable at a future date. (If the business fails to make profits in future periods or tax laws are changed).
 - At best "deferred-tax" is a contingent liability, other contingent liabilities are shown in notes not on the face of the statements.
 - The method is contrary to basic "accrual concepts". Companies having no taxable income pay no tax for the year in question, yet they have to pay other expenses that "accrue".
 - Income tax cannot be "matched" with particular revenues as AAS3 assumes since it is calculated on taxable income in aggregate. Deferral of expense recognition (or the converse) is then invalid.
 - Deferred-tax liability included in accounts distorts relationships by showing a non-existent liability.
- 7.11 In the context of Commonwealth undertakings the use of tax-effect accounting poses further problems. Where the taxing authority and owner are, for practical purposes, one and the same, can tax-effect accounting be considered a valid means for achieving basic reporting objectives? Will the technique permit the calculation of resources available to an entity, its solvency and "costs" of operations in a true and fair manner? Do figures so derived provide a satisfactory basis for decisions about the reduction or supplementation of national resources invested in the reporting body?
- 7.12 Even if no doubt exists as to the likelihood of deferred-tax liability being paid, the Commonwealth is in the special position as a "shareholder" of allowing its undertakings to retain funds on the supposition that they will later pay them as taxes. While it could be claimed that trading bodies should have access to funds on a basis similar to their private sector counterparts and be permitted to use tax-effect accounting, a strong case exists to the contrary.
- 7.13 If the assumptions of a body recording a deferred-tax liability work out in practice it will have the use of funds for an indefinite period while that liability is gradually extinguished by the payment of tax. If, as American evidence suggests, those assumptions are unlikely to be realised, the body will have succeeded in creating a substantial reserve. Under either condition a situation could arise where bodies are accused of concealing the real nature of financing arrangements or even that consumers are being called on to pay unnecessarily high prices while the undertaking supplying them "waxes fat".
- 7.14 When the matter of Future Tax Benefits is considered the problem takes on a more curious aspect. If reported profits are increased by the amount of tax benefit expected in future periods the undertaking is, effectively, anticipating revenues from the Commonwealth. A result of this is that the Commonwealth is likely to seek a greater dividend at the present time. Should that future benefit not be realised the Commonwealth will not (knowingly) make good the apparent shortfall in finances.
- 7.15 In consequence tax-effect accounting, in certain circumstances could act to the detriment of some Commonwealth undertakings and to the advantage of others. Funds could be withdrawn from an undercapitalised body or allowed to remain with an overcapitalised body, to the taxpayer's disadvantage in both cases. The likelihood of such occurrences can be gauged to a limited extent from research undertaken by one of the "Big Eight" accounting firms.
- 7.16 A study by Price Waterhouse & Co of tax-effect accounting in the USA concluded that:

"The only realistic justification for reducing income by charges for hypothetical income taxes is the statistical probability that there will be a payback."
(43)

Covering 1954-1965, a period of general economic growth interrupted by three minor recessions, the study established that of 100 major corporations surveyed, 98% of charges made against income for "deferred tax" did not have to be paid out in cash.
- 7.17 In the light of these considerations the working party undertook an exploratory study of tax-effect accounting in the Commonwealth sphere. This showed that only six of the major authorities and Commonwealth owned companies liable to pay income tax were, in fact, using tax-effect accounting. During the past five years total future tax benefits claimed by these bodies have tended to be balanced by total deferred tax liabilities. In 1979 however aggregate deferred tax liabilities did exceed aggregate future tax benefits by \$48.7 million.

- 7.18 The magnitude of sums involved and the possibility of the emergence of an upward trend lead the working party to recommend that a detailed appraisal of the particular implications of the use of tax-effect accounting by Commonwealth bodies be undertaken.

RESOURCES USED BUT NOT OWNED

- 7.19 Reference to situations where reporting entities utilise but do not own or finance significant resources has already been made in paragraphs 6.40-6.42 in relation to cultural bodies. The problem is not restricted to that category alone, but exists elsewhere, notably in the municipal sphere*.
- 7.20 Where significant resources are provided free of charge by other Commonwealth agencies to an entity the general reporting objectives set down in paragraph 3.34 require that they be disclosed to indicate the overall cost of operations of that body and its real resource base. In order to indicate solvency and to indicate that part of the operations/capital base of an entity for which its management is legally responsible it is necessary to clearly distinguish between information relating to each of these objectives.
- 7.21 The working party considers that this may most conveniently be achieved by use of footnotes or supplementary statements indicating the level of support provided free of charge. It is recommended that such notes or statements indicate separately assets provided in support and expenditures made on behalf of the reporting entity where material.
- 7.22 The following criteria for judging materiality are suggested. Assets or expenditures should be disclosed where:
- (a) the current value of assets provided equals, or, exceeds 5% of the written down value of the assets actually owned by the reporting body or \$100,000, whichever is the less; or,
 - (b) the amount of expenditure undertaken in direct support of an entity equals or exceeds 5% of the total expenses incurred by the entity in its own right, or, \$10,000 whichever is the greater.

* Equipment supplied by the armed services to Department of Productivity factories is an example from the "commercial" arena.

- 7.23 These criteria are based on consideration of the relevance of information provided and the tolerance for error inherent in calculations. To avoid possible attempts at circumventing these requirements by paying nominal charges to suppliers it is recommended that the following provision apply:

"Assets will be deemed to be provided "free of charge" when subject to "peppercorn rentals" or to other charges not reflecting the substantial economic value of support received".

ACCURAL REPORTING BY BODIES PREDOMINANTLY FINANCED FROM THE BUDGET

- 7.24 Where an undertaking is financed primarily from the Budget preparation of financial statements which simply mimic commercial practice may be potentially misleading both in relation to the cost of operations of an entity and the taxpayer's capital investment.
- 7.25 Prudent management of Commonwealth funds entails minimizing cash balances held by authorities and they are intended to receive in a reporting period only what they will actually pay out. Accrual accounting however measures expenses on the basis of the obligations incurred during that period, making provisions for depreciation, long service leave and other expenses incurred but not paid and also recognizing goods and services received but not paid for. Matching of expenses with revenues automatically leads to the calculation of a deficit.
- 7.26 Although that deficit actually represents the unfunded portion of the taxpayer's overall liability, it may readily be confused by the lay reader of the financial statements by signalling an apparent failure on the part of an undertaking's management to live within its means. This possibility is enhanced by using private sector terms to describe statements prepared. Many clubs and associations prepare income and expenditure statements, when these statements show deficits members have legitimate grounds for concern; the same concern is not usually justified in the case of Commonwealth bodies largely funded from the Budget.
- 7.27 To avoid potential, although unintended, deception two options are available:

- to discard accrual accounting altogether for this group of bodies; or
- to give reports relating to the transactions of this group a distinctive title and format.

The first option would involve discarding the basic objectives of reporting set down in paragraph 3.34 and is considered unacceptable. The working party recommends that the second approach be taken.

7.28 This will involve retitling accruals based transactions statements for this group (where presently in use these are generally called "Income and Expenditure Statements") as a "Statement of Activity". It would also involve rearrangement of the format of that statement so that major "non-cash" expenses are separated from these for which funds have been provided. The title "Statement of Activity" is one among several suggested by the AICPA for the accounts of non-profit bodies* and is not, to our knowledge, in use in Australia. As such it seems eminently suitable for our purposes.

7.29 Exhibits 7.1 and 7.2 provide a simple illustration of what is entailed in the changeover for the statements of a hypothetical body. Exhibit 7.1 indicates what is typical under present arrangements whereby such bodies prepare an income and expenditure statement (excluding depreciation charges). Exhibit 7.2 indicates disclosures achieved by Statement of Activity.

7.30 It should be noted that where the cost of significant goods and services has been accrued as an expense which is intended to be met from funds to be appropriated for the following year a separate provision has been shown. This would not normally be done for run of the mill, end-of-year accruals but could be necessary where, for instance, a major back dated pay-rise has been granted.

7.31 Both Exhibit 7.1 and Exhibit 7.2 make reference to a Statement of Capital Accumulation. These are presently used by a number of non-trading bodies to facilitate the preparation of a balance sheet and to disclose the substantive nature of changes in capital structure. The residual equity item (entitled "Capital Accumulation Account") contained in the balance sheet is usually cross referenced to a footnote or supplementary statement which sets out:

- the balance of the account brought forward;
- the classes of fixed assets on which capital funds appropriated for that year have been spent;

* Other titles suggested by the AICPA tend to be rather prolix eg "Statement of Support, Revenue, Expense, Capital Additions and Changes in Fund Balances" (10).

EXHIBIT 7.1

RARE OBJECTS RESTORATION TRUST INCOME AND EXPENDITURE STATEMENT FOR Y/E 30.6.79

INCOME	\$	\$
Parliamentary Appropriations	5,000,000	
less transfers to Capital Accumulation	<u>3,400,000</u>	1,600,000
Donations & Misc Income		<u>80,000</u>
Total Income		1,680,000
EXPENDITURE		
Salaries	650,000	
Travel & Subsistence	80,000	
Provision for Long Service Leave	30,000	
Other Expenses (listed)	<u>960,000</u>	
Total Expenditure		<u>1,720,000</u>
Deficit transferred to Capital Accumulation		<u>40,000</u>

Note: In accordance with accounting practices for non-profit bodies depreciation charges have not been included in this statement.

EXHIBIT 7.2

RARE OBJECTS RESTORATION TRUST STATEMENT OF ACTIVITY FOR Y/E 30.6.79

REVENUE		
Parliamentary Appropriation	5,000,000	
less transfers to Capital Accumulation	3,400,000	1,600,000
Donations & Misc Income		<u>80,000</u>
Total Operating Revenue		1,680,000
EXPENSES	\$	\$
Salaries	650,000	
Travel & Subsistence	80,000	
Other Expenses (listed)	<u>948,000</u>	1,678,000
Excess of Revenues over Current Expenses		2,000
Provisions and Other Unfunded Charges		
Depreciation of Exhaustible assets	20,000	
Provision for Long Service Leave	30,000	
Other Unfunded Accruals	<u>12,000</u>	62,000
Unfunded Liability transferred to Capital Accumulation		<u>60,000</u>

- . other capital accretions (gifts, transfers etc);
- . the surplus/deficit transferred from operations;
- . the closing balance of the account.

7.32 The Capital Accumulation Statement is particularly helpful in disclosing capital spending. The account readily indicates whether or not funds intended for acquisition of capital assets purposes have been so used. However much if not all of the information contained in this statement could be disclosed in a Statement of Changes in Financial Position of appropriate design. As a result the working party recommends that non-trading bodies be required to prepare a balance sheet and Statement of Capital Accumulation (whether as a footnote or supplementary statement) except where identical or superior disclosure is achieved by the Statement of Changes in Financial Positions.

CHAPTER 8 IMPLEMENTATION OF THE GUIDELINES - SOME IMPLICATIONS

- 8.1 To quote E.L. Normanton* "A concluding chapter is a hazard for both reader and writer. For the reader because he may be sorely tempted to read this chapter alone, in the hope that it will tell him everything of importance that has gone before ... for the writer because, foreseeing the temptation to which his reader will be exposed, he may produce a final chapter which summarises the rest of his book, and might at a pinch serve as a substitute for it."
- 8.2 This chapter provides neither substitute nor summary but deals with a number of matters which, although only marginally within the terms of reference of the working party, are essential to a balanced appraisal of the proposals advanced. In particular these concern the practicalities of implementation and the mechanics of maintaining a set of guidelines which continuously reflect contemporary accounting standards.

EXTENT OF CHANGES PROPOSED

- 8.3 In assessing the viability of the recommended guidelines the principal concern is with the nature and extent of change proposed. Changes resulting from the implementation of the guidelines may broadly be categorised in terms of undertakings affected and technical complexity as follows:
- (a) introduction of a Statement of Changes in Financial Position affecting all but the smallest entities (where cash based statements meet reporting objectives);
 - (b) major changes to accounting practices ranging from conversion from cash to accrual accounting, to the introduction of depreciation charges in accounts presently prepared on a "modified - accrual" basis;
 - (c) minor changes involving simply rearrangements of financial statements (eg introducing the Statement of Activity approach) and technical changes to accounting methods in order to conform to standards and "Guides to Accepted Accounting Practice".
- 8.4 Exhibit 8.1 gives a capsule summary of the changes required following the adoption of the Guidelines. The introduction of a Statement of Changes in Financial Position will affect nearly all undertakings - where entities are preparing accounts on an accrual basis it is assumed that sufficient data will be available to prepare this statement with minimum additional effort. For those undertakings not using accrual accounting, the preparation of a Statement of Changes in Financial Position becomes an issue secondary to the general requirements that statements be prepared on a full accrual basis.

* "The Accountability and Audit of Governments", Manchester, MUP, 1966.

EXHIBIT 8.1

OVERVIEW OF CHANGES RESULTING FROM GUIDELINES

CATEGORY	CHANGE IN		OTHER CHANGES		APPROXIMATE NUMBER IN CATEGORY
	FINANCIAL POSITION	NO CHANGE MINOR CHANGE		MAJOR CHANGE	
1.1	x	x			39
1.2	x	x			11
2.1	x	x		(a)	6
2.2	x			x(b)	3
2.3	x			x(c)	1
2.4	x			x(d)	6
2.5	x			x	4
2.6	x			x	5
2.7	x			x(e)	13
3.1	x	x			3
3.2	x			x	11
4	x	x			24
5	x			x(f)	11
6.1				x	1
6.2	x	x			5
6.3		x			3

- (a) depreciation;
- (b) full accrual accounting plus depreciation on exhaustible assets;
- (c) full accrual accounting, disclose all fixed assets and depreciation thereon;
- (d) full accrual accounting; depreciation on exhaustible assets plus disclosure, by way of note, for services provided free of charge;
- (e) case by case basis;
- (f) banks - comply with the Ninth Schedule.

8.5 Undertakings not presently preparing full accrual accounts range from those totally cash based (see Exhibit 8.2) to those which prepare accrual type statements but exclude depreciation changes. In between is a spectrum of bodies that provide a Statement of Receipts and Payments plus varying degrees of information relating to assets and liabilities (see Exhibit 8.3).

EXHIBIT 8.2

UNDERTAKINGS, PRIMA FACIE, REQUIRED TO CONVERT FROM CASH TO ACCRUAL

Aboriginal Land Fund Commission
ACT Schools Authority
Albury-Wodonga Development Corporation
ABC
Capital Territory Health Commission
CSIRO
National Library
Repatriation Commission
Services Centres Trust Fund

8.6 Clearly, adoption of the guidelines will require extensive changes for entities listed in Exhibit 8.2; this affects some very large undertakings. Whether or not those bodies have accounting systems (and records) to service accrual based statements is not known. In any event, implementation of the guidelines may require a gradual approach where the upgrading of data collection systems is phased in over a number of years.

8.7 Less extensive changes would be required in respect of the 21 bodies listed in Exhibit 8.3. These presently disclose a variety of information relating to assets and liabilities and seemingly have records which could be upgraded to service accrual based statements. At least two bodies are actively moving towards the production of full accrual statements.

EXHIBIT 8.3

UNDERTAKINGS PRESENTING ASSETS/LIABILITIES INFORMATION IN ADDITION TO RECEIPTS AND PAYMENTS

(*indicates presently moving towards full accrual)

Albury-Wodonga Development Corporation
Anglo-Australian Telescope Board
Australian Apple and Pear Corporation (non-trading activities)
Australian Atomic Energy Commission*
Australian Film Commission (special activities)
Australian Heritage Commission
Australian Institute of Aboriginal Studies
Australian Institute of Multicultural Affairs
Australian Institute of Criminology
Australian Institute of Marine Science
Australian Tourist Commission*
Australian War Memorial Fund
Criminology Research Council
Defence Forces Retirement Benefits Board
National Parks and Wildlife Service
Great Barrier Reef Marine Park Authority
Law Reform Commission
Legislative Drafting Institute
National Capital Development Commission
Parliament House Construction Authority
Snowy Mountains Hydro Electric Authority

- 8.8 Major changes affecting the remaining 28 bodies shown in the fourth column of Exhibit 8.1 relate mainly to depreciation and the disclosure of services/resources provided free of charge. Neither would seem to pose particular problems in terms of data collection and processing.

CONTINUOUS UPDATING OF GUIDELINES

- 8.9 Extensive research is presently being undertaken under the sponsorship of the professional accounting bodies which can be expected to result in the issue of numerous accounting standards in coming years. Not all of those standards will be equally applicable to all Commonwealth undertakings, consequently there is a need, if a consistent framework of accounting practices is to be maintained, to devise a mechanism whereby Guidelines may be continuously updated.
- 8.10 The working party considers that the most appropriate means of doing this is for the present Audit/Finance Steering Committee to continue in existence with a mandate to review professionally issued standards in terms of their ability to achieve, in the Commonwealth context, the reporting objectives established in 3.34 and to modify Guidelines accordingly.
- 8.11 The functions of the continuing Steering Committee could include:
- (a) allocating new undertakings to appropriate categories within Exhibit 5.2 and amending the classification of bodies as conditions changed;
 - (b) examining and endorsing the applicability to Commonwealth entities of professional accounting standards;
 - (c) commissioning research into significant aspects of accounting practice not adequately covered by AARF programs; and
 - (d) co-ordination of Audit/Finance participation in the development activities of AARF, particularly in the area of Exposure Drafts.

THE PREPARATION OF GROSSLY OUT OF DATE FINANCIAL STATEMENTS

- 8.12 The Third Report of the Senate Standing Committee on Finance and Government Operations Inquiry into Statutory Authorities of the Commonwealth (page 61) lists a number of undertakings that have encountered delays in presenting reports to Parliament. Information that is not timely has limited use in making economic decisions and, at worst, may have only historical value to information evaluators (of 4.11). Clearly, financial statements prepared 2 or 3 years after the close of the reporting period deprive Parliament and the public of information needed to evaluate an entity's performance, in addition such statements fail to meet the relevance requirement for objectives developed in 3.34.

- 8.13 As a general principle the working party considers that the major effort should be devoted to preparing the current year's financial statements (the most relevant) and those grossly delinquent statements should be prepared in the most expedient manner.

- 8.14 Adoption of this principle may require the Minister for Finance to approve a modified form of statements for delinquent statements and comparative figures would not be available for the current year's statements. A further constraint is the probability of an adverse report from the Auditor-General. However, on balance the working party believes that statements too far removed from the period they report on are of limited use and not worth the resources needed to produce them. The Third Report of the Senate Committee on Finance and Government Operations addresses the problem regarding the value of out of date information and puts forward the concept of an interim report with draft financial statements - the danger here is that the final statements may not bear an isomorphic relationship to the draft set, thus further impeding the information evaluators efforts.

CONCLUSION

- 8.15 The working party believes that the guidelines developed as a result of this study are both practical and viable. Clearly, in the limited time allocated to this project some issues were raised but no rigorous examination was possible - those areas are recommended for further study.

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EXPOSURE DRAFT

PROPOSED GUIDELINES FOR THE FORM AND STANDARD OF FINANCIAL STATEMENTS OF COMMONWEALTH UNDERTAKINGS

This draft is issued for consideration by Commonwealth statutory authorities and other interested persons. It has been prepared by a joint working party drawn from the Department of Finance and Auditor-General's Office and should be read in conjunction with the working party's report.

The draft Guidelines provide a recommended policy statement regarding objectives of financial statements and associated accounting practices. Comments are invited on the proposals and should be addressed to:

The Chairman
Joint Working Party on Financial Statements
of Commonwealth Undertakings
Room A301
Department of Finance
CANBERRA ACT 2600

Comments should be forwarded so as to arrive no later than 1 Dec 1980.

To facilitate evaluation of the proposed requirements, the Guidelines are cross referenced by marginal notations to:

- (a) paragraphs in the joint working party's report (eg 4.20);
- (b) relevant sections in the "uniform" companies legislation (eg UCA, S.167 (b));
- (c) comparable provisions in the Ninth Schedule to the various Companies Acts (eg 9th Schedule, 5 (2)(a)); and
- (d) provisions of Section 3C of the Official List Requirements of the Australian Associated Stock Exchange (AASE).

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- A4 Specific Objectives For Financial Statements
- A9 Accounting Standards Generally
- A10 Quality Requirements For All Financial Statements
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- A15 Nature and Content of Financial Statements
- A21 Valuation of Assets
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ATTACHMENT

- A1 General Accounting Standard - Items to be Disclosed Separately
- A2 Categorisation of Commonwealth Authorities and Undertakings
- A3-1 Mandatory Standards Applicable to Categories of Undertakings and Types of Statements to be Produced
- A3-2 "Guides to Accepted Accounting Practice" for Categories of Undertakings
- A3-3 Guides to Accepted Accounting Practice

- A1. These guidelines set out broad norms for published financial statements of Commonwealth statutory authorities and certain Departmental undertakings. They deal with the underlying precepts, basic objectives and quality standards considered necessary to meet the information needs of Parliament and other users. They are intended to provide common objectives for financial statements and to identify a body of sound accounting practices which may be drawn upon for the development of the financial statements of particular bodies rather than enforce uniform accounting.
- A2. In designing financial statements and accounting systems which service them it is essential that the accountant have a clear idea of the particular ends to be achieved by those statements and the priorities to be served. Specific objectives for the design of financial statements (hence of accounting systems) are founded on broad precepts regarding the value and role of financial reports. The information contained in reports is subject to standards designed to facilitate the achievement of those objectives. These guidelines proceed by first establishing those precepts and objectives, then setting out a General Accounting Standard applicable to all undertakings. Finally undertakings are divided into broad categories which may be associated with specific accounting standards and pronouncements to serve as a practical basis for the design of financial statements and the choice of accounting techniques.

BASIC PRECEPTS

- A3. The following precepts are considered to underpin specific objectives for financial statements. 3.4-3.6
- (a) The primary function of accounting systems is to accumulate and communicate information relevant to the understanding of the activities of an entity.
 - (b) Potential users of financial statements of Commonwealth undertakings include both the Parliament, management and the public at large. Accounting systems should maintain a balance in terms of their ability to meet the needs of internal and external users of reports.
 - (c) The interests of an undertaking's management should not take priority over those of external user groups where financial reports are concerned. Undertakings are obliged to provide statements that adequately service essential information needs of external groups.

SPECIFIC OBJECTIVES FOR FINANCIAL STATEMENTS

- A4. Deriving from the basic principles listed above are specific objectives for financial statements. In providing essential financial information that is useful or relevant to the needs of users in general, statements should permit the reader to establish as a matter of fact the:
- (a) cost to the taxpayer of operations of an undertaking over the reporting period and preceding periods;
 - (b) net resources currently devoted to its activities;
 - (c) solvency of the undertaking; and
 - (d) change in the level of net resources since the previous reporting date and the manner in which that change came about.

These objectives are elaborated below.

- A5. "Cost to the taxpayer" implies that the community is regarded as an equity holder in the reporting undertaking and that the net effect of operations on the financial position of that undertaking should be reported on a basis similar to that used for corporations in the private sector. 3.35-3.38
- A6. In reporting the level of resources used by an undertaking the concern is to obtain a measurement of the taxpayer's current investment. This involves disclosing the extent of property owned by the undertaking (assets) and all amounts owing by it to others (liabilities). It further requires disclosure of the amount of resources in the possession of and used by the entity but which are not legally owned by it. 3.39
- A7. To give a "fair view" of the financial soundness of an undertaking assets and liabilities should be categorised in terms of their effects on solvency. In the case of assets this implies categorisation according to relative ease of conversion into cash (ie liquidity) or in the case of liabilities according to the proximity of repayments. 3.40
- A8. Reporting the extent and nature of changes in the level of resources implies the disclosure of all significant sources of finance and the use to which those funds were put. 3.41

ACCOUNTING STANDARDS GENERALLY

- A9. Standards relate both to the quality and serviceability of statements generally and to inputs and processes used to compile them. Qualities expected of all financial statements (whatever the objective they serve), are identified below and have been used as the basis for a General Accounting Standard (see A14). More specific standards, of limited application, dealing with particular processes and accounting inputs have been identified for a series of broad categories of undertakings (see A31).
- 4.1-
4.14

QUALITY REQUIREMENTS FOR ALL FINANCIAL STATEMENTS

- A10. The fundamental quality requirement for financial statements is that they provide a 'true and fair' view of the situation or events they purport to describe. This entails two principles, viz that they be factual and relevant.
- 3.7-
3.9
- A11. Factuality implies that:
- 3.8
- (a) financial statements are historical records;
 - (b) separate observers could agree with the description of an entity contained in its financial statements; and
 - (c) statements are not biased towards the interests of particular user groups.
- A12. Relevance requires that statements should contain information essential to understanding the matter being reported upon; information which is relevant to the needs of users in general. Statements should neither be cluttered with detail (of use to a few readers) nor so brief as to leave the individual reader uninformed of matters considered relevant to all interested parties.
- 3.9
- A13. Relevance implies that statements conform to other criteria set out in Australian Accounting Standard AAS 6 viz that they are:
- (a) Material - being concerned with information which is sufficiently significant to affect economic evaluations or decisions (criteria are contained in AAS5);
 - (b) Consistent - so that accounting policies followed are consistent from one period to another;
- 4.10
4.11

- (c) Prudent - recognising the uncertainties surrounding measurements involved in the accounting process; and
- (d) Concerned with Substance Over Form - representing financial reality.

A GENERAL ACCOUNTING STANDARD

- A14. Financial Statements which are intended for inclusion in annual reports of Commonwealth undertakings or which are determined under Section 41D of the Audit Act 1901 should conform to the General Accounting Standard comprising paragraphs A15-A30 of these Guidelines. In addition they should observe the requirements of specific accounting standards applicable to the particular category of undertaking concerned as set out in paragraphs A31-A33 and Attachment A3.
- 4.25-
4.27

NATURE AND CONTENT OF FINANCIAL STATEMENTS

- A15. Except where it may be demonstrated that financial statements prepared on a cash basis are not materially different in terms of information conveyed to readers, statements for all undertakings shall be prepared on an accrual basis.
- A16. In the case of companies, undertakings financed largely from operations and banking and lending institutions statements shall include:
- (a) A Balance Sheet;
 - (b) A Profit and Loss statement;
 - (c) A Statement of Changes in Financial Position;
 - (d) Notes to the accounts.
- A17. The statements of other bodies shall include:
- (a) A Statement of Activity;
 - (b) A Statement of Assets and Liabilities;
 - (c) A Statement of Capital Accumulation (as appropriate);
 - (d) A Statement of Changes in Financial Position; and,
 - (e) Supplementary statements as required to disclose material auxiliary activities, and resources provided free of charge.
- 5
6.12

A18. There shall be included in the statements (whether by way of note or otherwise) amounts and descriptions, arranged in classes under appropriate headings, in respect of each of the items appearing in Attachment A1 to these guidelines. Where the total assets of an undertaking exceed ten million dollars amounts shown in the financial statements may be rounded off to the nearest 1000 dollars; provided that where an amount as a result of the round off is reduced to zero, that amount shall be shown to the nearest dollar by way of a note.

A19. Statements generally shall comply with the following Australian Accounting Standards:-

- (a) AAS5 Materiality in Financial Statements
- (b) AAS6 Accounting Policies: Determination, Application and Disclosure 4.13-4.15
- (c) AAS8 Events Occurring After Balance Date
- (d) AAS9 Expenditure Carried Forward to Subsequent Accounting Periods.

A20. In addition the following statements issued by the US Financial Accounting Standards Board are regarded as authoritative "Guides to Accepted Accounting Practice"; these statements have general application.

- (a) SFAS 5 "Accounting for Contingencies"
- (b) SFAS 7 "Accounting for Development Stage Enterprises"
- (c) SFAS 13 "Accounting for Leases" (as amended)
- (d) SFAS 34 "Capitalisation of Interest Cost".

VALUATION OF ASSETS

5

A21. Before financial statements are prepared reasonable steps shall be taken to:

- (a) cause all known bad debts to be written off and adequate provision made for doubtful debts; UCA S.162 (7)(a)
- (b) ascertain whether any current assets (other than debtors) are unlikely to realise in the ordinary course of operations their value as shown in the accounting records and, if so, to cause:- UCA S.162 (7)(b)

(1) those assets to be written down to an amount which they might be expected to realise; or

(11) adequate provision to be made for the difference between the amount of the value as so shown and the amount that they might be expected so to realise; and

(c) ascertain whether any non-current asset is shown in the books of the undertaking at an amount which having regard to its value to the undertaking as a going concern, exceeds the amount which it would have been reasonable to spend to acquire that asset as at the end of the financial year and (when adequate provision for writing down that asset is not made) to cause to be included in the accounts such information and explanations as will prevent the financial statement from being misleading by reason of the overstatement of the amount of that asset.

UCA
S.162
(7)(c)

A22. Where investments are quoted on any stock exchange, in Australia or elsewhere, a separate total shall be shown for each class of quoted investments. There shall also be shown in respect of each such class the aggregate quoted market values, calculated on the officially quoted market "buyer" price net of the prevailing transfer costs or commissions as at the end of the financial year.

9th
Schedule
7(5)

A23. The basis of valuation of each class of non-monetary asset shall be disclosed. Separate class totals shall be shown for each valuation method.

9th
Schedule
7(1)

VALUATION AND PRESENTATION OF LIABILITIES

A24. The amounts of liabilities shown in the financial statements shall be the nominal amount of all liabilities inclusive of interest accrued but unpaid as at the end of the financial year.

A25. In respect of each liability or contingent liability shown in the financial statements being a liability the payment of which is secured by a charge on assets of the undertaking whether registered or unregistered, there shall be shown a statement that it is secured and the extent to which it is secured, and each such liability or contingent liability shall be distinguished from any other liabilities or contingent liabilities the payment of which is not so secured.

9th
Schedule
6(1)

RESERVES AND PROVISIONS

- A26. The term "Reserve" shall not be used to describe any amount written off or retained by way of providing for depreciation, renewal or diminution in value of assets or retained by way of providing for any known liability, or any amount set aside to counter the effect of undue fluctuations in charges for taxation. 9th Schedule 1(1)(a)
- A27. Where "provisions" are made for the amortisation, depreciation or diminution in value of an asset there shall be shown separately, by way of note or otherwise, the gross amount of the asset, the accumulated amount of the provision and the written down (net) amount of the asset. 9th Schedule 7(2)
- A28. Recording of provisions shall be subject to conditions set out in Statement of Financial Accounting Standards 5 "Accounting for Contingencies" issued by the US Financial Accounting Standards Board.

RESOURCES PROVIDED FREE OF CHARGE

- A29. Subject to paragraph A30, where significant resources are provided free of charge by other Commonwealth agencies, the level of that support shall be disclosed in the accounts of the recipient, either by way of note or in the form of a supplementary statement, setting out actual amounts (or where that is not possible estimated amounts) of expenditure undertaken for the direct benefit of the entity and the written down value of assets provided in support. 7.19
- A30. The requirements of paragraph A29 shall apply where: 7.21
- (a) the (estimated) current value of assets provided free of charge equals or exceeds 5% of the written down value of assets actually owned by the reporting entity or \$100,000 whichever is the less; or
 - (b) the (estimated) amount of expenditure undertaken in direct support of an entity equals or exceeds 5% of the total expenses incurred by the entity in its own right or \$10,000 whichever is the greater.

Assets will be deemed to be provided "free of charge" when subject to "peppercorn rentals" or other charges not reflecting the substantial economic value of support received.

ACCOUNTING STANDARDS FOR SPECIFIC CATEGORIES

- A31. In addition to the General Accounting Standard financial statements of Commonwealth undertakings are required to conform to specific standards established by the accounting profession and others which are applicable to particular activities and types of institution. For this purpose Commonwealth undertakings have been divided into six broad categories: 5.12-5.15
- (1) Statutory bodies predominantly financed from operations (other than 4 and 5 below)
 - (2) Statutory bodies predominantly financed from the Budget (other than 3 and 6 below)
 - (3) Advisory/Research bodies
 - (4) Companies
 - (5) Banks and lending institutions
 - (6) Municipal activities
- Categories and associated sub-categories are shown in Attachment A2.
- A32. Standards applicable to each category and, in certain cases, pronouncements regarded as providing an authoritative guide to accounting practice in related areas, are listed in Attachment A3. All undertakings are subject to the requirements of the General Accounting Standard previously set out in paragraphs A15-A30. 6.1-6.86
- A33. Accounting standards shall be interpreted with regard to the objectives for financial statements set out in paragraph A4. Where there is conflict between the requirements of specific standards referred to in Attachments A3-1 and A3-2 and those of the General Accounting Standard set out in these Guidelines, the General Accounting Standard shall prevail.

ATTACHMENT A1

GENERAL ACCOUNTING STANDARD - ITEMS TO BE DISCLOSED SEPARATELY

REVENUES

- Appropriations, grants and subsidies received from the Commonwealth.
- Sales Turnover - being the gross amount of income generated as a result of the sale by an entity of its products or the provision by an entity of its services, less returns and trade allowances and less duties and taxes charged separately on sales invoices (or equivalent documents) on behalf of third parties and accountable to third parties. AASE
- Dividends received, or due and receivable. 9th Schedule 2(1)(a)
- Interest received or due and receivable on debentures, deposits, loans or advances. 2(1)(b)
- Gains from sale of assets (other than trading stock). 2(1)(c)
- Income from other sources. 2(1)(d)

EXPENSES

- Operating expenses appropriately classified by function or object (ie salaries, stationery etc).
- Interest paid or due and payable on debentures, deposits, loans or advances. 2(1)(e)
- Loss from sale of assets (other than trading stock). 2(1)(f)
- Depreciation and like charges. 2(1)(h)
- Any amounts set aside for renewal or replacement of fixed assets. 9th Schedule 2(1)(i)
- Bad debts written off in respect of each class of debtors shown separately. 2(1)(j)
- Any amounts set aside to a Provision for Doubtful Debts. 2(1)(k)
- Amount set aside for income tax attributable to the financial year. 2(2)

- Amount set aside to any provision for income tax attributable to a period other than the financial year. 2(2)
- Any other provision. 3(f)
- Amounts received or due and receivable by external auditor's for auditing services. 2(1)(m)
- Emoluments received or due and receivable by full-time directors, or commissioners. 2(1)(1)
- Emoluments received or due and receivable by other directors or commissioners. 2(1)(1)

TRANSFERS AND ADJUSTMENTS

- Each transfer or proposed transfer to or from a reserve. 3(e)
- Opening and closing balances of each reserve and equity account. 3

ASSETS

- Cash at bank and in hand inclusive of interest accrued but unpaid at the end of the financial year on interest bearing bank deposits. 9th Schedule 5(4)(a)
- Trade debtors and bills receivable (less provision for doubtful debts) being the sum of the amounts which, in the light of information available on due inquiry, are expected at the end of the financial year to be recoverable, provided that the amount of any debt payable with interest in instalments shall not be greater than would be accepted in full settlement of the debt at the end of the financial year. 5(4)(g)
- Loans to employees. 5(4)(i)
- Other debtors.
- Government, municipal and other public debentures, stocks and bonds quoted on prescribed stock exchanges in Australia or elsewhere. 5(4)(d) 7(5)
- Other Government, municipal and other public debenture stocks and bonds. 5(4)(d)
- Shares in public companies quoted on prescribed stock exchanges. 5(4)(e) 7(5)
- Shares in other companies. 5(4)(e)
- Debenture stock, bonds, notes and other securities quoted on prescribed stock exchanges. 5(4)(f) 7(5)

- . Other debenture stock, bonds, notes and securities. 5(4)(f)
- . Stock on hand. 5(4)(b)
- . Other inventories appropriately categorised. 9th
Schedule
5(1)
- . Land.
- . Buildings (showing gross value, accumulated depreciation and written down value).
- . Plant (showing gross value, accumulated depreciation and written down value).
- . Furniture and Fittings (showing gross value, accumulated depreciation and written down value).
- . Motor Vehicles (showing gross value, accumulated depreciation and written down value).
- . Other fixed assets appropriately categorised.
- . Patents and trademarks. 5(4)(j)

LIABILITIES

- . Bank loans. 5(2)(a)
- . Bank overdraft. 5(2)(b)
- . Debenture stock etc constituting a charge over assets. 5(2)(c)
- . Unsecured debentures. 5(2)(c)
- . Trade creditors and bills payable. 5(2)(d)
- . Provision for current tax liability. 5(1)(i)
- . Provision for future income tax liability. 5(1)(i)
- . Provision for doubtful debts 5(1)(i)
- . Other liabilities. 5(2)(g)

OTHER ITEMS BY WAY OF NOTE

- . The aggregate amount, or estimated aggregate amount, and particulars of capital expenditure contracted for, so far as the amount has not otherwise been provided for. 9th
Schedule
5(2)(f)

- . The maximum amount, or an estimate of the maximum amount, for which the entity could become liable in respect of other contingent liabilities with appropriate particulars of these liabilities. 5(3)

COMPARATIVE FIGURES

- . Except in the case of initial financial statements there shall be shown for each item appearing in the statements the corresponding amount for the preceding period or balance date. If financial statements do not contain an item corresponding to an item in the statement for the preceding period or balance date the previous item and the amount thereof shall be shown. 11

ATTACHMENT A2

CATEGORISATION OF COMMONWEALTH AUTHORITIES AND UNDERTAKINGS

CATEGORY 1 - FINANCIAL RESOURCES FROM OPERATIONS

1.1 STATUTORY AUTHORITIES AND DEPARTMENTAL UNDERTAKINGS

Australian Capital Territory Electricity Authority	Pipeline Authority
Australian Capital Territory Forestry Trust Account	Productivity - Department of - Various undertakings -
Australian Capital Territory Rental Housing	Aircraft Engineering, Workshop, Pooraka
Australian National Airlines Commission	Ammunition Factory, Footscray Australian Government Clothing Factory, Coburg
Australian National Railways Commission	Explosives Factory, Albion Explosives Factory, Maribyrnong Explosives Factory, Mulwala
Australian Military Forces Relief Trust Fund	Government Aircraft Factories Fishermens Bend and Avalon Munitions Filling Factory
Australian Postal Commission	St Marys Ordnance Factory, Bendigo
Australian Services Canteens Organisation Board of Management	Ordnance Factory, Maribyrnong Small Arms Factory, Lithgow
Australian Telecommunications Commission	Royal Australian Air Force Veterans' Residences Trust Fund
Australian Overseas Projects Corporation	Royal Australian Air Force Welfare Trust Fund
Canberra Commercial Development Authority	Royal Australian Navy Relief Trust Fund
Commonwealth Serum Laboratories Commission	Services Canteens Trust Fund
Defence Force (Papua New Guinea) Retirement Benefits Board	Snowy Mountains Engineering Corporation
Export Finance and Insurance Corporation	Stevedoring Industry Finance Committee
Health Insurance Commission	
Housing Loans Insurance Corporation	
Milk Authority of the Australian Capital Territory	
Overseas Telecommunications Commission (Australia).	

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CATEGORY 1.2 COMMODITY BOARDS (MARKETING)

Australian Apple and Pear Corporation	Australian Egg Board
- Apple and Pear Stabilisation Fund (S62A Trust Account)	Australian Honey Board
Australian Canned Fruit Sales Promotion Committee	Australian Meat & Livestock Corporation
Australian Canned Fruits Corporation	Australian Wheat Board
Australian Dairy Corporation	Australian Wine Board
- Asia Dairy Industries (Hong Kong) Ltd (the issued capital is wholly owned by the Corporation)	- Australian Fine Wines Ltd (the issued capital is wholly owned by the Board)
- PT Australia Indonesian Milk Industries (the Corporation owns a 50% interest together with a controlling share)	Australian Wool Corporation
	- Australian Wool Testing Authority
	- Wool Certification Ltd (wholly owned by the Corporation)
Australian Dried Fruits Corporation	

CATEGORY 2 STATUTORY BODIES THAT ARE PREDOMINANTLY FINANCED FROM THE BUDGET

CATEGORY 2.1 - EDUCATION

Australian Film & Television School	Australian Trade Union Training
Australian Maritime College	Canberra College of Advanced Education
Australian National University	

CATEGORY 2.2 - LIBRARIES, MUSEUM AND GALLERIES

Australian National Gallery	National Library of Australia
Australian War Memorial Museum	

CATEGORY 2.3 - HEALTH/HOSPITALS

Capital Territory Health Commission

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CATEGORY 2.4 - CULTURAL ORGANISATIONS

Australia Council	Australia-Japan Foundation
Australian Heritage Commission	Canberra Theatre Trust
Australian Institute of Multicultural Affairs	

CATEGORY 2.5 - PUBLIC BROADCASTING

Australian Broadcasting Commission	Australian Film Commission
Australian Broadcasting Tribunal	Special Broadcasting Service

CATEGORY 2.6 - SUPPORT FUNCTIONS: ADMINISTRATION AND PLANNING

Aboriginal Land Fund Commission	Legal Aid Commission (ACT)
Albury-Wodonga Development Corporation	National Capital Development Commission
Law Reform Commission	

CATEGORY 2.7 - MISCELLANEOUS

Australian Tourist Commission	National Standards Commission
Director of National Parks and Wildlife	River Murray Commission
Parliament House Construction Authority	Snowy Mountains Hydro-electric Authority

CATEGORY 3 - (ADVISORY/RESEARCH)

3.1 COMMODITY BOARDS

Australian Tobacco Board	Australian Wine Research Institute (wholly owned by the Australian Wine Board being a company limited by guarantee and not having a share capital)
Fruit Industry Sugar Concession Committee	

3.2 OTHER

Anglo-Australian Telescope Board	Commonwealth Scientific & Industrial Research Organisation
Australian Atomic Energy Commission	Curriculum Development Centre
Australian Institute of Aboriginal Studies	Great Barrier Reef Marine Park Authority
Australian Institute of Criminology	Legislative Drafting Institute
Australian Institute of Marine Science	Joint Coal Board

CATEGORY 4 - COMPANIES INCORPORATED UNDER STATE LEGISLATION/TERRITORY ORDINANCE

Aboriginal Arts and Crafts	Coal Mines Insurance Pty Ltd
Aboriginal Hostels Pty Ltd	Commonwealth Accommodation and Catering Services Ltd
Applied Ecology Pty Ltd	East-Aust Pipeline Corporation Ltd (wholly owned by the Pipeline Authority)
AIDC Securities Limited	
Southern Alloys Venture Pty Ltd	Great Keppel Holdings Pty Ltd
ANL Cargo Operations Pty Ltd	Great Keppel Island Pty Ltd
Australian National Line (UK) Limited	Great Barrier Reef Hotel Pty Ltd
Australian Art Exhibitions Corporation Ltd	Intersean Australia Pty Ltd (the three companies are 100% owned by the Australian Industry Development Corporation)
Bingil Bay Cruises Pty Ltd (the six companies are 100% owned by the Australian National Airlines Commission)	Keppel Investments Pty Ltd
Charybdis Trust (48% owned by the Australian National Airlines Commission. The trustee company is Wanderers Paradise Pty Ltd).	Medibank Properties Pty Ltd
	Qantas Airways Ltd
	- GH Tours Limited
	- Qantas Wentworth Holdings Ltd
	- Qantair Limited
	- Wentworth Hotel Limited

The Fawcett Group	Wanders Paradise Pty Ltd
- Fawcett and McAllan Pty Ltd	(58% owned by the Australian
- Rotary Tableting Corporation	National Airlines Commission)
Pty Ltd	
- Croydon Investments Pty Ltd	
- Barker House Pty Ltd	

Australian Bi-Centennial Authority

COMPANIES INCORPORATED UNDER STATE LAW BUT
INCLUDED IN CATEGORY 4:

CTB Nominees Limited	Corporation Properties Limited
Travelstrength Limited	CBFC Limited
Travelstrength Services Pty Limited	CBFC Leasing Pty Limited

(These companies are 100% owned
by the Commonwealth Banking
Corporation).

COMPANIES INCORPORATED UNDER STATE OR OVERSEAS LAW BUT INCLUDED IN
CATEGORY 1.2

Asia Dairy Industries	Australian Fine Wines Ltd
(Hong Kong) Ltd	
(the issued capital is wholly	Australian Wine Research
owned by the Corporation)	Institute
PT Australia Indonesian	Wool Certification Ltd
Milk Industries	

CATEGORY 5 - BANKING AND LENDING

Aboriginal Loans Commission	Defence Services Homes Corporation
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Australian Industry Development Corporation	Reserve Bank of Australia
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Commonwealth Banking Corporation

- Commonwealth Development Bank
- Commonwealth Savings Bank
- Commonwealth Trading Bank
- CTB Nominees Limited
- Travelstrength Limited
- Travelstrength Services Pty Ltd
- Corporation Properties Limited
- CBFC Limited
- CBFC Leasing Pty Limited

(These companies are 100% owned by
the Corporation)

CATEGORY 6 - MUNICIPAL ACTIVITIES

Sub-category 6.1

Canberra Municipal Accounts

Sub-category 6.2

Canberra Public Cemeteries Trustees	Canberra Showground Trust
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Australian Capital Territory Schools Authority	Australian Capital Territory Transport Trust Account
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Sub-category 6.3

Christmas Island	Norfolk Island
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Cocos Community Fund
(final statement)

TYPES OF STATEMENT

		2.1	2.2	2.3	2.4	2.5	2.6	2.7	3.1	3.2	
Balance Sheet (Incl. Capital Accumulation)	1.1	1.2									6.2
Income & Expenditure (P&L)	1.1	1.2									5
Activity Financial Position	1.1	1.2	2.1	2.2	2.3	2.4	2.5	2.6	2.7	3.1	3.2
Change in Financial Position	1.1	1.2	2.1	2.2	2.3	2.4	2.5	2.6	2.7	3.1	3.2
Supplementary (Special Funds)		2.1									5
(Resources Provided)											6.2
(Auxiliary Trading)					2.4						

MANDATORY STANDARDS

Mint Schedule Companies Act	1.1	1.2									5
ASSE List Requirements (Section 3C)	1.1	1.2									5
Australian Standards:											
AS1 (Profit and Loss)	1.1		2.1		2.3		2.5				5
AS2 (Inventories)	1.1										5
AS3 (Tax Effects)	1.1										5
AS4 (Depreciation)	1.1	1.2	2.1	2.2	2.3	2.4	2.5	2.6	2.7	3.1	3.2
AS5 (Materiality)	1.1	1.2	2.1	2.2	2.3	2.4	2.5	2.6	2.7	3.1	3.2
AS6 (Accounting Policies)	1.1	1.2	2.1	2.2	2.3	2.4	2.5	2.6	2.7	3.1	3.2
AS7 (Extractive Industries)	1.1										5
AS8 (Post Balance Date)	1.1	1.2	2.1	2.2	2.3	2.4	2.5	2.6	2.7	3.1	3.2
AS9 (Expenditure Carried Forward)	1.1	1.2	2.1	2.2	2.3	2.4	2.5	2.6	2.7	3.1	3.2

International Standards:

IAS3 (Consolidation/Equity)	1.1		2.1	2.2	2.3	2.4	2.5	2.6	2.7	3.1	3.2
IAS7 (Funds Statements)	1.1										5
IAS9 (BAD Expenditure)	1.1		2.1	2.2	2.3	2.4	2.5	2.6	2.7	3.1	3.2
IAS13 (Current Assets)	1.1	1.2	2.1	2.2	2.3	2.4	2.5	2.6	2.7	3.1	3.2

ATTACHMENT A3-1

MANDATORY STANDARDS APPLICABLE TO
CATEGORIES OF UNDERTAKINGS AND
TYPES OF STATEMENTS TO BE PRODUCED

RECOMMENDED GUIDES

US Standards:

		1.1	1.2	2.1	2.2	2.3	2.4	2.5	2.6	2.7	3.1	3.2	
SPAS5 (Contingencies)	1.1												5
SPAS7 (Development Stage Enterprise)	1.1												6.2
SPAS13 (Unaudited)	1.1												5
SPAS14 (Special Reports)	1.1			2.1	2.2	2.3	2.4	2.5					5
SPAS30 (Major Customers)	1.1	1.2											5
SPAS34 (Capitalization of Interest)	1.1	1.2	2.1	2.2	2.3	2.4	2.5	2.6	2.7	3.1	3.2		6.2

AICPA Statements and Guides*

Colleges and Universities Audit Guide	2.1												5
Finance Companies Audit Guide				2.3									
Hospitals Audit Guide													
SOP 74/8			2.1					2.5					
SOP 75/5								2.5					
SOP 76/1	1.1							2.5					
SOP 76/10	1.1			2.2			2.4	2.5	2.6	2.7	3.2		
SOP 79/4								2.5					

Other Guides*
American Association of Museums Guidelines

2.2

*See A3-3 for full titles of Guides

ATTACHMENT A3-2

"GUIDES TO ACCEPTED ACCOUNTING PRACTICE"
FOR CATEGORIES OF UNDERTAKINGS

GUIDES TO ACCEPTED ACCOUNTING PRACTICE

Issued by the American Institute of Certified Public Accountants
Accounting Standards Division
1211 Avenue of the Americas
New York NY 10036

- "Statement of Position 74-8: Accounting and Reporting by Colleges and Universities August 1974
- "Statement of Position 75-5: Accounting Practices in the Broadcasting Industry" December 1975
- "Statement of Position 78-10: Accounting Principles and Reporting Practices for Certain Non-profit Organizations"
- "Statement of Position 79-4: Accounting for Motion Picture films
- "Industry Audit Guide: Audits of Colleges and Universities" 1973
- "Industry Audit Guide: Audits of Finance Companies" 1975
- "Industry Audit Guide: Hospital Audit Guide" 1978
- "Industry Audit Guide: Audits of Voluntary Health and Welfare Organisations" 1979

Issued by the Financial Accounting Standards Board
High Ridge Park
Stamford Connecticut 06905 USA

- SFAS5 Accounting for Contingencies
- SFAS7 Accounting and Reporting by Development Stage Enterprises
- SFAS13 Accounting for Leases
- SFAS14 Financial Reporting for Segments of a Business Enterprise
- SFAS30 Disclosure of Information about Major Customers
- SFAS34 Capitalisation of Interest Cost

AMERICAN ASSOCIATION OF MUSEUMS
1055 Thomas Jefferson Street, NW
Washington DC 20007 USA

- "Museum Accounting Guidelines" (issued by the Association of Science-Technology Centers 1976) contained in "Museum Accounting Handbook" May 1978.

RESULTS OF THE PUBLIC ACCOUNTS COMMITTEE
QUESTIONNAIRE ON THE PROPOSED GUIDELINES
FOR THE FORM AND STANDARD OF FINANCIAL
STATEMENTS OF COMMONWEALTH UNDERTAKINGS

Introduction

During 1981-82 the Public Accounts Committee, in association with the Australian Society of Accountants conducted seminars in all State capital cities to discuss and evaluate the Joint Working Party's Report. These seminars were well attended, which indicates that there is a high degree of interest in the Report by government accountants throughout Australia.

At these seminars the Committee distributed a questionnaire to all participants. The purpose of this was to allow government accountants, many of whom would be required to implement the proposed guidelines to express their views on the issues addressed by the Joint Working Party's Report and Exposure Draft.

The Committee received many responses to the questionnaire. An analysis of these responses, together with selected comments to individual questions are contained in the following pages. It was pleasing to note that most government accountants accepted the need for improved disclosure and accountability standards for public sector authorities at all levels of government.

The Committee wishes to take this opportunity to thank all those who responded to the questionnaire for their contribution to the inquiry into this important area of government administration.

Questionnaire Responses

1. As a professional accountant do you support the need for Accounting Standards for Government Financial Statements?

YES: 100%

NO: -

OTHER: -

Comments

It is important that the financial statements of various Government entities be prepared in a consistent manner so that informed decisions can be made by those who have to allocate scarce resources between competing needs.

Accounting standards are intended to modernise accounting methods and bring them up to date with international standards. The standards will apply uniformly to all organisations and guide the accountants in the right direction.

An accounting standard will crystallise the requirements from bodies and could well protect these bodies from the individual whims and demands of audit officers who change each year.

They are essential and provide some protection for accounting people who can suffer pressure from unscrupulous administrators.

Many government departments, statutory authorities and instrumentalities are devoid of any reporting standards or requirements. Accounts format and reporting standards are generally a product of internal decision and convenience.

Provided the standards have the authoritative backing of the professional accounting bodies. Standards separate from central administration could give rise to divergent practices particularly in statutory authorities operating as normal commercial enterprises.

2. As a professional accountant do you support the general principles outlined in The Exposure Draft?

YES: 96%

NO: -

OTHER: 4%

Comments

I support the general principles but I consider that detailed procedures will have to be framed by each organisation to work within the principles according to its own needs. It will be advisable to issue some regulation to supplement the principles.

A good starting point - we need to develop standards for government authorities.

The guidelines do not set out 'basic principles', they list precepts which are in fact objectives. I find paragraphs A1 to A3 most confusing.

The standards should be drawn up to meet the requirements of Government and the general public - individual requirements should not be included just because they exist in the private sector.

There is need for some further refinement to adjust for the special information needs of the public - particularly because of the lesser importance of the profit motive and the absence of equity capital.

However we would be adverse to any 'interim' standards being developed - concern relates to possible changes from interim to final with need to redesign accounting systems.

Especially adoption of accrual accounting.

Pragmatic, but a working basis.

3. Do you consider that the objectives of The Exposure Draft, in particular relating to the degree of disclosure, equal or surpass that required in the private sector?

YES: 65%

NO: 33%

OTHER: 2%

Comments

Would like to see more emphasis on the non-monetary aspect of the annual report.

Right now it appears to me that they surpass private sector but that opinion may change when National Companies Legislation comes into effect.

In many respects the private sector gets off lightly. They don't have question and answer time in Parliament, the Auditor-General and the Public Accounts Committee, or the discipline of questions from any news media representatives at any time.

I believe the boon in reporting for government undertakings is that there is less fear in giving away 'trade' secrets, which is often a dominating influence in private sector reporting. They provide at a minimum the essentials of good accountability for any financial undertaking.

I have long held the view that the requirements of the Companies Acts are an absolute minimum.

Equal to - but the motives of the two sectors are different, and there should be differences in the need for accountability.

While comparable to the private sector, the requirements of disclosure in government accounting can be quite different to the private sector.

The degree of disclosure required in government accounts should be considerably less than in the private sector, as the Auditor-General inspects the books.

Only certain standards are selected but in Statement AAS 1 dealing with conformity with accounting standards the Society and Institute 'requires' compliance with all standards (para 4) and suggests 'inquiries into apparent failures ... to observe' in para 13.

Full disclosure is desirable and necessary. Both sectors (Public and Private) need to work together towards a common standard of disclosure.

4. Should existing public sector standards of disclosure be maintained?

YES: 72% NO: 24% OTHER: 4%

Comments

They should be improved.

What are these standards beyond legal and financial compliance?

If this question means that the present practice which follows all private sector requirements no matter how irrelevant, should be maintained - then definitely no.

Joint Parliamentary Accounts Committees should employ independent consultants to prepare annual critiques of relevant bodies.

Many authorities presently provide tedious and meaningless detail.

Where they are relevant to the activities and financial structure of the authority.

Should be increased not with the introduction of one general standard, but with individual standards as released by the AARF.

Disclosure will depend upon policy. However there is a need for general enhancement of information involved in financial statements.

They are insufficient and inadequate.

5. As an Accountant who would be involved in applying the concepts in The Exposure Draft do you envisage any practical difficulties. If so, please identify main areas of concern?

YES: 48% NO: 46% OTHER: 6%

Comments

Suitably qualified staff to operate system.
Installation and maintenance of suitable back-up systems.
Additional ADP Resources.
Training and educating staff - all areas on input/output.
Management acceptance and support.
Management training and education on output.

Auxiliary activities and resources provided free of charge.

There may be some complicated reconciliation for cash flow accounting of cash budget systems which include capital expenditures as a cost of the period in which they are incurred.

Professional bodies should get behind the application and observance of standards in the Government sector.

Disclosure if non-current assets are less than real value but no requirement to report by note any significant upward movement.

Resistance to adopting a publicly viable accrual system.

The cost of accrual accounting is not always warranted.

The degree of difficulty would depend on the force of the legislation. If the draft had the power of legislation the only difficulties would be that of interpretation. If the draft had less than this power, opposition against wholesale acceptance of all requirements might be expected where it involved major changes to the present account presentation format.

Classification of operating expenditure needs further clarification - depends on the particular authority.

Simply from a technical viewpoint, many definitions require interpretation. Restructuring of financial accounting may require an adaptation for loss of information previously reported.

In moving from a cash based system to an accrual system extensive effort is needed. Manpower and existence data (e.g. on fixed assets) are put under pressure.

The true cost to the taxpayer would be difficult if not impossible to determine in cases where services provided by

co-ordinating authorities e.g. Public Service Board are not costed.

The treatment of very long lived assets could present some problems and may not reflect the full costs of the years operations through depreciation.

Political veto of sensitive decisions.

I would see a need for a campaign of public relations designed to commit managements to the accountability concepts and to employ the necessary accounting and other expertise needed to implement and maintain systems.

Checks supplied by the Commonwealth on State Governments.

Expect perhaps from senior operational management, and perhaps the desire for uniformity by Treasury and Auditor-General.

No operational difficulties. May be some problems implementing - e.g. calculating values of fixed assets but these are the same problems which private enterprise faces.

6. What do you see as the main purpose of the Published Accounts of a Statutory Authority - legal and financial compliance, solvency, full cost of operations, management effectiveness and efficiency in financial terms, or any other (rank)?

Of the 33 respondents who ranked the purposes:

Purpose Ranking	Legal & Financial Compliance	Solvency	Full Cost of Operations	Management Effectiveness & Efficiency	Other
1st ranking	15	0	9	8	1
2nd ranking	3	4	5	17	4
3rd ranking	7	9	9	2	3
4th ranking	6	13	5	3	2
5th ranking	0	3	1	0	10

Other Purposes of Published Accounts

Extent of public funds involved - public accountability.

To convey relevant information to the government (and taxpayers) to enable them to make informed decisions on the allocation of scarce resources.

Fulfilment of a need of the community. Advancement in terms of national and international standards.

To give a true and fair view of the operations of the authority.

Comparison with other authorities or private enterprise.

The public sector should naturally aim to serve the public interest and therefore a wide and diverse report is required.

Short and long term budget forecasting.

Reporting to the members contributing funds to the organisation, as distinct from Parliament.

Program Budgeting Statements showing full costs of operations.

7. Do you believe accrual accounting will improve disclosure and accountability?

YES: 96%

NO: 4%

OTHER: -

Comments

There may be little or no benefit in respect of service type authorities.

I have reservations about charging depreciation on the assets of non-trading entities. It would in my opinion be preferable for the entity to go back to the Parliament if it wants to replace a capital asset.

This is a debatable issue. It should be borne in mind that the modern trend is toward cash flow management.

Long Service Leave, Holiday Pay, Superannuation, Depreciation are among many significant costs, which are not adequately revealed until accrual accounting is adopted.

As materiality and relevance have different meanings in the case of non-profit orientated bodies, a full accrual approach would lead to shortcomings in the financial reports.

More of a 'going concern nature' is promoted as recognition is given in the present period to past and future effective expenditure.

The degree of improvement is related to the degree of government funding.

There are too many possible variations that can affect the result in cash accounting and not truly reflect what has actually happened.

If provisions for accrual liabilities are funded.

8. Do you agree with the approach used in The Exposure Draft in drawing upon the 9th Schedule of the Companies Act?

YES: 92% NO: 4% OTHER: 4%

Comments

Adoption of 9th Schedule has also meant the adoption of certain anomalies e.g. 'class' is not defined in paras A22 and A23. 'Extent' is not defined in para A25. Similarly does Government funding represent 'capital' or debt financing.?

I do not believe that we should be mesmerised by the 9th Schedule.

Providing the differences of financing public sector operations are recognised.

Particularly for commercial undertakings where comparison with the private sector may be required.

More stringent rules are required for public utilities and statutory bodies.

Might be situations where the publication of all investments would be a very big job e.g. Government Retirements Benefit Authority.

Although it should not automatically be assumed that private sector standards are appropriate to public sector organisations, they are a good starting point.

If it is necessary for the private sector it is also necessary for the public sector.

At present acceptable, but why not draw up a separate schedule for government authorities.

In so far as income statements and balance sheets provide Parliament and the public with the information they require.

Commercial principles where appropriate should also apply to the public sector.

9. Are there any inconsistencies between the objectives of the Exposure Draft and those of the 9th Schedule? (Specify)

YES: 11% NO: 61% OTHER: 28%

Comments

9th schedule is more concerned with 'bottom line' than with individual cost factors.

There could be but I do not put that probability into the problem area.

Objectives of the two sectors are different. With full accrual accounting a non-trading Government body could be operating at maximum effectiveness and efficiency and yet convey an impression in its reports of insolvency which would not only liquidate a private sector entity but also result in charges being brought against it.

Perhaps it is unreal to regard the taxpayer as an equity holder because he does not have the powers of a stockholder (sack directors for example) but the 9th schedule is a useful tool.

Company reporting with a pure profit motive should have different reporting objectives to an organisation accountable for objectives other than profit. It is considered that the objectives of the draft are not all embracing in accountability terms.

Maybe some need to be more specific on non-current asset valuation.

10. Do you see any relevant standard or practice in private sector reports which could, with advantage, be included in the draft?

YES: 33% NO: 59% OTHER: 8%

Comments

Source and application of funds statement.

All standards.

Events occurring after balance sheet date.

That Statutory Heads sign similar certificates to that by private sector directors re material factors affecting accounts, contingent liabilities.

Details on capital market operations.

Information to assess efficiency e.g. number of services performed.

Except that the standards used by the Australian Institute of Management in its Annual Report awards should be recommended to Authorities in the preparation and presentation of their reports.

The undertaking will determine its needs and should apply the most meaningful type of practices. In light of this the Department of Finance should monitor the application of standards.

11. Is the Exposure Draft sufficiently specific in relation to depreciation of non-current assets?

YES: 55% NO: 43% OTHER: 2%

Provided that Commonwealth Audit monitor to ensure full and proper compliance and consistency.

This is largely a matter for management determination - disclosure of leases is the vital point.

Specific authorities could experience some problems with some assets peculiar to the authority.

No justification is given for the application of AAS 4. In the private sector capital has to be maintained but with Government entities that requirement does not necessarily apply.

The possibility of adopting AAS 4 in toto should be considered.

Some difficulty with A 21(c) - Does this mean that all non-current assets must be written down to current market value e.g. land held for development even though there are no prospects for loss at book value?

There needs to be settled which generation should pay for major public sector capital works - whether depreciation should be just cost recovery over the life of the asset or have additional components to build up cash reserves for increased costs of replacement and/or obsolescence.

Better guideline should be given. Adoption of the straight-line method and a recommendation to line up changes with those recommended by the Taxation Department would reduce variances in interpretation.

As indicated the Exposure Draft's thrust does not reflect the reality of the situation in this regard. I support the concept of reporting resources consumed but not in a way which distorts operations.

It does not define 'class' of assets. Although it advocates depreciation, no notion is made of 'rates'. Possibly rates should be included as well.

Merely to say 'don't overvalue' is not specific enough.

Guidelines for depreciation rates and purposes are needed together with an undertaking from the Commonwealth on asset replacement.

I believe all assets, liabilities and provisions should reflect the true situation at balance date. In particular the liabilities for long service leave and superannuation relate to an employee's current service.

12. Is there a need for a linking statement between cash accounting and accrual accounting in the published reports?

YES: 65% NO: 31% OTHER: 4%

Comments

Parliaments are accountable for cash resources. The annual budget is a cash budget.

Our experience has been that the major financial statement users do not properly comprehend the distinctions between each, nor the separate purposes of them.

It would be desirable, as users would try to link the statements so it must reduce problems if this is done by the authority.

Financial statements prepared on a cash accounting system must also attempt to be complete and disclose the financial position.

There should be only one operating statement. The Statement of Activity appears feasible but needs redrafting.

Should apply one or the other according to cost/benefit of preparing accrual accounts.

Parliamentary appropriations should be consistent with accrual accounts. In the first year a linking statement may be necessary depending on Parliament's progress.

At present an academic question on which more research is needed.

Not if there is sufficient other disclosures which would not leave any doubts as to how accrual items have been treated.

13. If the answer to Q.12 is YES, do you believe that a Funds Statement Presentation would suitably perform this function?

YES: 70%

NO: 13%

OTHER: 17%

Comments

An elaborate funds statement would be necessary. I will not be surprised if many members of Parliament at present do not understand what the budget papers are all about. More informative statements would be welcomed by the people.

Provided it is a funds statement that has some meaning - not merely a front to bamboozle the politicians and the public at large.

A funds statement and suitable notations is vital.

A funds statement linking published reports to cash on hand may still require some experimentation.

The funds statement should provide the link between one balance sheet and the next. A Statement of Capital Accumulation is not necessary.

A funds statement is vital irrespective of system. While cash accounting is virtually a funds statement, I see the main information need as -

(a) what public resources were made available to the activity;

(b) how were those resources applied.

14. Do you agree with the concept of disclosing in the accounts, 'resources provided free of charge' as outlined at paragraphs A17 and A29-30 of the Exposure Draft?

YES: 83%

NO: 15%

OTHER: 2%

Comments

But only as a revenue item. The capital value of assets used is of no relevance. If an entity has free use of a building a notional rent expense and donation received of the same amount should be booked.

Wholeheartedly - in some ways this is the greatest hiding place of all. Bureaucrats know that if cash does not pass hands, many things may be wrought by the 'you scratch my back' syndrome. This area can be one of the main undisclosed avenues for waste and/or misappropriation.

This is necessary to provide full cost of operations and to more accurately measure/assess management of available resources. Accords with the doctrine of full disclosure.

Provided resources are 'material'. I believe that the concept should be a guide only as it would not have universal application.

I would initially adopt a 'soft pedal' approach on this issue as a matter of strategy.

By way of note. Otherwise there is not proper disclosure to the user of the statements - particularly if there is to be some measurement of management effectiveness and efficiency in financial terms.

I consider that 'resources provided free of charge' should be included in the accounts, but this is dealing with the symptom rather than the disease. A system in which services are provided free to other Commonwealth bodies by other public sector organisations seems fundamentally wrong. Not only does this inhibit the adequacy of financial statements but, possibly more importantly organisations might be more modest in their demands for these 'free' services if they themselves had to seek and subsequently account for the funds required to provide them.

'Support' is not adequately defined in the draft. It would seem to indicate financial support, but what about investments of property, assets, etc.

Paras A29 and A30 are not sufficiently expensive. What happens when the level of support is below market value but above that of a 'peppercorn'. How is this difference reflected?

People generally only read 'surplus \$' as 'profit \$'. They do not take notes into account. I believe there should be no 'resources'. Make the user pay.

15. Do you see any difficulties in defining material auxiliary activities as raised in paragraph A17 of the Exposure Draft?

YES: 48%

NO: 52%

OTHER: -

Comments

What are they?

In principle I agree with the concept of 'resources provided free of charge', 'material auxiliary activities' etc, but I have serious reservations of the practical implications of such. This could open up an endless range of possibilities and whilst it is paramount that the reader be informed, too much information could be confusing if not misleading.

Definition needs to be much more precise. Monitoring by audit could overcome the difficulty to some extent.

Yes, unless restricted to items of significance.

But no more than in ascertaining and describing the general activities.

Depends on interpretation of 'material'. Does it include secondary benefits? Should not be any major difficulty if guidelines are pragmatic.

A29 and A30 provide a definition for resources which could set a yardstick for any other activity within this meaning.

I agree in principal with the views in paragraph 5.3 of the Progress Report, but see a lessening of disclosure when the parent is large and is funded from the Budget, and where subsidiaries are very small.

I do not comprehend any problem in principle but each case will have to be decided on its merits.

Main set of consolidated accounts can solve this.

The role of the entity should be defined and the 'material' auxiliary activities should be visible. If they are not then the information system should be geared to provide the necessary management information.

16. Would you agree that the Exposure Draft has not sufficiently defined criteria for identifying resources which are to be included in supplementary accounts? If so, please provide a suggested definition.

YES: 39% NO: 43% OTHER: 18%

Comments

Resources provided free of charge are those resources which if provided by or to a private enterprise firm would normally be paid for by the recipient.

Supplementary accounts are special trust accounts. Special trust accounts means an account of money held by or deposited with the organisation by statutory obligation or otherwise as a trustee or custodian for accomplishment of a purpose or efficient management to achieve a goal.

17. Do you see the concept of supplementary accounts, including resources and trust funds, posing difficulties?

YES: 35% NO: 59% OTHER: 6%

Comments

I can see no reason for disclosing the extent of trust funds held by an entity which has no beneficial interest in those funds. Disclosure would tend to mislead the reader.

Correlation between main and supplementary accounts could reduce the effectiveness of either accounts.

I would prefer disclosure by way of a note until more research is done on this question.

Except where the accounting system is geared to provide the required information.

If separate sets of books are kept for the same and treated under the rules and regulations governing the funds.

Just more work.

The supplementary account can be treated and regarded as subsidiary operations, separate and distinct from the 'mother' organisation and reported on accordingly. The effect could be similar to consolidating accounts in a large and diverse public company.

18. Do you see any inherent problems in producing a general standard specifically for government accounting in the Australian Public Service?

YES: 37% NO: 63% OTHER: -

Comments

A general standard when tested in the field can/could be found to be wanting, possibly non specific in certain respects. On the one hand it could be seen as law, as a directive to be followed at all costs, or then it could be seen as a guideline only - depending on how convenient such view is to the public body.

Drafting clear and concise accounting standards is a difficult and time consuming exercise.

- (a) Training of people who will set the standard.
- (b) Cost involved.
- (c) Wide spectrum and diversity of interested groups.

- (d) Creating a new group of accountants with new sets of standards which may pose a problem of inter-changeability with the private sector.

Unless politicians think there might be some votes in it.

I would be disappointed, indeed dismayed, if professional accountants did not object to professional standards being vetted and implemented by a bureaucratic organisation eg. Department of Finance.

Must distinguish between trading and non-trading activities.

If a department is involved in activities that are also carried out in private enterprise or a statutory authority in another state, then trading statements should be prepared. Non-trading departments may need different standards.

Should be broad enough to enable application to a wide range of activities.

It must be proclaimed and protected by Parliament to reduce biased government interference.

It is a matter of resolve. The Society's standards are generally sufficient but there are instances where some modification is required for government e.g. tax-effect accounting.

As long as it is stated that it is to be only for the Commonwealth public service.

Provided that public relations exercises are carried out with a view to keeping all concerned parties informed (including the public) so that there is sufficient commitment all round.

Why bother? - Incorporate both standards into one.

Not if the Department of Finance takes a positive modern approach.

19. Can you identify any private sector accounting standards which may not be applicable to the operations of Government undertakings?

YES: 54% NO: 46% OTHER: -

Comments

AAS 1; AAS 3; AAS 4; AAS 5; AAS 7.

Too numerous for comment.

Current Cost Accounting.

Acceptance of 'Directors Valuations' for assets instead of independent confirmation or reasonability review.

Items such as depreciation, long service leave accruals, unused recreation leave, etc ought not to be reported in the statements but rather in the notes.

Tax effect accounting.

The concepts of profits, losses, and dividends are not usually relevant.

20. Do you consider the recommendations as to materiality could exclude significant items from the notes of the accounts for large organisations?

YES: 24% NO: 67% OTHER: 9%

Comments

AAS 5 which defines materiality in terms of a percentage of profit or a class of balance sheet assets does not seem appropriate when public funds are being considered. The taxpayer unlike the shareholder, does not invest voluntarily and in my opinion more stringent disclosure requirements should apply.

Because it depends on the accounting item involved. I believe that the money limit straight jacket should be simply a guideline - if a finance officer or auditor considers it significant because of nature rather than amount - then it should be considered as 'material'.

However AAS 5 is concerned with the nature of the item as well as the amount; also, it could be stated that materiality is not relevant if the item relates to a breach of an authorities enabling Act of Parliament.

Standards should specify exceptions to be disclosed.

Materiality of course relates to both nature and amount. I think Government Accounting (the taxpayer concept) can be more insistent on disclosure regardless of materiality.

Unless the principle of materiality applies the accounts could well end up in a confused mass of detail.

If they are required to be applied with commonsense appreciation of the implications - public interest - and not just applied in a purely technical way.

21. Is there any general comment you would wish to make?

YES: 65%

NO: 33%

OTHER: 2%

Comments

The proposed guidelines are an excellent starting point.

In the private sector there is usually a working relationship between the enterprise and the public accountant for an efficient audit to be conducted at a sensible price. In the government sector there appears to be no ceiling on time or cost and an individual audit officer can pursue either detail or a fine point of principle to whatever length he wishes. A standard with practical guidelines would assist both the government enterprise and the auditor to produce financial statements of an acceptable standard.

Timeliness - In my experience with preparation of accounts for both State and Commonwealth governments, problems in relation to the form of accounts occur ONLY in the Commonwealth sphere because of the involvement of a third party (Dept of Finance) and the need for a formal determination by the Minister of Finance. To my mind the Department of Finance is far too concerned with immaterial legal technicalities and precise wordings of notes.

Possibly the draft proposes to be too 'all encompassing'. The private sector requirements for reporting are broken down into concentrated areas. While much of 'tier system' overlaps and has to 'make up' for what the prior requirement lacked, the sub-stratum of requirements manages to fill in many gaps. This approach may have worked to advantage here, where, for example, the Australian Accounting Standards focus attention on individual areas, giving a more precise requirement for disclosure.

Although the shift towards accrual accounting is desirable, full accrual accounting is not totally appropriate for non-profit orientated government organisations and probably not appropriate for all trading (government) organisations.

Rather than have standards issued by a body separate from the professional accounting bodies - it would be best to develop standards applicable in the government sector through the mechanism of the Government Accountants Group, with financial endorsement by ASA/ICA prior to issue.

I fully support my colleagues who condemned delays in approving accounts by Finance and Audit. This large problem must be solved by placing responsibility for forms and contents of accounts with the organisation concerned. My organisation pays large audit fees to the Auditor-General for external audit activities and if his officers cannot ensure

compliance with accounting standards by negotiation with management, then force can be used via the audit certificate and report to Parliament.

I doubt whether the accountants in the service are currently paid commensurately for the responsibility of keeping two sets of complicated books. The Treasury system is only effective as a control mechanism. It is completely ineffective as a management tool. There will need to be more accountants as well.

The exposure draft is a step in the right direction but the general absence of and difficulty in providing accurate management accounting information in the Commonwealth public service is a major problem. It is virtually impossible to discover the 'real' cost of any program or service. Anything short of changing every item of expense to an appropriate cost centre has the potential to be incomplete and therefore incorrect.

Development of high standards of financial reporting by statutory authorities is highly commendable. Once complete, we should develop a system of financial reporting by departments which will achieve the objectives set for statutory authority reporting.

The idea of developing these standards is good and should be encouraged in the States.

The most important thing with a set of standards is that they should be enforceable. Therefore the profession should move quickly to introduce the standards and make them binding as members.

In Government Departments and Statutory Authorities that are income generating people tend to make comparisons with results achieved in the private sector. Even with the adoption of full accrual accounting there are three problems which affect the ability to compare performance.

- (i) Resources provided free of charge is covered by A29.
- (ii) Government Policies - e.g. Government bodies cannot sack staff even though there is insufficient work.
- (iii) Statutory authorities have no working capital equivalent to paid shares or shareholders funds.

I support the use of the Exposure Draft for trading activities whether they be Statutory Authorities or Departments of State. However for non-trading activities I consider that the resulting reports may be meaningless.

I feel that given that the emphasis of the Exposure Draft is to provide the external parties with more information, then these parties would be better served by Program Performance Budgeting Statements. The advantage of Program Performance Budgeting is that it is output oriented rather than input oriented, whilst still satisfying the control required by modern government.

I support the desire to introduce standards for government accounting and reporting. Trading departments and authorities are easier to cater for but many features would also apply to non trading departments.

APPENDIX C

CONCLUSIONS OF THE JOINT IMPLEMENTATION COMMITTEE ON INTERNAL AUDIT REPORT ON THE CONTRACTING OUT OF INTERNAL AUDIT SERVICES

The Committee's main conclusions may be summarised as follows:

- (i) It would be quite inconsistent with the concept and purpose of internal auditing to attempt to pass over the function in toto to the private sector - or indeed to any other organisation in the public sector. Unlike external auditing, internal auditing is an appraisal mechanism established within an organisation and it may be required to review any aspect of departmental operations from the standpoint of reliability, efficiency or effectiveness. It is an integral part of departmental management and departmental personnel need to be closely and actively involved.
- (ii) Nevertheless, in some circumstances, the use of properly controlled and organised resources from outside an organisation's own establishment can help to make its internal auditing operations more efficient and effective.
- (iii) In general, the need for some external help is most likely to arise in respect of the smaller internal audit organisations and in situations where a temporary injection of specialist or other audit skills may be required.
- (iv) In all such cases appropriate relationships need to be established with the organisation's internal processes and management. In particular the organisation should retain full control over its auditing program and full responsibility for the auditing operations while all projects contracted out should be oversighted by departmental management - usually by the Chief Internal Auditor.
- (v) In some situations the possibility of making some use of external resources may need to be ruled out. For example:
 - . Where the auditing would involve access to Government information of a highly sensitive kind.
 - . Where private firms would be involved in conflict-of-interest situations.

- . Where first-hand and intimate knowledge of an organisation's activities and policies may be necessary.

- (vi) Departments seeking outside help in respect of audit projects should explore all relevant sources in both the public and the private sectors. They should also retain full flexibility in choosing and drawing on those contracting firms or organisations which best meet their needs.
- (vii) In the Commonwealth Government sector organisations may enter into joint servicing arrangements with other departments. Organisations may also seek advice on their auditing problems from the JIC/IDAC and the Board's Implementation Unit. The Joint Committee of Public Accounts has proposed that an Audit Bureau be established to provide 'internal' auditing services but this proposal involves some difficulties and is unlikely to lead to the early availability of further audit services.
- (viii) In the private sector, a number of leading firms of public accountants have displayed interest in carrying out auditing services for departments. Other sources of professional and technical advice in the private sector may also be relevant.
- (ix) The contracting out of internal audit projects would need to be subject to the same principles and procedures as apply to the contracting out of other similar services. Departments should pay particular attention to the economy, efficiency and effectiveness of such arrangements. All contractual arrangements (including the work carried out by contractors) may be subject to investigation and evaluation by the Auditor-General.

F.C. Pryor
Chairman
Joint Implementation Committee
on Internal Audit
18 December 1981