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LEGISLATIVE ASSEMBLY OF THE NORTHERN TERRITORY

PUBLIC ACCOUNTS COMMITTEE

**Report on the Auditor-General's
Annual Reports 1987/88 and 1988/89**

REPORT NO. 12

MAY 1991



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MAY 1991

Secretariat

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PUBLIC ACCOUNTS COMMITTEE

REPORT ON THE AUDITOR GENERAL'S REPORT ANNUAL REPORTS 1987/88 AND 1988/89

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CHAPTER ONE

THE NORTHERN TERRITORY PUBLIC ACCOUNTS COMMITTEE

The Northern Territory Public Accounts Committee was first established by temporary Standing Order 21a of the Legislative Assembly on 16 August 1986.

The Committee's status was altered, by way of motion of the Chief Minister on 23 August 1988, from a Sessional Committee on a trial basis only to a Standing Committee of the Parliament.

As a Committee of the Assembly, its authority is derived from the Northern Territory (Self Government) Act of the Commonwealth and the Legislative Assembly (Powers and Privileges) Act.

The Committee is comprised of five (5) members, presently three (3) Government and two (2) Opposition members.

The duties of the Committee are:

- (a) to examine the accounts of the receipts and expenditure of the Northern Territory and each statement and report transmitted to the Legislative Assembly by the Auditor-General, pursuant to the Financial Administration and Audit Act;
- (b) to report to the Legislative Assembly with such comments as it thinks fit, any items or matters in or arising in connection with those accounts, statements or reports, or in connection with the receipt or disbursement of the monies to which they relate, to which the Committee is of the opinion that the attention of Parliament should be drawn;
- (c) to report to the Legislative Assembly any alteration which the Committee thinks desirable in the form of the public accounts or in the method of receipt, control, issue or payment of public monies;
- (d) to inquire into and report to the Legislative Assembly on any question in connection with the public accounts of the Territory -
 - (i) which is referred to it by a resolution of the Assembly; or
 - (ii) which is referred to it by the Administrator or a Minister; and
- (e) to examine the reports of the Auditor-General laid before the Legislative Assembly with the accounts of a Public Authority of the Northern Territory (including any documents annexed or appended to those reports).

CHAPTER TWO

COMMITTEE MEMBERS

Members of the Public Accounts Committee are:

Mr Mick PALMER - MLA, Chairman

Country Liberal Party

Member for Karama. First elected 1983.

Other Committees: House; Subordinate Legislation and Tabled Papers; Use and Abuse of Alcohol by the Community; Environment (Chairman)

Mr John BAILEY - MLA

Australian Labor Party

Member for Wanguri. First elected 1989.

Shadow Minister for Mines and Energy; Industries and Development; Trade Development Zone.

Other Committees: Constitutional Development; Environment; New Parliament House; Publications.

Mr Rick SETTER - MLA

Country Liberal Party

Member for Jingili. First elected 1984.

Government Whip.

Other Committees: Publications (Chairman); Subordinate Legislation and Tabled Papers (Chairman); Constitutional Development; New Parliament House.

Mr Syd STIRLING - MLA

Australian Labor Party

Member for Nhulunbuy. First elected 1990.

Shadow Minister for Transport and Works; Power and Water Authority; Sports and Recreation; Racing and the TAB; Ports; Government Printer.

Other Committees: Constitutional Development; Subordinate Legislation and Tabled Papers.

Mr Eric POOLE - MLA

Country Liberal Party

Member for Araluen. First elected 1986.

Chairman of Committees.

Other Committees: House; Publication; Subordinate Legislation and Tabled Papers; Use and Abuse of Alcohol by the Community (Chairman).

CHAPTER THREE

INTRODUCTION

The Public Accounts Committee has a standing reference to review and inquire into matters raised in the reports of the Auditor-General and to prepare a summary report on the results of those reviews and inquiries.

The fact that the recommendation for the 1987/88 report had been superseded by the 1988/89 report meant that the Committee has, in essence, reviewed only the 1988/89 report.

Because of the nature of the Auditor-Generals recommendations the Committee decided to appoint two consultants both based in New South Wales:

- : Professor R.G. Walker - Professor of Accounting -
University of New South Wales
- : Nicholas Clarke and Associates - Economic and
Management Consultants

to review the contents of the Auditor-Generals reports and make appropriate recommendations. These reports are attached at Appendix A and B.

The Committee is of the view that it is inappropriate to take action on matters raised in the Consultants reports until such time as comments had been received from relevant Departments and Authorities.

These comments are attached at Appendix C.

CHAPTER FOUR

TERMS OF REFERENCE

As recorded in the Minutes of Proceedings of the Legislative Assembly for Wednesday 18th October 1989, the then Member for Nhulunbuy, Mr Danny Leo, moved that the following matter be referred to the Public Accounts Committee.

- (1) this Assembly note and accept the recommendation of the Auditor-General specifically made to the Assembly on pages 16 and 17 of his annual Report for the year ended 30 June 1989; and
- (2) those recommendations of the Auditor-General in paragraphs headed:
 - (a) Ex-Summary of Audit Matters arising;
 - (b) Ex-Government as a Whole;
 - (c) Ex-Departments; and
 - (d) Ex-Corporations;

be referred to the Public Accounts Committee and that the Committee undertake the reviews recommended therein and report, if necessary on an interim basis, by 31 March 1990.

After debate, the Chief Minister, Marshall Perron, moved an amendment to the reference by -

- (a) omitting from paragraph 1 the words 'and accepts'; and
- (b) omitting from paragraph 2 the words 'if necessary on an interim basis, by 31 March 1990' and inserting in their stead 'to the Assembly'.

The motion was passed.

The Committee under its terms of reference has a Standing Reference to examine all reports transmitted to the Legislative Assembly by the Auditor-General. Hence, this report not only covers those matters raised in Parliament but includes the entire annual report of the office of the Auditor-General and in addition his report upon Public Sector Corporations.

CHAPTER FIVE

ANALYSIS OF REPORTS

Reports of the Auditor-General for the year ended 30 June, 1988

The Auditor-General transmitted two separate reports for the year ended 30 June 1988. These were:

| Name of Report | Date Tabled |
|---|------------------|
| . Annual Report of the Auditor-General | 4 October 1988 |
| . Report upon Prescribed Statutory Corporations | 14 February 1989 |

As pointed out below, because the Auditor-General's Annual report for the subsequent year (1988/89) covered such a wide scope many of the recommendations made in earlier reports were overtaken. Accordingly the Committee has considered the two years' reports together. The only matter arising from the Auditor-General's 1987/88 reports which warrants separate mention is his recommendation that a comprehensive and long-term plan be prepared for development of the financial management systems in the Territory public sector.

Annual Report of the Auditor-General for the year ended 30 June 1989

This report was tabled in the Legislative Assembly on 10 October 1989.

A significant feature of the report was the emphasis given to reviews conducted elsewhere in Australia into various aspects of government financial accountability and audit arrangements and the suggestion that the results of such reviews may prove of benefit to the Northern Territory in pointing to possible and desirable improvements.

Recommendations made by the Auditor-General were of two types:

- i) matters of financial accountability as directed to the Legislative Assembly for consideration; and
- ii) matters of possible cost savings and efficiency gains as directed to the government for consideration.

The Committee sees as its first priority the accountability matters raised by the Auditor-General and these are considered in sections 1 to 4 below. Since the Auditor-General has directed the other matters (those of possible cost savings and efficiency gains) to the government for consideration the Committee feels that its involvement with those is more in the nature of a monitoring role. As such the Committee will be interested to see what comments, if any, the

Auditor-General makes in future reports as to any action the central government agencies have taken in regard to the matters raised.

The Committee notes that some of the matters of possible cost savings and efficiency gains have been raised by the Auditor-General before and these are considered in section 5 below.

1. Northern Territory Accountability Framework

In recent years the Auditor-General's Annual Reports have moved away from concentrating audit commentary on low-level systems matters to the point where the 1989 Annual Report was concentrated on the accountability framework itself. This was because more and more audit criticisms were being traced back to gaps in the overall accountability framework and, in terms of development, it was considered that the Northern Territory should concentrate on improving the framework before attempting to improve systems within that framework.

As a starting point the Auditor-General recommended that the Northern Territory look to developments which have occurred elsewhere in Australia including the major reviews that have been conducted into public sector financial accountability issues. In the past 10 years or so there have been significant changes in legislation elsewhere in Australia effecting:

- . financial accountability of Ministers;
- . financial accountability of government departments and corporations; and
- . parliament's requirements of the audit function.

2. Reporting by Whole-of-Government

The Auditor-General's recommendation in this area was that a specific review should be undertaken to ascertain what the particular information needs are of those people and organisations which actually use the Northern Territory government's financial reports (that is, those reports which provide information on the whole of government).

Whilst acknowledging that the Northern Territory was in no way unique, the Auditor-General was of the view that the financial information relating to whole-of-government operations could be made more relevant and meaningful to the users of the information. It was further suggested that the improvements process should involve identification of the actual users of such reports and their information needs.

Whole-of-government financial information presently comes from various separate sources including:

- a) the Treasurer's Annual Financial Statements;

- b) the budget paper;
- c) reports from the Australian Statistics; and
- d) the Public Accounts Committee's own enquiries.

The Auditor-General expressed a view that a simple summary of such information would probably be most useful - something which provided an overview of the key financial information presently found in the separate and more detailed reports.

A separate matter was the desirability of rationalising the Treasurer's Annual Financial Statements and the related audit requirements in view of the cost involved in compiling and auditing those statements despite the fact that much of the information was merely a duplication of what was presented in the Budget nearly two months earlier.

3. Annual Reporting by Departments

An on going criticism by the Auditor-General in recent years has been that government departments were not required to provide information regarding their financial operations to the Legislative Assembly or to the public at large. The Public Accounts Committee supported the Auditor-General's comments and, from its considerations of the Auditor-General's reports for the year ended 30 June 1987, recommended that:-

'Departmental financial statements be prepared as an integral part of departmental annual reports, in the form recommended by the Auditor-General' (Report number 7, page 24).

In the Auditor-General's 1988/89 Annual Report this deficiency was again pointed out. In addition it was noted that, quite apart from the financial content of annual report, there was no single authoritative guidance as to what other non-financial information should be included in annual reports. Recommendations had come from a number of sources (including the Auditor-General, the Under Treasurer, the Public Accounts Committee and those involved with the Northern Territory Public Sector Annual Report Awards scheme) but the diversity of views needed to be reconciled so that there was one authoritative source of guidance. The Auditor-General recommended that a review be undertaken to determine the adequacy of current annual reporting methods by departments.

On 28 June, 1990 Treasurer's Directions were issued which required departments to disclose some, but not all of the financial information recommended by the Auditor-General and the Public Accounts Committee. The matter of what other, non-financial information should be provided in annual reports remained unaddressed.

4. Government-owned companies, corporations, trusts, etc.

This section of the Auditor-General's Annual Report considered all of those government entities which are not

government departments. It included those government entities which have a corporate existence (such as companies and other ventures). The Auditor-General pointed out that often a considerable volume of government business can be transacted through these types of entities and, as a consequence, the government may have potential financial exposures.

Pointing to the results of reviews elsewhere in Australia the Auditor-General raised a number of questions including the following:

- a) whether there should be restrictions to ensure that such entities are created, acquired and used only in appropriate circumstances;
- b) once they are established, is it desirable that their existence and government ownership or participation be made public via a central register or advice to the Legislative Assembly;
- c) should such entities provide financial information to the Legislative Assembly;
- d) should an audit report on such entities be provided to the Legislative Assembly;
- e) should the Auditor-General be the auditor of such government entities (or at least have an oversight of the audit function).

The Auditor-General's recommendation was that a review be undertaken as to the adequacy of the accountability and reporting arrangements which exist in respect of government-owned companies, corporations, trust etc. The review should include consideration of such aspects as:

- a) the processes for the creation or acquisition of such entities;
- b) statutory reporting requirements; and
- c) whether the Auditor-General should have an involvement in the audit function of those entities.

5. Recommendations to the government on possible cost savings and efficiency gains.

In his Annual Report for 1988/89 the Auditor-General suggested that the government consider a number of matters of possible cost savings and efficiency gains. Of the recommendations made by the Auditor-General the Committee takes a particular interest in two which have been raised previously. One relates to the audit requirements in relation to local government councils and the other relates to the audit requirements in relation to Commonwealth acquittals.

In Section 3 of his Report upon Prescribed Statutory Corporations for the year ended 30 June, 1986 the

Auditor-General expressed the view that the local government accounting and auditing requirements were overly detailed and prescriptive and that the cost of producing and auditing the financial reports exceeded the value to the information. A similar comment was made in the Auditor-General's Annual Report for 1987/88 and again in the 1988/89 report. As a result of its enquiries into the matter the Committee considers the Auditor-General's concerns to be warranted and that the opportunity for cost savings and efficiency gains does exist.

A similar situation exists in respect to Commonwealth acquittals (ie. those financial statements which the Territory must provide to the Commonwealth in relation to some Commonwealth grants to the Territory). Again because of the usually overly-detailed and restrictive accounting and audit requirements, the Auditor-General recommended in his Annual Report for 1986/87 that his advice should be sought before the accounting and auditing requirements were finalised. Arising from it considerations of that report, the Committee recommended that such consultation occur. The Auditor-General repeated his comments in his Annual Reports for 1987/88 and 1988/89.

Report of the Auditor-General upon Public Sector Corporations

This report was tabled in the Legislative Assembly on 20th February, 1990. The report related to government corporations and local government councils and restated the recommendations which had previously been made in the Auditor-General's Annual Report in relation to those entities. The report also contained information as to the dates of issue of audit reports on various financial statements. The report also contained a set of model financial statements to assist corporations in preparing annual financial statements which meet legislative and professional accounting requirements.

Since the recommendations contained in this report are a restatement of those contained in the Auditor-General's Annual Report they have been dealt with above.

CHAPTER SIX

CONCLUSIONS AND RECOMMENDATIONS

In framing its conclusions and recommendations the committee took cognizance of responses from the various departments and organisations to which it had circularised copies of the consultants reports.

The committee also held a number of briefing sessions with the consultants, relevant government departments and the Office of the Auditor-General.

Northern Territory Accounting Framework

Auditor-General's Recommendation:-

'That a review be undertaken to adopt any appropriate measures from developments elsewhere which can improve the financial accountability arrangements in respect of Northern Territory government operations'

It was this recommendation that prompted the committee to seek the advice of the two consultants it subsequently appointed and to request them to provide the committee with an insight into what was happening elsewhere in Australia in terms of accountability. In addition, it requested them to report on the other recommendations the Auditor-General made to the Assembly. (See Appendix A and B)

The committee is of the opinion that it is essential for governments to keep abreast of developments in Public Service Accounting, Reporting and Auditing. The committee is conscious of the level of expertise and knowledge required to adequately evaluate the consultants reports and responses and feels this would be best achieved by the establishment of a working group which would report to the committee twice yearly. This working group would consist of representatives from the Northern Territory Treasury, Public Service Commissioners Office, Department of the Chief Minister and Office of the Auditor-General, otherwise known as the Central Agencies.

RECOMMENDATION 1

It is recommended that a working group be established comprising of a representative from each of the four central agencies to consider the recommendation of the Auditor-General taking into account the consultants reports and responses that are attached to this report and other developments that may be occurring elsewhere.

Such a working group should, from time to time through the Public Accounts Committee, make reports to Parliament.

It is further recommended that The Northern Territory Treasury be charged with the responsibility for coordinating the workings of the group.

Reporting by Whole of Government

Auditor-Generals Recommendations:-

'That a review be undertaken to determine the information needs of the users of government financial reports'.

After due consideration the committee believes that the information requirements of users of government financial reports is adequately set out in The Australian Accounting Research Foundations Statement of Accounting Concepts 'Objectives of General Purpose Financial Reporting' commonly referred to as SAC 2. (See Appendix D)

The purpose of this Statement is to establish the objective of general purpose financial reporting by reporting entities in the private and public sectors. The Statement identifies the users of general purpose financial reports, the common information needs of such users and the broad types of information, consistent with those needs, that general purpose financial reports should provide.

Whilst the committee realises that different users will have different needs from government financial reports it supports the view that a report prepared in accordance with SAC 2 recommendations will satisfy the majority of user information requirements.

RECOMMENDATION 2

That it is not necessary to carry out a review of information needs of the users of government financial reports.

RECOMMENDATION 3

That the concepts of SAC 2 be adopted in the preparation of Department and Statutory Authorities Annual Reports.

Turning to the issue of duplication and hence cost implications between the Budget Papers and the Treasurers Annual Financial Statement the committee sees merit in this issue being referred to the working party of representatives from the Central Agencies for their investigation and recommendations.

RECOMMENDATION 4

That the working party of representatives from the Central Agencies advise the committee on the desirability of rationalising the Treasurers Annual Financial Statements.

Annual Reporting by Departments

Auditors-Generals Recommendation:-

That a review be undertaken to determine the adequacy or otherwise of current annual reporting methods by departments in terms of their appropriateness.

The committee is aware of the varying state/territory legislative basis for preparation of annual reports which currently exist.

It also notes that the Public Sector Accounting Standards Board will be issuing a discussion paper on Financial Reporting by Government Departments in which it will be recommending the preparation of 'General Purpose Financial Reports' and the adoption of the accrual basis of accounting.

The Northern Territory Treasury currently reviews accounting standards and is responsible for updating the Treasurers Directions which, as demonstrated by Treasurers Direction A7/90 'Amendment to section 24 of the Treasurers Directions: Departmental/Financial Reporting, is the current method for changing the content of departmental annual reports.

It is the committee's belief that a review of the content and current legislative arrangements in relation to departmental annual reports needs to be carried out and is of the opinion that this matter should be referred to the working party of representatives from each central agency.

RECOMMENDATION 5

That the Working Party of representatives from each Central Agency carry out a review of current departmental annual reporting requirements and report to the Parliament through the Public Accounts Committee on the adequacy of these requirements.

Government-Owned Companies, Corporations, Trusts etc

Auditor-Generals Recommendation:-

That a review be undertaken as to the adequacy or otherwise of the accountability and reporting arrangements which exist in respect of government-owned companies, corporations, trusts, etc. The review should include consideration of such aspects as:

- (a) *the processes for the creation or acquisition of such entities;*
- (b) *statutory reporting requirements; and*
- (c) *whether the Auditor-General should have an involvement in the audit function of those entities.*

The Public Accounts Committee sent a letter to all government departments and statutory authorities which requested they advise the committee of all government-owned companies, corporations and trusts established by and/or controlled by them. This involved 'non active' companies, corporations and trusts which had not been officially wound up.

After evaluating the responses the committee sees merit in the maintenance of a register of government-owned companies, corporations and trusts and is of the opinion that this register would best be maintained by the Northern Territory Treasury.

RECOMMENDATION 6

That the Northern Territory Treasury establish a Register of Companies, Corporations and Trusts which the government initiated and/or has a financial interest in.

In examining the issue of the Auditor-General's involvement in the audit of these entities, the Committee considered the arguments advanced by concerned parties, however, your Committee is of the view that accountability to Parliament and the People outweigh any potential breach of commercial confidentiality.

The committee heard evidence from the Auditor-General of the Northern Territory who tabled a statement known as the 'Waitangi Statement' from the (1989) conference of Australian Area Auditors-General which said in part:

1. *All government agencies should be accountable to Parliament from which they derive their authority and should be subject to the scrutiny of the Auditor-General or his agent.*
2. *The responsibilities of Auditors-General extend beyond those of private sector auditors in that they have a wider legislative mandate designed to meet the needs of Parliament and to protect the interests of the public.*
3. *If Auditors-General are to provide Parliament with adequate assessments of public sector accountability there should be no restriction on audit scope.*

This view has been supported by a number of academics including Professor RB Walker who stated in his New Accountant article of 6 September 1990 titled 'The SBV: Accounting Joke of the Year' that:

The SBV may be on the block, but Victoria should take steps to ensure that henceforth the Auditor-General will be responsible for the audit of all state-owned enterprises, perhaps in association with arrangements for the appointment of private-sector auditors under contract .

It should be noted that the Northern Territory Office of the Auditor-General has been using private sector auditors under contract to audit government departments and statutory authorities since 1982.

In a 1989 article 'Governments Hide Behind Exempt Status', also in New Accountant, Professor Walker posed the following question:

Why are governments using exempt proprietary companies as vehicles to operate government business or administer government programs?

Directors of such companies need not comply with public service rules requiring the formal authorisation of transactions. If they support a private sector auditor operating solely in terms of the local companies act or code then the auditors need only report on whether the financial statements provided a 'true and fair' view.

But the most significant feature of the use of exempt proprietary companies by governments is the fact that if they appoint an auditor and are subject to audit, then they do not have to place any financial statements on the public record.

In its March 1991 review supplement, the Financial Review Newspaper published an article 'Bureaucrats in Business' which stated in part:

Victoria is primarily worried about making sure that accountability to Parliament through the Minister is maintained. The Cain government used corporate performance measures for some of its enterprises and the State Bank/Tricontinental collapse, in particular, exposed the fact that the Companies Code and commercial auditing standards are not sufficient for public business.

According to James Guthrie, a lecturer in accounting and auditing at the University of NSW, many pro-corporatisers are dangerously supportive of proposals to replace public sector scrutiny (emphasising probity and compliance with often-exhaustive rules for financial administration) with private sector audits. The reputation of private sector audits has been undeniably poisoned by

the Rothwells example and others like it. In some cases, public enterprise has gone the same way.

Take for example the private sector audit of the Victorian Economic Development Corporation which Arthur Andersen's managing partner, Fergus Ryan, later criticised in a review which said the audit has failed to report adequately on a series of major problems.

Given the weight of professional opinion, and the fact that accountability to the Parliament and the people is an essential pre-requisite of government, the Committee endorses the proposal that the Auditor-General be responsible for the audit of all government owned companies, trusts and corporations.

As a part of its deliberations, the committee considered a paper 'Guidelines for Companies, Joint Ventures and Trusts in the Public Sector', prepared by the Victorian Treasury. (Appendix E)

The committee is of the opinion that this paper together with sections 67 and 68 of the Financial Administration and Audit Act should form the model for guidelines issued in the Northern Territory.

RECOMMENDATION 7

That the Auditor-General for the Northern Territory be responsible for the audit of all companies, corporations and trusts in which the Government maintains a controlling interest.

It is further recommended that guidelines similar to those in use in Victoria be issued for the guidance of both public sector managers and the Auditor-General and that such guidelines be properly adhered to.

Recommendations to the Government on Possible Cost Savings and Efficiency Gains

The Committee is aware that a review was undertaken of accounting/reporting requirements of local government councils and that a report was prepared for the Minister for Local Government. Furthermore, it is the committee's understanding that the Office of the Auditor-General participated in this review. The results of this review are relevant to a committee inquiry which is currently being undertaken into Grants-in-Aid.

RECOMMENDATION 8

That the Office of Local Government provide the Committee with a written report of the review.

In relation to the situation that exists in respect to Commonwealth acquittals, the Committee notes its previous support of the Auditor-General's recommendation and the fact that it would appear this consultative process is not occurring in some instances.

RECOMMENDATION 9

That Northern Territory Government Departments direct increased priority to providing the acquittal statements required by the Commonwealth.

RECOMMENDATION 10

That prompt advice be sought from the Office of the Auditor-General in all cases where auditing requirements are being proposed for Commonwealth acquittals.

CONSULTANT'S REPORT
by
PROFESSOR R G WALKER

REPORT TO THE PUBLIC ACCOUNTS COMMITTEE
LEGISLATIVE ASSEMBLY OF THE NORTHERN TERRITORY OF AUSTRALIA

R.G. Walker

7 August 1990

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REPORT TO THE PUBLIC ACCOUNTS COMMITTEE

LEGISLATIVE ASSEMBLY OF THE NORTHERN TERRITORY OF AUSTRALIA

1. INTRODUCTION

1.1 I have been asked to prepare a report to the Public Accounts Committee, offering comments on:

- (i) matters arising from certain comments made by the Auditor-General of the Northern Territory, Mr. E.M. Isaacson in his Annual Report for the year ended 30 June 1989;
- (ii) the form and content of the Treasurer's Annual Financial Statements;
- (iii) the format of the model financial statements for NT Corporations - as suggested by the Auditor-General in a report titled Model Financial Statements for Northern Territory Corporations (February 1990).

1.2 Regarding item (i), the particular matters I have been asked to address were summarised on pp. 16-17 of that Report, and were framed as recommendations to both the Legislative Assembly and to the government. My brief from the Public Accounts Committee was to address issues contained in the following recommendations from the Auditor-General:

To the Legislative Assembly

- 1. That a review be undertaken to adopt any appropriate measures from developments elsewhere which can improve the financial accountability arrangements in respect of Northern Territory government operations.
- 2. That a review be undertaken to determine the information needs of the users of government financial reports.
- 3. That a review be undertaken to determine the adequacy or otherwise of current annual reporting methods by departments in terms of their appropriateness.
- 4. That a review be undertaken as to the adequacy or otherwise of the accountability and reporting arrangements which exist in respect of government-owned companies, corporations, trusts, etc. The review should include consideration of such aspects as:
 - (a) the processes for the creation or acquisition of such entities;
 - (b) statutory reporting requirements; and
 - (c) whether the Auditor-General should have an involvement in the audit function of those entities.

To the government

1. That a process of progressive review of the efficiency and effectiveness of the financial management processes and systems employed in managing the public sector overall be incorporated in appropriate programs undertaken by Treasury.
2. That a programme of review be instituted to identify likely efficiency gains in the financial management processes and systems employed by departments.
3. That in revising the Treasurer's Directions, the philosophy and concepts required to improve departmental financial management be considered for inclusion.

1.3 In preparing this report, I have been supplied with:

1987 Annual Report of the NT Auditor-General
1988 Annual Report of the NT Auditor-General
Auditor-General, Report upon public sector corporations,
February 1990.
Auditor-General, "Model financial statements for
Northern Territory Corporations", February 1990.
Treasurer's Directions, 1989 and revisions 1990.
Treasurer's Annual Statements, 1989.
Various annual reports of NT Departments, Treasury, and
prescribed statutory corporations.

1.4 The arrangement of this report generally follows the order of the Auditor-General's recommendations. Those parts of the brief which are listed under (ii) and (iii) above (i.e. comments on the form and content of the Treasurer's annual financial statements, and on the format of the model financial statements for NT corporations suggested by the Auditor-General) are discussed in connection with the Auditor-General's recommendations 3 and 4 to the Legislative Assembly, cited above in paragraph 1.2.

2. SUMMARY OF RECOMMENDATIONS

The brief from the Public Accounts Committee sought comments on a wide range of issues. The major recommendations to the Committee arising from this review are shown in bold type.

Review of information needs of users of government financial reports

- 4.16 That the Auditor-General's recommendation that a survey be conducted to determine the "information needs" of various users of government financial reports be not acted upon, in light of the fact that a similar exercise has recently been undertaken by the Australian Accounting Research Foundation.

Current annual reporting methods of departments

- 5.15 That Treasury be asked to consider whether the Treasurer's Directions should be further expanded to require departmental financial reports to include:
- (a) more detailed guidelines concerning disclosure of liabilities and other financial commitments arising from departmental activities;
 - (b) explanations as to the basis of attributing money values to properties "written off".
 - (c) narrative descriptions of the major resources held, controlled or maintained by departments.
- 5.30 That the Public Accounts Committee suggest that the Treasurer's Directions should be further expanded to provide encouragement to departments to devise and publish indicators of the economy, efficiency and effectiveness with which they have conducted their major programmes during a financial year.
- 5.38 That the Public Accounts Committee endorse suggestions that departmental financial statements be subject to audit by the Auditor-General.

That the Public Accounts Committee seek legal advice as to whether any statutory amendments are necessary to require departmental financial statements to be subject to audit - or whether it would be sufficient to make further amendments to the Treasurer's Directions.

Form and content of the Treasurer's Annual Financial Statements

- 5.47 That Treasury give consideration to the inclusion within the Annual Statements of a five-year summary of payments for capital works, showing expenditure in terms of such categories as roadworks, housing, hospitals, educational facilities, police fire & emergency services, etc.

- 5.53 That Treasury give consideration to the inclusion within the Treasurer's Annual Statements of explanations of such matters as "appropriations [from] former years", the basis of inter-fund transfers, and "recovery of principal and interest".

That Treasury give consideration to the inclusion within the Treasurer's Annual Statements of cash-flow statements depicting operating, financing and investing activities undertaken by the NT public sector. Consideration should be given to the preparation of cash flow statements encompassing the Consolidated Fund, the Trust Fund and trust accounts external to the NT government account (after eliminating inter-fund transfers).

That Treasury give consideration to the inclusion of cash flow statements in its quarterly reports to Parliament.

- 5.60 That Treasury give consideration to expanding the content of Statement 6 "Guarantees and contingent liabilities" to encompass "Liabilities, commitments for expenditure and contingent liabilities".

That consideration be given to the presentation in the Annual Statements of information concerning "liabilities" and "commitments for expenditure" in the form required by clause 21 of Schedule 7 of the Companies Code.

Adequacy of accountability and reporting arrangements for government-owned companies, corporations, trusts, etc

- 6.22 That the Auditor-General be established as the auditor of all government-owned or government-controlled companies or trusts - save that the Auditor-General may contract-out such audit work to private-sector audit firms.

That Treasury be asked to consider revisions of the Treasurer's Directions so as to require Departments, and statutory authorities to include in their annual financial statements:

- (a) a list of subsidiary companies and trusts, and of other companies or trusts in which the Territory holds 20% or more of the shares or units;
- (b) a description of the principal activities of those companies or trusts.

- 6.62 That the Committee consider the merits of either:
- (i) the expansion of the Treasurer's Directions relating to prescribed statutory corporations so as to incorporate additional guidance on financial reporting issues; or
 - (ii) the introduction of legislation along the lines of the NSW State-Owned Corporations Act, adapted for the requirements of the Northern Territory, so as to establish accountability arrangements for all public sector corporations (both prescribed statutory corporations, and other government-owned or government-controlled companies (or trusts)).

- 6.77 That the Auditor-General be encouraged to develop or adopt a set of auditing standards dealing with the conduct of "compliance" auditing, and with reporting the findings of that auditing work to management, boards of public sector corporations, Ministers and Parliament.

That the Auditor-General consider the introduction of guidelines for the reporting to Parliament (perhaps through the Public Accounts Committee) of any matters raised in management letters which have not been rectified or attended to within six months from the date of those letters.

Model financial statements

- 7.20 That the Auditor-General's recommendation that all corporations should comply with the proposed model financial statements should not apply to incorporated school councils.

That the Public Accounts Committee consider reviewing how the accountability arrangements for school councils established by the Education Act and accompanying guidelines are operating in practice.

- 7.27 That the Auditor-General's recommendations not be accepted in their present form for application to superannuation funds.

That Treasury be advised that in exercising discretions in terms of section 68 of the Financial Administration and Audit Act, it would be appropriate for NT superannuation funds to adopt only those Australian Accounting Standards which are relevant to the superannuation industry.

That it be suggested to Treasury that consideration be given to requiring annual reports of superannuation funds to include a Statement of Cash Flows (rather than a Statement of Sources and Applications of Funds).

- 7.32 That the Auditor-General's recommendations for the adoption of model financial statements not be accepted as appropriate for community government councils.

That the Auditor-General's recommendations for the adoption of model financial statements (implying as they do the use of accrual accounting) not be supported as appropriate for local government councils at this stage.

Reviews of the efficiency and effectiveness of financial management

- 8.9 That the Public Accounts Committee support proposals that government departments and statutory authorities should review the efficiency and effectiveness of the financial management processes and systems they employ in managing the public sector - but that it not support suggestions that monitoring those activities should necessarily be the responsibility of Treasury.
- 8.13 That the Public Accounts Committee express the view that it encourages departmental reviews of financial management, but would not endorse the suggestion that formal reviews of financial management practices and systems be instituted across departments, pending further advice from the Auditor-General concerning substantive evidence of "problems".
- 8.24 That the Public Accounts Committee support the efforts of the Auditor-General to undertake occasional reviews of the economy, efficiency or effectiveness of selected public sector activities.
- 8.38 That the Auditor-General be encouraged to develop or adopt standards dealing with the conduct of "performance auditing" and with reporting the findings of that auditing work to public service managers, Ministers and Parliament.
- 8.39 That the Auditor-General be encouraged to discuss draft standards on compliance auditing and performance auditing with the Public Accounts Committee.
- 8.40 That at a later date the Public Accounts Committee review the activities of the Auditor-General's office in performance auditing, with a view to considering whether the office is adequately funded for such activities.

3. CHANGING ARRANGEMENTS FOR FINANCIAL ACCOUNTABILITY - AND THEIR RELEVANCE TO THE NORTHERN TERRITORY.

3.1 The first major recommendation in the 1989 Auditor-General's report was

that a review be undertaken to adopt any appropriate measures from developments elsewhere which can improve the financial accountability arrangements in respect of Northern Territory government operations (p.16).

3.2 Any suggestion that financial accountability arrangements can be "improved" implies the adoption of some criterion or criteria for evaluating those arrangements (and, in the case of multiple criteria, some method for weighting each of them). However one frequently encounters statements suggesting that the accountability arrangements adopted in a particular setting are deficient - but without making explicit what criterion or criteria the author of those comments has adopted in making that evaluation. In many instances commentators may be doing little more than offering opinions based on personal impressions and values.

3.3 The term "accountability" is often used (rather imprecisely) as a component in pejorative terms: one frequently encounters comments about a "lack of accountability" or a need for "greater accountability". Few articulate what they mean by references to "accountability".

3.4 Some refer to accountability as a relationship that subsists between parties whereby one is answerable in some way for his conduct. Others have identified a range of such relationships. At one end of the continuum is a simple obligation to "render an account" or a statement of acquittals, indicating that moneys have been spent in the manner in which they were intended. Other accountability relationships may encompass financial reporting which encompasses more than cash transactions, and extend to the use of some form of accrual accounting which recognises certain commitments, to other forms of financial reporting which discloses a wider range of commitments than those customarily incorporated in private-sector accrual accounting. Towards the other extreme of the continuum are relationships whereby the performance of one party in utilising financial and other resources may be subject to some form of review. It has become customary to refer to reviews of the economy, efficiency, and effectiveness with which managers (or other parties) have conducted certain activities.

3.5 What might lead to an improvement in accountability? To some, a movement along the continuum of relationships constitutes an "improvement". But there are several other senses in which commentators call for changes which they describe as "improvements". Listed below are some changes which have been (or could be) characterised as "improvements" in accountability in financial matters:

- (i) a more open arrangement - which leads to greater disclosure of financial arrangements;
- (ii) the adoption of a formal arrangements whereby the persons responsible for rendering an account are answerable to other parties. (To give a private sector example: many of the entities listed on the stock exchange are trusts; many unlisted trusts also attract public investment. Despite the fact that units in those trusts are publicly traded, there are at present no formal requirements for the managers of trusts to hold annual meetings at which managers are answerable to unitholders. The introduction of requirements for annual general meetings by unitholders might be seen as "improving" accountability).
- (iii) arrangements whereby financial information is more readily accessible to particular interest groups, or to the public at large;
- (iv) requirements for information to become available in a more timely fashion (or the adoption of practices which achieve that effect);
- (v) the introduction of regulations prescribing that information be prepared in a standard fashion or format by various reporting entities - thus enhancing the comparability of that information or the speed with which that information can be reviewed;
- (vi) the introduction of arrangements for the audit of financial statements, and other information;
- (vii) the formal articulation of the responsibilities of managers in relation to the preparation of financial reports;
- (viii) the formal articulation of the responsibilities of auditors concerning the matters which they are required to report, and the parties to whom those reports are to be directed;
- (ix) the introduction of new elements in accountability relationships within complex organisational arrangements (e.g. appointment of internal auditors, or audit committees);
- (x) changes in financial controls (e.g. adoption of asset registers; improved controls over consumable items, etc.)
- (xi) changes in financial reporting which generate information believed to be more relevant to users of financial reports (e.g. a switch from cash to a form of accrual accounting, or a switch from one form of "modified" accrual accounting to another).

- (xii) the introduction of arrangements whereby persons entrusted with the management of the resources of some other party are subjected to reviews of the economy, efficiency and effectiveness with which they have undertaken that task;
- (xiii) the introduction of arrangements whereby evaluations of the economy, efficiency and effectiveness with which public service managers have undertaken certain tasks are placed before Parliament (and therefore, the public).

It will be noted that the above list includes both changes in the nature of the relationship between two parties, and changes in the manner in which that relationship is conducted.

3.6 As noted above, the Auditor-General suggested in his 1989 report that "a review be undertaken to adopt any appropriate measures from developments elsewhere which can improve the financial accountability arrangements in respect of Northern Territory government operations" (emphasis added). However the Auditor-General did not indicate what he intended by references to "improvements". It is possible that he was referring to some or all of the factors listed above.

3.7 The point could be made that what one person may regard as an "improvement", another might regard as a costly or time-consuming exercise of no particular value. Different persons affected by proposals for change may have different perspectives. Even independent observers may see things differently - depending upon their prior knowledge, beliefs and values.

Developments elsewhere

3.8 Similar observations might be made about the use of the term "developments". What one person regards as a "development" in accountability - an improvement - might be viewed by another person as simply a change (or even a retrograde step). For example, the introduction of arrangements which see public servants subject to close and hostile cross examination in public hearings might be viewed by some as a "development" in accountability; others might view it as a dysfunctional activity which distracts public-sector managers from their role in the delivery of services to the community, which lowers morale, and which contributes to the loss of talented public servants to the private sector.

3.9 Some might suggest that the Auditor-General's report to Parliament may have been more useful had it actually indicated what "developments" elsewhere were regarded by the audit office as relevant or appropriate to the Northern Territory. Further, while some "developments" may be relevant, the costs of implementation may outweigh the expected benefits. For example, some of the accountability arrangements adopted in the USA for government programmes involving billions of dollars would probably be too costly for the Territory.

3.10 Further, it must be acknowledged that some of the issues raised in the Auditor-General's report are overlapping. To illustrate, the recommendation that there be a review of "developments elsewhere" would inevitably overlap the recommendations that there be a review of accountability arrangements adopted for government-owned corporations. For that reason it is proposed to integrate references to "developments elsewhere" with discussion of specific recommendations.

4. INFORMATION NEEDS OF USERS OF GOVERNMENT FINANCIAL REPORTS

4.1 Recommendation 2 from the Auditor-General was

That a review be undertaken to determine the information needs of the users of government financial reports.

4.2 During the 1960s academic writers on accounting and financial reporting started promoting the idea that accounting was essentially a service function; that the design of accounting reports should be geared towards meeting the "needs" of users of those reports. It was soon recognised that many users make decisions without the benefit of information which others might regard as "needed" to make those decisions. For example, while some may argue that an individual contemplating the purchase of a company's shares "needs" detailed information concerning the profits and financial position of that company, the fact is that many (if not most) individual investors purchase securities on the basis of tips or recommendations.

4.3 Restating the task as one of providing information which was "relevant" to "interested parties", academic writers sought to model the judgments or decisions faced by different categories of users, and to identify what information was relevant to those judgments or decisions. It was also recognised that different categories of "users" may regard different types of information as relevant to the decisions they may face. The information which is most relevant to a secured creditor may concern the capacity of an enterprise to generate cash flows, and the value of the assets which constitute the underlying security. A present or prospective shareholder may be more concerned with the track record of profits, with the aim of predicting future income streams and cash flows.

4.4 It was also recognised that a wide range of data may at some stage be "relevant" to members of a particular user-group, who are contemplating a particular type of judgment. For example, a shareholder who is making a routine judgment about whether to sell or hold shares may consider that the aggregate of the current resale values of assets held by a company may be relevant to his assessment of that company's financial position; the current resale value of overall "businesses" owned by a company (perhaps through subsidiary companies) may also be relevant, as an indicator of what the company could obtain if it chose to divest itself of those assets. The current replacement values of those same assets might also be relevant to assess the likelihood of existing profits attracting future competitors to enter the industry. That same shareholder may be interested both in the face value of existing "liabilities", the "present value" for long-term liabilities, and also the quantum of other contractual commitments which are not regarded as fitting the accounting definition of "liability". A host of data may be "relevant", though (analytically) some items may be considered of more immediate interest than others.

4.5 Even for a given class of users, different items of information may be relevant (or of particular significance) at

different times. The financial data which may be relevant to a shareholder making routine judgments about whether to sell or hold shares may differ from the data which is relevant when considering whether to accept a takeover bid. Similarly, the types of data which may be regarded as significant to a shareholder may depend upon wider circumstances within the market-place: for example, a shareholder might be extremely interested in the extent to which a company's manufacturing activities depended upon the use of a particular commodity (e.g. petroleum products) if the supply of that commodity was under threat; at other times he might have little interest in that issue.

4.6 After several decades of academic and profession-sponsored research, there is still no consensus as to what kinds of information which are relevant to the needs of particular classes of users, and therefore should be reported in annual financial statements. There is even less agreement about what kinds of information should be incorporated into financial statements which are intended for the use by several categories of users or potential users. The design of "general purpose financial reports" may involve trade-offs between the concerns and interests of one class of user and another. Moreover, some interested parties (such as company directors or managers) may seek to influence the preparation of financial reports so that they convey an optimistic or pessimistic view of an entity's profitability and financial position.

4.7 In summary: despite several decades of discussion and debate, there is still no consensus about the information "needs" of users of private sector financial reports.

4.8 There has been far less attention to the concerns of users of financial information in the public sector. Only a few papers have sought to address such issues. Local contributions include:

- * A 1986 survey of South Australian parliamentarians sought expressions of views about contemporary reports from SA government 'expenditure' departments - those which raise no revenue but provide services to the public. Those accounts were prepared as a simple summary of receipts and payments (with "receipts" including special grants from the Australian government).

The responses indicated that the accounts are used for a variety of purposes by most parliamentarians, with a minority (10%) claiming "never to use them". Only 22% claimed to analyse the accounts of all departments, 62% analysed the accounts of "selected" departments, and 16% one department only. Respondents suggested that no "single overriding use of the accounts made by parliamentarians", though five uses were "more common than others": so that parliamentarians could satisfy themselves that public moneys are correctly spent; to determine the extent of resources available for use in departments; to establish changes in the level of resources used in departments; and to provide information about departments for use in debates. (S. Henderson and B. Scherer, 1986).

- * a monograph prepared by the P. Sutcliffe for the Australian Accounting Research Foundation (AARF) Financial reporting in the public sector - a framework for analysis and identification of issues set forth a series of issues warranting further investigation, concerning the identity of major users of "general purpose financial reports" in the public sector, and the nature of their information "needs".

This monograph formed the basis of a subsequent "Proposed statements of accounting concepts" (ED42A-D, 1987) jointly issued by the Public Sector Accounting Standards Board, which adopted a series of "assumptions" about the identity of public-sector users of financial reports, and their "needs" for information. However these assumptions were adopted without any prior empirical investigation of those users' "needs".

4.9 Without reviewing the academic literature in detail, there has been few efforts to investigate the information needs of users of public-sector financial reports. That is not in itself surprising: most exercises in the regulation of financial reporting (whether by government, the stock exchanges or the accounting profession) are undertaken without the benefit of any prior, systematic empirical investigations. To insist on such work being undertaken would only add to the costs of regulatory processes, and ensure that a system of regulation was unable to respond quickly to new problems and changing conditions.

4.10 Against this background, the Auditor-General's recommendation that a "review be undertaken to determine the information needs of the users of government financial reports" seems somewhat idealistic and optimistic. "Idealistic" since regulatory change rarely proceeds on the basis of systematic observation and investigation. "Optimistic" since, without denigrating the talents of staff of the Territory's public service, it is unlikely that many of them would have the research skills to undertake such a project. Indeed, a rigorous and systematic examination of what information is relevant to users of government financial reports has yet to be undertaken anywhere in the world.

4.11 As indicated above, most attempts to introduce changes in arrangements for financial reporting are based upon individual observation and opinion, rather than reviews of information "needs". Certainly most reforms to the financial reporting requirements contained in company laws, the listing rules of the stock exchanges, or accounting standards have been undertaken on that basis. This is explainable, in part, by the efforts of policy-makers to respond to emerging problems and changing conditions (often before evidence is available from "research").

4.12 Indeed, it would appear that when the Auditor-General prepared a set of "model financial statements" for use by NT corporations, the proposals contained therein were not formulated on the basis of any "review of information needs". Rather, staff

in the audit office prepared a set of guidelines which would, in their opinion (and on the basis of their knowledge of public sector financial arrangements) lead to the presentation of information which would be relevant to users of those reports.

4.13 Similarly, staff of the audit office have indicated their views about the identity of the main users of public sector financial reports. A paper by Mr. John Rosier observed that :

from the audit office point of view we would list the main groups as: -

- * the government
- * Legislative Assembly
- * Public Accounts Committee
- * ministers
- * public service managers
- * others
 - the commonwealth
 - lenders and providers of funds
 - analysts and the media
 - taxpayers and the general public
 - special interest groups

Rosier went on to say that he was "not suggesting that there is an overwhelming demand among the general populace" for what he termed "better financial information from government". However he indicated that the Auditor-General's office favoured some kind of survey of what information users "want":

How could we go about doing it? Well, there are the user groups - on the board - some of them can be contacted individually - in other cases we would perhaps need to seek representatives - but all can be asked whether they would wish to participate in a survey.

Now arranging such a survey would require people having special skills - and probably a mixture of skills - but it would not be an impossible task. Similar exercises have been carried out elsewhere....

It appears that these sentiments led to the recommendation contained in the Auditor-General's 1989 Annual Report that a "survey" be undertaken.

4.14 Many attitude surveys would take as their starting point the conclusions drawn from analytical studies of the public sector environment and individual opinion as to the most significant of a range of objectives of financial reporting in that context. The findings of such surveys must be interpreted cautiously; perhaps they are best seen as only indicating something about respondents' attitudes towards particular propositions. For example, a large proportion of respondents may claim to want information about "public debt" - though different respondents (and possibly the investigators) may have quite different ideas about what they mean by such a term. It must also be recognised that respondents attitudes are likely to change over time, in response to changes in the environment,

greater awareness of alternatives, and so forth.

4.15 Whatever the merits of using survey-based research, it may be noted that the recommendations of the NT Auditor-General have been overtaken by the initiatives of the Australian Accounting Research Foundation. In October 1989, the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation distributed a questionnaire to persons whose responsibilities encompass "the use, and/or analysis" of financial reports and/or governments as a whole. Respondents were asked the purposes for which they "require/use financial information", and a series of questions concerning what information they "desired/needed". Respondents were also asked whether they considered financial reporting would be "improved" by the adoption of "full accrual accounting" or "some form of accrual accounting".

4.16 The findings of this study have yet to be published, but it should not be expected that it will provide conclusive evidence on these various questions. Debate is likely to continue.

Recommendation:

That the Auditor-General's recommendation that a survey be conducted to determine the "information needs" of various users of government financial reports be not acted upon, in light of the fact that a similar exercise has recently been undertaken by the Australian Accounting Research Foundation.

5. ANNUAL REPORTING BY DEPARTMENTS

5.1 The Auditor-General's third recommendation in his 1989 annual report was:

that a review be undertaken to determine the adequacy or otherwise of current annual reporting methods by departments in terms of their appropriateness.

5.2 This recommendation follows earlier advocacy by the Auditor-General of changes in the form of financial reporting adopted by the NT government. In his 1987 and 1988 annual reports the Auditor-General advocated:

- * the preparation by departments of "general purpose" financial reports;
- * the introduction of requirements for departmental financial reports to be subject to audit;
- * the inclusion in departmental annual reports of narrative information on its operations, supported by relevant statistics; and
- * the preparation of consolidated statements for "whole of government".

Other comments by the Auditor-General may also be interpreted as recommending the use of "accrual accounting" in the financial statements of government departments (see 1988 Annual Report, p.49). Indeed, the practice of consolidation accounting, and the use of the term "general purpose financial reports", are both commonly associated with "accrual accounting".

5.3 The point could be made that the Auditor-General's recommendations are somewhat inconsistent. On the one hand, they suggest that surveys be undertaken to establish what information users of public sector financial reports would like to receive; on the other hand, they suggest that existing reporting practices are inadequate - a judgment which may be based on (unstated) assumptions about what information "users" want, or "should" receive.

5.4 The statements made by the Auditor-General about the desirable form and content of public sector financial reports are similar to views expressed in draft statements issued by the Australian Accounting Research Foundation (see in particular, "Proposed statements of accounting concepts", ED 41A-D, December 1987). Similarly, some major accounting firms have actively campaigned for government departments (or the "budget sector") to change their accounting from a "cash" to an "accrual" basis.

5.5 It would not be appropriate to canvass in detail the merits of arguments about the use of accrual accounting, common accounting standards, or reporting for "whole of government" within this report. However some brief observations on the general trend in the debate about public sector accounting are offered:

- * advocacy of the application of "accrual accounting" to the public sector is a comparatively recent phenomenon. As recently as 1974 the Australian Society of Accountants recommended that the state of Queensland retain the use of cash-based accounting, arguing that "where the determination of profit is not central to the accounting function, but rather the control of expenditure is against cash budgets (parliamentary appropriations) we see no particular need to introduce the complication of accrual accounting. It would not bring any greater clarity to the public accounts, nor would it add to public understanding of the transactions that they portray" (quoted in Sewell, 1979).
- * some of the early proponents of the adoption of accrual accounting in the public sector argued that accrual accounting should replace cash-based accounting. Those arguments are rarely heard nowadays. Rather, it is recognised that accrual accounting and cash-based accounting operate in tandem, since the use of cash-based accounting is an essential component of current accountability arrangements whereby parliament allocates funds for particular purposes each year, and later is advised how those funds have been expended.
- * the proposals by the accounting profession's Australian Accounting Research Foundation for the introduction of common accounting standards for both the public and the private sectors are not accepted in other countries. Recently the profession's stance on that issue has softened somewhat; claims about the need for "common standards", are now restated as statements about the desirability of having a "common series of standards" - and an acknowledgment that there may be a case for "additional specific industry standards" (see, e.g., Carpenter, 1990).
- * the view that all public sector entities should prepare financial statements on an accrual basis has been accepted in principle by the state of New South Wales, and by the government of New Zealand, but does not appear to have found favour in other countries. Even then, NSW is in the process of implementing a form of accrual accounting which is not consistent with that advocated by some elements of the accounting profession (particularly in relation to the treatment of "community" or "heritage" assets). It might also be noted that the accounting profession's Public Sector Accounting Standards Board has yet to produce accounting standards relating to the identification and valuation of "assets" and "liabilities" in the public sector context.
- * the suggestion that consolidated income and expenditure statements and consolidated balance sheets should be prepared to encompass "whole of government" has likewise not been widely accepted; moreover there are no settled views about how those accounts are to be prepared. Among

the Australian states, New South Wales and South Australia have set out to prepare consolidated statements covering the whole of government. NSW claims to have published "the most comprehensive" consolidated financial statements by any government in the world. Even then, the government has not prepared a single set of consolidated statements covering "whole of government". Since NSW government departments currently prepare accounts on a (modified) cash basis while NSW statutory authorities use accrual accounting, the government has been forced to prepare not one but two sets of consolidated statements: separately consolidating the financial statements of departments, and the financial statements of statutory authorities.

5.6 A recent editorial in the US research journal Accounting Horizons by R.K. Mautz reflects the current state of the game. Writing to an audience of accountants, Mautz suggested that all private-sector accounting techniques were not readily transferable to the public sector:

We accountants are so indoctrinated with the idea of matching revenue and expense that we have difficulty in believing that a similar matching is not appropriate for any organization that receives and expends resources. But matching, properly understood, does not relate only to income measurement. Matching is a reporting concept that includes associating related information in financial statements in the most informative way feasible. In the balance sheet we match current assets with current liabilities because they have a certain relationship to one another. There are data related to not-for-profit organizations that can appropriately be matched and otherwise assembled and presented, but that does not mean we must have a statement of operations and a balance sheet to emulate for-profit accounting as closely as possible.

For any number of reasons, we have difficulty even conceiving of financial statements that do not include an articulated balance sheet and statement of income. Somehow it seems like an assault on the double entry system itself. Perhaps that is why we have such difficulty in visualizing financial statements that appropriately take into account the differences between profit-making enterprises and not-for-profit organizations (Mautz, 1988).

Certainly some public-sector managers argue that private-sector notions of presenting a balance sheet showing "assets" and "liabilities" may not generate information that is relevant to the decisions faced by readers of public-sector reports - and may indeed convey a misleading impression of the capacity of public sector organizations to meet emerging financial commitments. There seems to be an acceptance that disclosure of data about liabilities (in schedules supplementing cash-based accounting reports) may provide useful information about the financial obligations incurred by government departments. Likewise, disclosure of information about certain assets (particularly

those representing claims to cash, or other items which are readily marketable) is also widely regarded as providing some relevant information. On the other hand, there is less agreement about the utility of reporting asset valuations obtained from other accrual-based accounting techniques: such as the depreciated cost of roads, bridges and other infrastructure assets. Furthermore, some question the significance of the results of combining these disparate items in an overall "balance sheet" for individual (or all) government departments.

5.7 The general point to emerge from current debate about public sector financial reporting, is that as yet there is little agreement as to what forms of financial reporting are optimal for the public sector. It seems highly likely that the position adopted in draft statements issued by the Australian accounting profession will be modified in the light of comments on those draft statements, and in view of further investigations being undertaken by the Australian Accounting Research Foundation. In this connection, it is noted that the commonwealth and all state and territory treasuries have agreed to assist in funding projects on public sector financial reporting being presently undertaken by the Australian Accounting Research Foundation over the next three years (Carpenter, 1990, p.4).

Annual financial reporting

5.8 It has been the practice in the Territory for government departments to prepare and publish annual reports. However, as the Auditor-General has previously observed (in his 1988 Annual Report), there are no statutory requirements for those reports to include financial statements in those annual reports.

5.9 It should be recognised that certain NT departments have been obliged to include some financial information in their annual reports - not by statute, but in response to directions issued by the NT Treasury. Until recently, those Treasurer's Directions only prescribed the preparation of financial reports to reflect "operations of a manufacturing, trading, commercial or like activity conducted by a department". Otherwise, the inclusion of financial statements concerning other activities in departmental annual reports was voluntary. However, the Treasurer's Directions (1989, clause 24.7A) required all departments to provide a summary of moneys and public property written off during the financial year, and a summary of cases where the accountable officer had approved the waiver or remission of the right to recover moneys or property during the financial year.

5.10 That is not to say that (unaudited) financial information about the activities of departments has not been available in the Territory. The annual budget papers have provided considerable detail about the financial activities of government departments. The NT's Budget Paper No. 4 ("Detailed estimates") discloses historical information concerning:

- * outlays by programme;
- * outlays by line items (i.e. categories of expenditure).

Budget Paper No.4 also indicates the sources of funds used to finance those programmes.

5.11 It is noted that a report of the Public Accounts Committee tabled May 1989 included the following observation:

The absence of departmental financial statements in the form and content of the Treasurer's Annual Financial Statements does not provide the most desirable basis for management of the Territory's economy and review of that management by the Legislative Assembly.

The Committee's recommendations included the following:

Departmental financial statements be prepared as an integral part of departmental annual reports, in the form recommended by the Auditor-General and not as 'balance sheets'

Guidelines be developed along the lines proposed by the Under-Treasurer and as to be applied in the Northern Territory treasury, for the preparation of all departmental annual reports in the Treasury.

5.12 In August 1989 Treasury distributed a paper containing guidelines for departmental reports. The proposed format was adopted by the majority of departments, as indicated in the accompanying Table prepared by staff of Treasury.

DEPARTMENTAL FINANCIAL STATEMENTS FORMAT 1988/89

| STATEMENT | A-G | CM | ED | H&CS | DID | L&AS | L&H | L/A | LAW | M&E | OMBUD | POLICE | PIF | T&W | TRSY |
|--|-----|----|----|------|-----|------|-----|-----|-----|-----|-------|--------|-----|-----|------|
| 1. Expenditure by Activity and Program | Y | Y | N | Y | Y | Y | N | Y | Y | Y | N | N | Y | N | Y |
| 2. Budget Variations | Y | Y | N | N | N | Y | N | N | N | Y | N | N | Y | N | Y |
| 3. Receipts | Y | Y | Y | N | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y | Y |
| 4. Trust Account Transactions | Y | Y | N | N | Y | Y | N | N | Y | Y | N | N | Y | Y | Y |
| 5. Trust Account Descriptions | N | Y | N | N | Y | Y | N | N | Y | Y | N | N | Y | Y | Y |
| 6. Accounts Payable | Y | Y | N | Y | N | N | N | N | N | Y | N | N | Y | N | Y |
| 7. Accounts Receivable | Y | Y | N | Y | N | N | N | N | N | Y | N | N | Y | N | Y |
| 8. Employee Entitlements Outstanding | Y | Y | N | N | N | Y | N | N | N | Y | N | N | N | N | Y |
| 9. Write-offs and | Y | N | Y | Y | Y | N | N | N | Y | Y | N | Y | Y | Y | Y |

5.13 In May 1990 Treasury proposed that these guidelines be included within the Treasurer's Directions, and sought responses from departments about those proposals. Recently, Treasury announced revisions to the Treasurer's Directions to require the preparation of departmental financial statements (Treasury Circular, June 1990). The revised directions are set out below (after omitting references to appendices which illustrated the types of disclosures to be provided).

24.7 The Accountable Officer shall prepare departmental financial statements in accordance with Treasurer's Direction 24.8.

24.8 The Accountable Officer shall ensure that the Annual Report prepared under Section 22(1) of the Public Service Act includes the following:

(1) A statement of Expenditure by Activity and Program for Budget and Actual expenditure over the financial year.

* * *

(2) A statement of Budget Variations of expenditure by Activity, Source of Funds and Category of Cost for the financial year, each to disclose authorised variations in the following categories:-

i) Section 12(2) Transfers - administrative changes to departmental functions.

ii) Section 13(1)a) Transfers - allocation of savings to a division from another division.

iii) Section 13(a)b) Transfers - allocation of savings to a sub-division to another sub-division.

iv) Section 14(1) Issues - from Advance to the Treasurer.

* * *

(3) A statement of Receipts showing revenue from all sources.

* * *

(4) A statement of Trust Fund Transactions by Activity and Trust Account showing opening Balance, Receipts and Payments during the financial year, and closing Balance of all Trust Accounts operated by the Department.

* * *

(5) A description of the purposes of the individual Trust Accounts reported under Direction 24.8(4).

* * *

(6) A statement of Accounts Payable as at the end of the financial year, reported by Activity and Program, and showing two aged categories: 'under 30 days' and '30 days and over'; and Total Payable.

* * *

(7) A statement of Accounts Receivable as at the end of the financial year, reported by Activity and Program, and showing two aged categories: 'under 30 days', and '30 days and over'; and Total Receivables.

* * *

(8) A statement of Employee Entitlements Outstanding as at the end of the financial year, reported by the following categories:-

- i) Airfares
 - ii) Recreation Leave
 - iii) Long Service Leave, showing two categories (5 to 10 years service, and over 10 years service).
- A description of the Basis of Calculations used to arrive at the outstanding entitlements shall be shown.

* * *

(9) A statement of Write-offs and Waivers Authorised by the Accountable Officer Under Delegation Approved by the Treasurer for the Financial Year.

* * *

5.14 The following comments are offered about the type of financial reporting which will be required by departments in terms of the revised Treasurer's Directions:

- * the financial information to be provided is to be prepared on a cash basis - enabling comparisons to be made between budgetary appropriations and actual expenditures, while also recording trust fund transactions.
- * additional information which is to accompany the departmental financial reports will convey information about moneys receivable or payable. Further, information will continue to be required regarding write-offs and waivers. These reporting requirements may capture many of the supposed benefits of "accrual accounting" without requiring the introduction of additional records (in parallel to the existing cash-based recording system).
- * the requirement to disclose information about "write-offs" does not require disclosure of the basis of calculating the value of property "written off". Hence readers of departmental reports will be unable to assess whether the values written-off are historical cost, written down value, or estimates of the market values of the items.
- * the information to be supplied about accrued employee entitlements does not encompass accrued superannuation benefits, attributable to the past service of employees within individual departments. If a comprehensive "accrual accounting" system were to be applied on a department-by-department basis, then these obligations would be regarded as "liabilities".

The aggregate of accrued superannuation entitlements attributable to past service may be material. However in cases where there is considerable staff mobility between departments, the task of calculating the sum attributable to past service by cohorts of employees within individual departments would be fraught with difficulty, involving the adoption of many arbitrary assumptions. At the end of the day calculation of this information probably not produce information which is relevant to departmental managers - particularly since under current arrangements responsibility for meeting those payments rests with Treasury.

- * the prescribed disclosures will not reveal the extent to which departments have entered into contractual commitments to make outlays in future, but which would not be regarded as "accounts payable" (e.g. finance leases, or contractual arrangements regarding future capital expenditures). Nor, it might be added, would some of those items be regarded as accounting "liabilities" in terms of an accrual accounting system. However disclosure of such commitments by public companies and non-exempt proprietary companies is required in terms of the requirements of Schedule 7 of the Companies Act and Codes.
- * the prescribed disclosures do not require any descriptions nor listings of the "assets" held or controlled by departments.

Among proponents of an "accrual" system of accounting, the identification and measurement of "assets" is a matter of considerable controversy - particularly in relation to "heritage" assets (such as parks, monuments or the contents of museums), and items purchased with funds provided by special-purpose grants (such as commonwealth grants), or gifts.

Given the existing use of a cash-based accounting system, it would still be possible for department reports to include some information about "asset" items - and such disclosures would provide one form of indication of the scale of administrative responsibilities undertaken by some departments. It is noted that in Victoria, government departments provide narrative descriptions of "non-current assets".

5.15 The foregoing observations lead to several recommendations regarding the content of departmental financial statements.

Recommendations

That Treasury be asked to consider whether the Treasurer's Directions should be further expanded to require departmental financial reports to include:

- (a) more detailed guidelines concerning disclosure of liabilities and other financial commitments arising from departmental activities;
- (b) explanations as to the basis of attributing money values to properties "written off".
- (c) narrative descriptions of the major resources held, controlled or maintained by departments.

Other information in annual reports

5.16 It will be recalled that the Auditor-General's recommendation being considered in this section concerned "the adequacy or otherwise of current annual reporting methods by departments". This recommendation concerns more than the contents of "financial statements" and could encompass such matters as:

- * tabular displays of financial and other information (e.g. in the form of key indicators of performance about major programmes); and
- * reports in narrative form concerning key departmental activities, policies regarding equal employment, staff training, etc.

5.17 The Auditor-General's comments should be read in conjunction with comments and recommendations in his earlier reports, notably the following extract from the 1988 Annual Report:

Operational Reporting

Financial reporting, no matter how comprehensive and how informative, does not provide the total picture of an entity's performance. Reporting, to be effective, has to include narrative information on a department's operations and be supported by relevant statistics.

A majority of States now require fairly extensive and detailed reporting on operational aspects covering such matters as:

- * charter
- * aims and objectives
- * performance indicators
- * access
- * management and structure
- * summary review of operations
- * legal change
- * economic or other factors
- * management and activities
- * research and development
- * human resources
- * promotion

As an interim measure departments should follow readily available reference resources as to good annual reporting practices.

5.18 The basis of the above recommendation appears to be an appeal to the authority of practice in other jurisdictions. However that appeal to authority was not supported by a detailed analysis of the statutory or other requirements in other states, and it would not be fair to say that a majority of the states are prescribing disclosure of all the items listed by the Auditor-General. Furthermore, statutory prescription is not always matched by outcomes: since 1985 Western Australia has required departments to publish performance indicators, and for those data to be audited, but in practice, many departments have (in the view of the WA Auditor-General) been unable to "develop criteria

for the establishment of performance indicators" to the extent that they can be audited. The WA Auditor-General has recently recommended repeal of the requirements for the audit of performance indicators (Report of the Auditor General, 1990, Vol 1, p. 43).

5.19 While the NT Auditor-General has recommended that departments should follow "readily available references" concerning "good" annual reporting practices, much of that material is normative in tone and fails to make clear what assumptions are being made about the judgments being made by users of those reports, and what kinds of information are relevant to those judgments.

5.20 Further, the Auditor-General's report does not acknowledge that NT departments are presently, as a matter of course, reporting information about such matters as aims and objectives, management and departmental structure, and providing a summary review of their operations (which may incorporate descriptions of major factors occurring during the year under review).

5.21 Annual reports for Treasury and the following Departments were reviewed for 1989 (unless otherwise stated):

- Chief Minister
- Education (1988 report)
- Health and Community Services
- Industries and Development
- Lands and Housing
- Labour and Administrative Services
- Law
- Legislative Assembly
- Primary Industry and Fisheries
- Transport and Works

All provided indications of organisational structure, main activities, and all provided financial reports on activities - in many cases, disaggregated in terms of programmes. It would therefore seem that, in practice, the Territory's Departments have been providing detailed and informative reports, in the absence of statutory prescription. There may be some minor variations in approach but parliament must consider whether tightly regulating the form and content of those reports will inhibit innovation and experimentation in departmental reporting.

5.22 It may be of interest to note that in the commonwealth, where guidelines for departmental reporting were produced by the Commonwealth Joint Committee on Publications ("Annual reports of commonwealth departments and authorities") as long ago as 1979, concerns are still expressed about reporting practices. A recent report from the Senate Standing Committee on Finance and Public Administration, The timeliness and quality of annual reports (Canberra, 1989) expressed disappointment at the management of public reporting, and at the lack of timeliness of those reports, and the failure of many government entities to conform to regulations and guidelines. The lesson to be learned may be that the preparation of formal rules may be less effective in raising

the standard of departmental reporting than the continued interest (and oversight) of parliament.

Performance indicators

5.23 Not all Northern Territory departments are presently publishing performance indicators. In some cases, performance indicators are being published but they often only concern "processes" (e.g. the number of transactions processed, enquiries or clients handled, activities undertaken). Few of the reported performance indicators related "inputs" to "outputs" (so as to shed light on the efficiency with which certain operations are being conducted), or incorporated data which indicated the effectiveness of overall programmes.

5.24 It has been argued that formulation of performance targets by public sector managers provides a basis for the internal evaluation of performance. Moreover, publication of both target data, and data concerning actual performance, may provide a basis for readers of annual reports to assess the economy, efficiency and effectiveness with which public sector entities have operated.

5.25 An alternative view is that a preoccupation with the development of statements of objectives and associated performance indicators (and accounting-based assessments of financial performance) reflects a "managerialist" view of public administration (see, e.g. Bryson, 1987; Parker & Guthrie, 1990). In terms of what has been described as a "cult of managerialism", public servants may be caught up in the game of demonstrating that they are effective managers - at the expense of devoting time and attention to managing the delivery of services. Some argue that this preoccupation creates winners and losers: the winners being those who know how to play the game, the losers sometimes being persons who have concentrated on the delivery of services.

The introduction of requirements for the publication of performance indicators may lead to conflicts of interest as both managers and ministers seek to publish only those figures which indicate "good" performance, while suppressing those which suggest "poor" performance. It is sometimes suggested that requirements for public sector entities to publish performance indicators which are linked with stated objectives can distort resource allocation, lead to a diminution of the quality of service delivery in some areas, and lead to some "dysfunctional" consequences.

5.26 There is much to be said for both views about the usefulness and use of performance indicators. Overall it may be better for readers of financial reports to have access to some performance indicators relating to major areas of activity and programmes (whatever the associated problems of interpretation) than to have no other guides to the performance of public sector entities. Publication of performance indicators - like "old age" - may not be very attractive until one considers the alternative.

5.27 However, the task of producing a set of performance indicators which would satisfy all potential readers of financial reports of an organisation is not to be underestimated. It is comparatively easy to identify several indicators relating to the economy and efficiency with which operations have been conducted. Even so, experience has suggested a tendency among public sector bodies to adopt one set of indicators for short periods of time, and abandon some of them (apparently because they suggest unfavourable performance) without explanation. Some governments now require explanations of the reasons for the abandonment of previously-reported indicators.

5.28 Performance indicators which enable assessments of effectiveness are more difficult to devise. To illustrate these difficulties, the following list of 12 "attributes" of management representations of effectiveness was proposed by the Canadian Comprehensive Auditing Foundation (1987):

- * management direction: the extent to which the objectives of an organization, its component programs or lines of business, and its employees, are clear, well-integrated and understood, and appropriately reflected in the organization's plans, structure, delegations of authority and decision-making processes
- * relevance: the extent to which a program or line of business continues to make sense in regard to the problems or conditions to which it is intended to respond
- * appropriateness: the extent to which the design of a program or its major components, and the level of effort being made, are logical in light of the specific objectives to be achieved
- * achievement of intended results: the extent to which goals and objectives have been realized
- * acceptance: the extent to which the constituencies or customers for whom a program or line of business is designed judge it to be satisfactory
- * secondary impacts: the extent to which other significant consequences, either intended or unintended and either positive or negative, have occurred
- * costs and productivity: the relationships among costs, inputs and outputs
- * responsiveness: an organization's ability to adapt to changes in such factors as markets, competition, available funding or technology
- * financial results: the matching of, and the accounting for, revenues and costs and the accounting for and valuation of assets, liabilities and equity
- * working environment: the extent to which the organization

provides an appropriate work atmosphere for its employees, provides appropriate opportunities for development and achievement, and promotes commitment, initiative and safety

- * protection of assets: the extent to which important assets - such as sources of supply, valuable property, key personnel, agreements, and important records or information - are safeguarded so that the organization is protected from the danger of losses that could threaten its success, credibility, continuity and, perhaps, its very existence
- * monitoring and reporting: the extent to which key matters pertaining to performance and organizational strength are identified, reported, and carefully monitored.

5.29 Even though some of the items in the above list would not be relevant to government departments (or all other public sector entities), a set of performance indicators which would satisfy the above list of "attributes" would be very extensive - and expensive to prepare. The Canadian Comprehensive Auditing Foundation insists that "information about only one or a few of these attributes is insufficient to allow governing bodies to form a balance judgment about the effectiveness of an organization" (p.23). It has proposed five basic "guidelines" to help managers develop representations of effectiveness:

1. All applicable attributes of effectiveness should be considered in making management representations and an explanation should be given where any attribute, otherwise expected, is not used.
2. Representations should reflect the full range of information generated in their preparation and contain whatever explanations or qualifications about the information and analysis that may be necessary to allow users to make informed judgments.
3. Representations should be prepared in such a way as to take into account the interests of governing bodies.
4. Representations should be made at the highest meaningful level, and to accomplish this top management must be involved in preparing them.
5. Each organization should establish a comprehensive strategy for reporting management representations on effectiveness over an agreed period of time (pp.25-7).

5.30 In view of the complexity of the task of designing and preparing indicators of the economy, efficiency and effectiveness with which departments have conducted their operations, the Committee is cautioned against giving uncritical or unquestioning support to proposals that performance indicators should be mandatory disclosures in the annual reports of government departments or statutory authorities, or that performance

indicators be "audited". The difficulties encountered in Western Australia should be salutary.

Recommendations

That the Committee suggest that the Treasurer's Directions should be further expanded so as to encourage departments to publish indicators of the economy, efficiency and effectiveness with which they have conducted their major programmes during a financial year.

Audit arrangements

5.31 According to an explanatory memorandum on the proposed Financial Administration and Audit legislation dated 8 May 1978 tabled by the then executive member for finance and planning, the 1978 Ordinance required the Auditor-General to audit:

- (a) the Public Accounts kept by the Treasurer and the Treasurer's Annual Statement and report thereon to the Assembly;
- (b) accounts kept by departments and non-prescribed statutory corporations and any related financial statements and report thereon to the responsible Minister who is required to table the report in the Assembly; and
- (c) accounts kept by prescribed financial corporations...

5.32 Similar requirements were incorporated in the Financial Administration and Audit Act (as in force 1 August 1989). In terms of this statute, the Auditor-General has a responsibility to audit the financial statements relating to "manufacturing, trading, commercial or other like activity" conducted within departments - but this will only arise where the Treasurer has directed that an accountable office prepare such accounts.

5.33 The Financial Administration and Audit Act followed earlier legislation in providing that the Auditor-General shall audit the Treasurer's Annual Statement. However the Act does not provide for the preparation of annual departmental financial statements, or for the audit of those statements by the Auditor-General.

5.34 The question arises as to whether the departmental financial statements now required to be prepared in terms of the June 1990 amendments to the Treasurer's Directions need be subject to audit. It would seem that those financial statements would not relate to

manufacturing, trading, commercial or other like activity

and as such would not have to be audited in terms of section 30

of the Financial Administration and Audit Act.

5.35 The further question arises as to whether it is desirable that the financial statements included within departmental annual reports should be subject to audit - given that reports based on the same data will later be audited as part of the Treasurer's Annual Statement.

5.36 It is noted that during 1989 the Auditor-General provided an audit report on the financial statements presented by the Department of Transport and Works. The form of opinion provided was as follows:

In my opinion the statements which have been prepared on the basis set out in Note 1 are in agreement with the accounts and records kept by the department in accordance with Part II of the Financial Administration and Audit Act.

5.37 The audit work required to enable the Auditor-General to express an opinion in this form, on financial statements prepared on a cash basis, should not be unduly time-consuming at year-end - assuming that audit-work had been undertaken progressively throughout the accounting period. Hence the audit of departmental financial statements should not delay the production of annual reports. Moreover, the addition of an audit opinion on departmental financial statements should provide greater assurance to readers about the accuracy and quality of that information.

5.38 In its Report No.3 (May 1988) the Public Accounts Committee expressed concern about "the accuracy of financial information relating to individual user departments...". It is understood that since the preparation of that report, the successful implementation of a new computerised accounting system has speeded up the process of account-preparation, so that the draft reports should be prepared in a timely fashion for presentation to the Auditor-General.

Recommendations

That the Public Accounts Committee endorse suggestions that departmental financial statements be subject to audit by the Auditor-General.

That the Public Accounts Committee seek legal advice as to whether any statutory amendments are necessary to require departmental financial statements to be subject to audit - or whether it would be sufficient to make further amendments to the Treasurer's Directions.

Treasurer's annual financial statements

5.39 Part of the brief from the Public Accounts Committee was to provide comments on "the form and content of the Treasurer's Annual Financial Statements".

5.40 Section 29 of the Financial Administration and Audit Act provides that:

(1) The Treasurer shall, as soon as practicable after the end of each financial year, prepare a full and particular statement in detail of the expenditure of the Consolidated Fund for the financial year last past and of the Trust Fund for that year under the several trust accounts of that Fund and also of the receipts of the Consolidated Fund and the Trust Fund and shall transmit such statement to the Auditor-General.

(2) The Treasurer shall cause a signed copy of the statements referred to in subsection (1), together with a signed copy of the Auditor-General's report under section 57, to be tabled in the Legislative Assembly within 6 sitting days after the receipt of the report by the Treasurer.

While (to accountants) the use of the term "expenditure" in the above clause might suggest that the statute requires the adoption of accrual accounting, the term "expenditure" is defined in section 3 as meaning "the payment of Territory moneys and includes an advance, transfer, set off or deduction made within the Public Accounts".

5.41 The Treasurer's Annual Statements comprise six separate statements (some with accompanying schedules) dealing with:

1. the Consolidated Fund
2. the Trust Fund
3. summary of funds and public account balances
4. ex gratia payments, write-offs, gifts of public property and waivers
5. borrowings and public debt
6. guarantees and contingent liabilities

The Annual Statements are prepared on the following basis:

Transactions are recorded on a cash basis, which recognises receipts and payments as they are made. No account is taken of accruals or prepayments, nor is there any differentiation in accounting treatment between capital and recurrent receipts or expenditure.

5.42 Public sector financial statements are often difficult to understand. Even some of the few parliamentarians in the country who are qualified accountants have commented (privately) that they find public-sector accounting reports somewhat bewildering. Of course, such comments may reflect the limited attention

devoted to public-sector accounting in the conventional curriculum - so that many qualified accountants have little knowledge of the features of "fund" accounting. But the comments may also indicate the difficulties faced by the majority of parliamentarians (and other interested parties) in interpreting the public accounts. (Of course, the same persons might experience difficulties interpreting private-sector accounting reports prepared on an "accrual basis").

5.43 One reason public sector financial reporting is complex and detailed is that the underlying phenomena are complex and involve a host of special-purpose grants and funding allocations which, under present arrangements for public-sector financial management and accountability, can only be spent in specified ways. The style of financial reporting is largely driven by acceptance of the view that persons allocated funds for specific purposes are accountable for the way they expend those moneys. Further, central agencies (such as Treasury) have a responsibility to maintain monitor and control the use of public funds. The format of Treasurers' annual financial statements (in the Territory and elsewhere) have evolved with regard to this overall objective of handling resource allocation and maintaining financial controls. Hence the statements set forth particulars of appropriations, authorised variations, final allocations and actual expenditures among departments; considerable detail is provided about budgeted and actual sources of receipts.

5.44 However the style of financial reporting which is appropriate for accountability relationships between departments and Treasury may not be the optimal way to communicate information to parliamentarians and other readers. Financial reports to these users may be more more readily interpretable if they included some general summaries of transactions during the period; they may be more informative if they were accompanied by explanations of major items of receipts and payments, and major variations between budgeted and actual expenditures.

5.45 The statement of the Consolidated Fund in the Treasurer's Annual Statements:

- * conveys some sense of the relative significance of the Territory's cash flows from commonwealth grants, local taxation, borrowings.
- * depicts comparisons between "estimates" of receipts, and actual receipts.
- * indicates the expenditures by departments or "divisions" and certain statutory authorities.

It should be recognised that the Annual Statements include features not always found in other states (e.g. Schedule 4 details ex gratia payments, write-offs, gifts of public property and waivers; Schedule 5 presents considerable detail about borrowings and public debt, and Schedule 6 lists "guarantees and contingent liabilities" - discussed further below).

5.46 However even to the serious reader some of the items contained in the Annual Statements may be difficult to understand, and warrant further explanations, perhaps by way of footnotes. For example:

- (i) while it is easy to accept that in cash-based financial statements, some receipts from Territory sources may be described as "other revenue", it is not clear why some of those receipts are said to represent "appropriations [from] former years", and are attributable to various departments. If they represent moneys appropriate but not spent in the previous year, they might have been better described as balances brought forward. CHECK
- (ii) there seems to be a case for greater disclosure of inter-fund transfers. The Consolidated Fund financial statements for 1988-89 reveal that there had been "Trust Fund Repayments" of \$1.9 million, but corresponding payments were not separately identified in the financial statements of the Trust Fund.
- (iii) while receipts from "borrowings" are readily understandable, the line-item "recovery of principal and interest" (\$44.3 million) is not. (From what entities were those sums recovered - and why?)

5.47 An appendix to the Consolidated Fund reports capital works undertaken in the current year - showing details about works "on which \$1m or more was spent", while categorising expenditure on "works less than \$1m" in terms of departments or agencies.

Arguably, readers of the financial statements interested in the pattern of expenditures on public works might find it more useful to have a summary, extending over several years, which indicated the expenditure on major categories of public works (such as roadworks, housing, hospitals, educational facilities, and police fire & emergency services). Disclosure in this form might not be relevant to current-year concerns with "control" and "accountability", but could provide a broader view of the manner in which expenditures have been allocated to particular areas over a period.

Recommendation

That Treasury give consideration to the inclusion within the Annual Statements of a five-year summary of payments for capital works, showing expenditure in terms of such categories as roadworks, housing, hospitals, educational facilities, police fire & emergency services, etc.

5.48 The Trust Fund

comprises those Trust Accounts ... established by the Treasurer under the Financial Administration and Audit Act, or certain other laws of the Territory, as accounts forming part of the Trust Fund

and is a repository for moneys which are not regarded as part of the "budget" for a particular period. In addition, other trust accounts are held "external to the Northern Territory Government Account".

5.49 While there may be good reasons (for control purposes) to separate funds appropriated for expenditure within the current year, and recurrent funds, the preparation of separate sets of financial statements adds to the difficulties of interpreting the public accounts. This difficulty is compounded by the fact that certain transactions take place through "Trust accounts external to the Northern Territory Government". Moreover (as noted in a following section) certain other activities may be undertaken through vehicles such as companies or trusts.

5.50 The Auditor-General has argued for the preparation of public-sector financial statements on an accrual basis, and for the preparation of a statement (or set of statements) depicting the activities of the "whole of government" - presumably also on an accrual basis. Yet arguments for this style of reporting for all areas of the public sector are far from conclusive: claims made about the supposed advantages of accrual accounting have not been clearly articulated (Walker, 1989); the basis upon which accrual accounting reports are to be prepared remained contested; and (perhaps more fundamentally) it is yet to be demonstrated that accrual accounting and whole-of-government consolidated statements would actually provide more relevant, and more readily interpretable information to the audiences those reports are supposed to serve. It is sometimes forgotten that individual investors in the private-sector are often bewildered by "accrual accounting" reports - particularly those reports have been prepared with the use of some "creative accounting".

5.51 If there is any consensus in debates about public-sector financial reporting, it is that cash-based reporting is here to stay. Likewise, in the private sector, the US accounting profession now prescribes the preparation of statements of cash flows for presentation in conjunction with accrual accounting reports (see the Financial Accounting Standards Board's accounting standard FAS 95, "Cash flow statements", 1989).

5.52 There is also some agreement about the desirability of presenting financial statements which provide an overview of activities within the public sector. Pending resolution of some of the more contentious issues concerning the application of accrual accounting to the public sector, there may be merit in considering some innovatory ways of preparing statements consolidating the affairs of government departments and the trust funds external to the government. Departments presently prepare financial statements on a cash basis, and the outcome of these transactions are prepared in the Annual Statements, in the form

of a statement of receipts and expenditure. Another way of presenting that data would be in the form of a cash flow statement, consolidating the financial statements of all departments. This may provide an overview of the data recorded in terms of existing cash-based accounting systems, and make both Annual Statements easier to interpret.

5.53 Similar observations could be made about the content of the quarterly statements provided to parliament in terms of the Financial Administration and Audit Act. Inclusion of quarterly cash-flow statements on a consolidated basis may provide a convenient overview of the public accounts for the benefit of parliamentary readers. Given parliamentary concerns about the phenomenon of "year-end spending", the presentation of quarterly cash flow statements might also provide some insights not available from reports prepared on an annual basis.

Recommendations:

That Treasury give consideration to the inclusion within the Treasurer's Annual Statements of explanations of such matters as "appropriations [from] former years", the basis of inter-fund transfers, and "recovery of principal and interest".

That Treasury give consideration to the inclusion within the Treasurer's Annual Statements of cash-flow statements depicting operating, financing and investing activities undertaken by the NT public sector. Consideration should be given to the preparation of cash flow statements encompassing the Consolidated Fund, the Trust Fund and trust accounts external to the NT government account (after eliminating inter-fund transfers).

That Treasury give consideration to the inclusion of cash flow statements in its quarterly reports to parliament.

5.51 The Treasurer's Annual Statements include a statement of "borrowings and public debt", and of "guarantees and contingent liabilities". Arguably, these disclosures are intended to indicate the amount and the due dates of financial commitments faced (or potentially faced) by the government. If so, it can also be argued that the information currently being disclosed in the Annual Statements provides only a partial representations of the Territory's present and emerging financial obligations.

5.52 Some significant financial obligations may have already been entered into but would not be reported in the current format of the Treasurer's Annual Statements:

- * employee entitlements for long service leave, recreation leave and travel;
- * accrued obligations to pay superannuation benefits;
- * finance leases;
- * commitments for capital expenditure.

5.53 The revised Treasurer's Directions (1990) requires that information about employee entitlements for long service leave & travel is to be disclosed in departmental financial statements, commencing for the year ended 30 June 1990. It should be feasible to disclose the aggregate of these commitments for the whole of the budget sector.

5.54 As already noted, the Treasurer's Directions (1990) do not as yet incorporate similar requirements for the disclosure of accrued entitlements for superannuation; it was also suggested that, with a workforce shifting between departments it may not be practical to make such calculations on a departmental basis. However Treasury has been monitoring these emerging commitments, and data about estimated accrued liabilities and projected cash commitments to meet superannuation obligations was supplied to the Public Accounts Committee in connection with its concurrent enquiry into "guarantees and contingent liabilities". The following data are indicated. It should be noted that these estimates were calculated in November 1988, and have been updated by converting the estimates into June 1989 prices - and as such understate the liabilities and projected cash flows in 1990 dollars.

NT public sector superannuation

| | 1989/90 | 1990/91 | 1991/92 | 1992/93 | 1993/94 |
|---|---------|---------|---------|---------|---------|
| | \$M | \$M | \$M | \$M | \$M |
| Accrued liability (30 June) | 324.0 | 399.0 | 475.0 | 551.0 | 627.0 |
| Source of projected cash flows to meet emerging commitments | | | | | |
| NT Authorities | 8.6 | 8.6 | 8.6 | 8.6 | 8.6 |
| Other* | 1.3 | 2.6 | 5.5 | 8.6 | 10.8 |
| Total | 9.9 | 11.2 | 14.1 | 17.2 | 19.4 |

* Comprises net transfers from the Employers Superannuation Trust Fund and appropriations from the Consolidated Fund.

5.55 A (simplified) commentary may aid interpretation. The estimated accrued liability for superannuation commitments at 30 June 1990 was \$324 million (in 1989 prices). This is a "present value" calculation rather than a simple fraction of the amounts expected to be paid out in due course. The other estimates of

accrued liabilities in that row (i.e. at 30 June 1991, 1992, 1993 and 1994) increase partly because by those dates additional years of employee service will have meant that public sector employees will have "earned" additional entitlements to superannuation.

5.56 The projected cash outlays show a steeply-increasing burden on the budget sector: with projected cash rising from \$1.3 million in 1990 to \$10.8 million within four years. Again, it is stressed that these estimates are in terms of 1989 prices; the actual cash outlays in those years will be in greater. Of course, one can also expect to find that Territory revenues and grants from commonwealth sources will also increase over this period.

5.57 The scale of emerging superannuation commitments suggests that there may be merit in including updated estimates in future editions of the Treasurer's Annual Statements.

5.58 The Territory has incurred some financial obligations through entering into leases, and other financing arrangements - described in Statement 6 of the Annual Statements. While other governments in Australia have entered into similar financing arrangements, particulars have not always been publicly disclosed.

5.59 On the basis of the descriptions provided, it appears that some of the Territory's obligations may represent "actual", rather than "contingent", liabilities - though it is uncertain whether the quantum of all of these "liabilities" can be accurately estimated. Further, as indicated above, some of these commitments are not "liabilities" since the counter-party has yet to perform a service or provide other consideration.

5.60 Accordingly, certain of these obligations should not be regarded in the same light as "borrowings" or "accounts payable". Nevertheless, as was argued above, certain readers of public sector financial statements may well wish to ascertain the amounts and due dates of financial commitments faced by the government. For similar reasons, companies operating in the private sector are required to provide notes to the financial statements describing "commitments for expenditure". Clause 21 of Schedule 7 of the NT Companies Code require the inclusion in notes to the accounts of "commitments for expenditure", subdivided into types of expenditure which are "material", and showing

the aggregate amount of that type of commitment for expenditure that is payable-

- (a) not later than one year;
- (b) later than one year but not later than 2 years;
- (c) later than 2 years but not later than 5 years;
- (d) later than 5 years,

after the end of that financial period.

5.60 It is suggested that the uniform presentation of various "commitments for expenditure" may make Statement 6 of the Treasurer's Annual Statements more informative.

Recommendations:

That Treasury give consideration to expanding the content of Statement 6 "Guarantees and contingent liabilities" to encompass "Liabilities, commitments for expenditure and contingent liabilities".

That consideration be given to the presentation in the Annual Statements of information concerning "liabilities" and "commitments for expenditure" in the form required by clause 21 of Schedule 7 of the NT Companies Code.

6. ACCOUNTABILITY OF NT CORPORATIONS

6.1 The Auditor-General's fourth recommendation was:

That a review be undertaken as to the adequacy or otherwise of the accountability and reporting arrangements which exist in respect of government-owned companies, corporations, trusts, etc.

The review should include consideration of such aspects as:

- (a) the processes for the creation or acquisition of such entities;
- (b) statutory reporting requirements; and
- (c) whether the Auditor-General should have an involvement in the audit function of those entities.

6.2 Parts of this recommendation were later amplified by the Auditor-General when he proposed use of standard-format financial statements of government-owned companies and other public sector corporations and trusts ("Model financial statements for Northern Territory Corporations", February 1990).

6.3 It should be noted that "government-owned companies" are only a sub-set of a larger group of entities: public sector corporations. Companies may be formed by a simple process of incorporation in terms of the NT Companies Code. The Companies Codes define different classes of company (e.g. public, proprietary, exempt proprietary, borrowing corporations, listed companies) and specifies different requirements for the financial reporting and audit of companies belonging to each of those classes. The term "corporation" is also applied to bodies formed by or in the light of other statutory instruments. Statutory authorities, local government councils, community government councils, school councils are all NT "public sector corporations".

6.4 This part of the report deals with government-owned companies and prescribed statutory corporations. Section 7 discusses arrangements for financial reporting by educational corporations, local government councils, community government councils - together with superannuation funds (which the Auditor-General suggested should also use the "model financial statements" proposed in the February 1990 report).

6.5 As the Auditor-General suggested, there has been fairly extensive debate about the use of government-owned companies elsewhere in Australia. The main outcome of this debate has been greater awareness of the fact that use of the vehicle of a company, incorporated in terms of the Companies Act and Codes, places an activity under a different regime of accountability than would have been the case had that activity been operated as a statutory authority, or within a government department. There are differences in:

- * the powers of managers to enter into financial transactions, or provide guarantees and indemnities;
- * requirements for the content of financial reports;
- * the distribution of financial reports;
- * the type of audit conducted (e.g. whether an audit is concerned only with providing an opinion on the financial statements, or whether it is concerned with assessing the adequacy of financial controls, whether the entity had complied with all relevant laws and regulations, or with assessing the economy, efficiency and effectiveness with which an organisation has conducted its activities);
- * the distribution of reports of the findings of an audit (i.e. which parties would receive reports on various phases of an auditor's activities).

6.6 However there is as yet no overall consensus as to what set of accountability arrangements may be appropriate for government-owned companies. This may reflect a belief that the arrangements which suit a public service of the scale of (say) the commonwealth, may not be appropriate in a public service of a small state or territory. Disagreements also reflect ideological differences about whether the public sector has a role in business activities.

Why do governments conduct activities through companies?

6.7 Why use a company to conduct public-sector activities? Various commentators have suggested the following advantages:

- * to avoid red tape, and to enable the public sector to quickly establish the means to own property, borrow moneys, and conduct business operations;
- * to permit classes of executives to be remunerated at levels in excess of those available to public servants, generally;
- * as an administrative convenience - to enable certain activities to be conducted as discrete activities, which can be administered in a decentralised fashion more efficiently than if they were part of the overall operations of a government department. For example, universities or colleges have formed corporations to establish residential accommodation for students, or to conduct consulting or research activities, as an ancillary operation to the major functions of teaching and research;
- * as a prelude to the privatisation of government business enterprises - whereby government business activities are transferred to a corporation, some or all of the shares in which are later to be offered to the public;
- * as a way of ensuring business privacy for certain ventures (e.g. candidates for privatisation) - so as not to

prejudice future commercial negotiations;

- * as a convenient means of conducting joint-venture operations with private investors for the purpose of developing public facilities;
- * as a means of investing moneys contributed by public employees to superannuation schemes (e.g. some superannuation schemes invest in property, often in conjunction with a private-sector developer, and undertake that investment through the medium of a company, trust or joint venture);
- * as a means of widening the funding base of a region (e.g. while the states or territories are restricted by Loans Council agreements from borrowing more than a designated amount, some may secure additional funding through a limited liability company);
- * as a means of attracting relatively cheap finance - enabling private sector enterprises to invest funds in a tax-effective way (N.B. similar considerations may apply to the use of trusts).

Concerns expressed about the use of corporations

6.8 Critics have raised the following issues

- * managers of a corporation established by a government department may have greater powers than managers of the department, as established by statutes which have been reviewed by Parliament;
- * the use of the corporate form may place certain financial activities beyond the scrutiny of an Auditor-General - unless the Auditor-General is appointed auditor, or is empowered to employ private-sector auditors under contract;
- * if the audit of a company is limited to that required in terms of the Companies Code, or as prescribed by the profession's Auditing Standards, the auditors' report may merely express an opinion on financial information contained in the company's financial statements - whereas an auditor's report on the activities of government departments or statutory authorities may deal with a wider range of issues (depending in part upon the requirements for audit contained in particular legislation, or how an Auditor-General chooses to exercise his powers to report to parliament);

(In particular, public-sector auditors have placed far greater emphasis on reporting publicly about weaknesses identified in internal controls, or findings that a public-sector entity has failed to comply with relevant laws or regulations or has undertaken illegal activities. Currently some steps are being taken to widen the responsibilities of private-sector auditors in these

areas).

- * the use of exempt proprietary companies may place the financial affairs of particular government activities completely beyond public scrutiny - since exempt proprietary companies which have appointed auditors are not required to place any financial information on the public record;
- * parliament may not be informed as to the activities of government-owned companies since their financial reports are addressed to shareholders (who may be public servants, as nominees for the beneficial owners) and there may be no requirement for those reports to be transmitted to parliament;
- * even if companies were required to file financial information and audit reports with parliament, the proliferation of the use of companies leads to a large number of annual reports being prepared - and the volume and complexity of this data may make it difficult for interested parties to obtain a sense of how governments are conducting their financial affairs.

Developments elsewhere

6.9 A brief survey of some recent parliamentary reviews of the use of companies (and other observations by auditors-general) may indicate the kinds of concerns which have been raised elsewhere.

6.10 It is not suggested that the following review is comprehensive - but it may be sufficient to highlight some of the main areas of concern (and differences of opinion about the kind of accountability arrangements that are appropriate in order to strike a balance between on the one hand, a desire for some type or level of accountability, and on the other, a concern to maintain the confidentiality of commercially-sensitive information).

New South Wales

6.11 In NSW the government recently introduced legislation (the State Owned Corporations Act, 1989) which establishes new accountability arrangements for government-owned entities; a company limited by shares will become a state-owned corporation (SOC) by having its name inserted in a schedule to the Act by subsequent legislation.

6.12 SOC's will be obliged to table a statement of "corporate intent" setting out their main undertakings, the nature and scope of their activities, statements of accounting policies and performance targets. Later they are to table six-monthly reports, which detail actual performance against targets for the half-year.

6.13 The NSW Auditor-General is to be the auditor of SOC's, and annual reports are to include a report from the Auditor-General

on the accounts. The financial statements are to conform to the requirements of the NSW Companies Code, although the legislation does not specify whether the relevant requirements are those applicable to (say) exempt proprietary companies, or listed public companies.

6.14 The NSW legislation specifies that the Auditor-General is to have all the powers of an auditor under the Companies Code. "Compliance" and "regularity" auditing is those not required, through the Auditor-General is empowered to make special reports "on any matter arising from audit which in the opinion of the Auditor-General should be brought to the attention of Parliament".

Commonwealth:

6.15 The Joint Committee of Public Accounts in its Report 296, The Auditor-General: Ally of the Parliament and the People (1989) offered the following observations:

The implications for accountability to Parliament of the audit of a government instrumentality being conducted under the Companies Code rather than the Audit Act are as follows:

(a) no requirement of the minister to table in Parliament the instrumentality's annual financial statements and the audit report on the financial statements;

(b) if government enterprises are incorporated as exempt proprietary companies there may not be any public disclosure of financial information;

(c) elimination of any vehicle for the auditor to report to Parliament except where the Auditor-General has dual appointment;

(d) Parliament will no longer receive reports on waste, misappropriation, lax management or inefficiency within government enterprises as a matter of course. Even ministers may not receive such information;

(e) Parliament will be less likely to receive reports on whether Commonwealth bodies have broken their own legislation or other laws

6.16 Other comments concerned the practice whereby certain audits were being put to tender. The Joint Committee of Public Accounts recommended that the Auditor-General be "reinstated" as external auditor of statutory marketing authorities and government business enterprises (for which recent legislation had permitted the appointment of private-sector audit firms). The Committee also recommended that the commonwealth Audit Act 1901 be amended to require the Auditor-General to be appointed the external auditor of all government companies - though the Auditor-General "may decide to contract a private sector auditor to undertake the

audit on the Auditor-General's behalf".

* * *

6.17 In 1989 the Senate Standing Committee on Finance and Public Administration issued Government companies and their reporting requirements which recommended inter alia:

- * the establishment of a central register of companies and incorporated associations which the Commonwealth controls or in which it has a substantial interest;
- * that no direct interest in a company be established without legislative authority - either in the form of an enabling act, or in the form of a government companies act specifying procedures "which will ensure proper accountability";
- * that each department be required to list, in its annual report, all companies and incorporated associations within its minister's portfolio (encompassing all companies in which the commonwealth holds 20% or more of the capital; companies limited by guarantee and incorporated associations in which the commonwealth is a member or guarantor;
- * that the general provisions for formation, reporting, audit and disposal of government companies be set out in a Government Companies Act;
- * that no government company be incorporated so as to be eligible for exempt proprietary status; and that action be taken to convert to public company status all existing directly owned government proprietary companies;
- * that all government companies which are not subsidiaries of other government companies or statutory authorities should conform to the financial reporting requirements applying to statutory authorities;
- * that a statutory requirement be introduced for the annual reports of all directly-owned government companies to be tabled in Parliament;
- * that all government companies be audited in accordance with the requirements of the Audit Act as well as those of the Companies Code;
- * that all commonwealth undertakings, whatever their legal form, should be audited by the Commonwealth Auditor-General (though this would not rule out the use of private auditors under contract to the Australian National Audit Office).

Western Australia:

6.18 The WA Commission on Accountability recommended restrictions on the use of partnerships or limited liability companies by government (p.23), arguing that "accountability and public scrutiny cannot be satisfactorily achieved" under such arrangements:

The Companies Code now gives companies the rights, the powers and the privileges of a natural person. This allows a company to change direction at will. It can readily move from one activity to another or from one industry to another. Its responsibilities can change overnight on the decision of the directors. Such unbridled flexibility can operate so as to outflank Parliamentary control (p.23).

However it expressed the view that if government was to use such vehicles, then recognition must be given to two levels of accountability, namely:

- * accountability to a Minister of the Crown as the first-line legal owner; and
- * accountability through and by the Minister to the Parliament representing the interests of the electors, the ultimate owners from whom the resources have been drawn upon or put a risk to undertake that venture.

To quote from the report:

Greater access to information is likely for this purpose than is normally provided to shareholders as owners.

Companies are reporting to shareholders who have invested voluntarily and who can exercise a choice to realise upon their investment. Government is reporting to persons who have compulsorily acquired resources and who are 'locked-in'. The standard required in the latter case should be no less than the standard prescribed in the Financial Administration and Audit Act and Treasurer's Instructions (pp. 17-18).

The Committee recommended that the Auditor General

be responsible for the audit of all government agencies and the Financial Administration and Audit Act be amended for the Auditor General to be the auditor of each subsidiary or related body, notwithstanding the Companies (Western Australia) Code provisions relating to the appointment of an auditor. Where a subsidiary company is incorporated outside Western Australia, the departments and statutory authorities should be required to exercise their voting rights to appoint as auditor a person nominated by the Auditor General and the appointee shall, in addition to the audit requirements under the statute of the jurisdiction in which it is incorporated, perform such other audits and/or

examination as the Auditor General may direct (pp. 23-4).

It also recommended that

comprehensive Treasurer's Instructions be issued on the reports, financial statements and performance indicators of subsidiary and related bodies and the "parent" department or statutory authority (p.24).

Current arrangements for reporting by companies owned or controlled by the NT government

6.19 It appears that there are no formal restrictions on the formation of companies within the NT public sector. Published reports make several references to the use of government-owned companies:

- * The Treasurer's Annual Statements disclose that, of the total balances of the Consolidated Fund, Trust Fund and Trust accounts external to the government account (\$180.7 million), \$50 million is held in a "long term investment in Investnorth Limited". The statements also disclose that

the Territory has agreed to advance funds to a government related Company to meet the Company's net financial obligations as they fall due. Any amounts paid by the Territory under this agreement shall constitute an interest bearing loan, repayable on demand. The Company's outstanding external obligations as at 30 June 1989 totalled \$28 million (p.56).

- * The Annual statements also disclose (in connection with guarantees provided in relation to the Amadeus Basin to Darwin Gas Pipeline) that "the Territory has guaranteed the gas producers in support of the obligations of a subsidiary company of the [Power and Water] Authority under purchase contracts. As at 30 June 1989, the balance of the contract to supply gas to the pipeline totalled \$81.9 million in NVP (sic) terms".
- * The audited financial statements of the Power and Water Authority show that "investments in subsidiary companies" are recorded in the Authority's own accounts at cost (which evidently is less than \$1,000). Notes to the accounts report that at 30 June 1989 the Authority had two subsidiary companies, Darnor Pty Ltd and Gasgo Pty Ltd. The Authority has also made additional investments through these subsidiaries in the Amadeus Gas Trust, and in NT Gas Pty Ltd (see 1989 Annual Report of the Power and Water Authority, pp.52, 60-1).
- * The Auditor-General's 1989 Report upon public sector corporations discloses that the Auditor-General conducts the audit of two government-owned companies: Droving Australia Pty Ltd and Vico Pty Ltd (p.7).

6.20 The Senate Standing Committee on Finance and Public Administration has suggested that three criteria should be present before a government entity is incorporated: "competition with the private sector, no explicit social objectives and a strong commercial culture" (1989, clause 4.4.2). Further, it argued that a further test should be applied in the event of company status being considered in future:

that a company structure will result in clearly identified efficiencies and/or other benefits which cannot be obtained without recourse to that structure (1989, clause 4.4.3).

Government-owned companies have been used in the course of promoting developments considered beneficial to the local economy (e.g. tourism facilities, gas distribution), with the aim of obtaining benefits of the type listed above.

6.21 In his 1989 Report upon public sector corporations the Auditor-General expressed concern that

some corporations such as those managing tourism infrastructure support are not required to report upon financial operations to the Legislative Assembly. In respect of these entities there is no requirement for the Auditor-General to have any knowledge of their operations and thus he cannot assist the Legislative Assembly.

However, compared with practices adopted by some other Australian governments, the accountability relationships regarding the use in the Territory of government-owned or controlled companies appear to be relatively open. While there are no formal requirements for the financial statements of these corporations to be placed on the public record, parliamentarians have had open access to those financial statements during reviews by the Public Accounts Committee of the Territory government's "guarantees and contingent liabilities".

6.22 It was noted earlier in this report that different factors might affect accountability relationships between executive government and Parliament (and hence the community):

- (i) Some government-owned or controlled companies are formed as "exempt proprietary companies" which do not have to place financial statements on the public record. Other investments occur through trusts (which similarly are not obliged to place financial information on the public record).

(It is acknowledged that there are sound commercial reasons for the maintenance of some level of business privacy. As noted above, government has made available financial information concerning at least some of these enterprises to parliamentary committees).

- (ii) Departments are presently not obliged to disclose the existence of "subsidiary" companies in their annual reports. It is possible that public sector activities may be conducted through companies, without parliament having any awareness of their existence. (This is not to suggest that the government has in fact formed or acquired companies without any public disclosure).
- (iii) The Auditor-General does not audit the accounts of government-owned or controlled companies or trusts. This leads to the situation in which the Auditor-General is not in a position to maintain oversight over the whole spectrum of public sector financial activities, and to report to Parliament about any matters of concern arising from those activities.
- (iv) The terms of audit engagements for companies would generally be limited to the conduct of an audit in terms of the requirements of the Companies Code - which means that (private-sector) auditors may not be reporting publicly on such matters as whether there has been compliance with laws or regulations.

Recommendations:

That the Auditor-General be established as the auditor of all government-owned or government-controlled companies or trusts - save that the Auditor-General may contract-out such audit work to private-sector audit firms.

That Treasury be asked to consider revisions of the Treasurer's Directions so as to require Departments, and statutory authorities to include in their annual financial statements:

- (a) a list of subsidiary companies and trusts, and of other companies or trusts in which the Territory holds 20% or more of the shares or units;
- (b) a description of the principal activities of those companies or trusts.

Comparison with reporting requirements of prescribed statutory corporations

6.23 Under the Financial Administration and Audit Act, the Auditor-General may be appointed auditor of prescribed statutory corporations (PSCs). Earlier, the 1978 ordinance provided that the Auditor-General would be the auditor of prescribed statutory corporations. The explanatory memorandum also indicated that

where the Territory has some interest in or makes moneys available to a body which is neither a department or a statutory corporation the Auditor-General may at the request of a Minister and with the agreement of the body, audit the accounts of that body.

As noted earlier, not every government-owned company is a "prescribed" statutory corporation.

6.24 In June 1986, the then Treasurer determined that the financial statements of a PSC should include:

- (a) An income and expenditure statement;
- (b) A balance sheet;
- (c) A statement of Sources and Application of Funds in the form of the Statement of Australian Accounting Standard (AAS12).
- (d) Notes to the accounts; and
- (e) A certificate signed by the Chairman/Chief Executive and one member of the governing body/council.

The Treasurer also determined that the financial statements should be prepared in accordance with generally accepted accounting standards including Australian Accounting Standards and the Ninth Schedule of the Companies Act. The Ninth Schedule of the Companies Act has subsequently been replaced by the Seventh schedule of the Companies (Northern Territory) Regulations.

6.25 In the revised version of Schedule 7, different forms of financial reporting are required of different classes of company. It appears that the current requirements for financial reporting by PSCs do not make clear which set of requirements in Schedule 7 requirements are relevant.

6.26 One approach would be to suggest that PSCs be subject to the requirements established in Schedule 7 for listed public companies. However the Ministerial Council for Companies and Securities agreed that most of Schedule 7 should be progressively transferred to "approved accounting standards"; and the NT Auditor-General has put forward a set of model financial statements for corporations - so the latter may (perhaps after some modest refinement) serve as a more appropriate set of guidelines for prescribed statutory corporations to follow in future.

Model financial statements for NT corporations

6.27 The Auditor-General's model financial statements constitute a set of "pro forma" reports which are said to illustrate how those corporations might comply with "legal and professional accounting requirements". The introduction to these materials explains that the pro-forma financial statements

have been prepared in accordance with accounting principles generally applied in commercial practice, the accounting standards and disclosure requirements of the Australian Accounting bodies and the provisions of Schedule 7 of the Companies (Northern Territory) Regulations.

6.28 Plainly the preparation of these pro-forma financial statements was intended as a constructive step to assist the staff of NT "corporations" in preparing their accounts, and in promoting uniformity in reporting practice. In many ways the model financial statements are similar to those prepared by major accounting firms as a guide to partners and staff (and to the staff of auditees) as to how reporting entities might comply with the requirements of the Companies Act and Codes, approved accounting standards issued by the Accounting Standards Review Board (ASRB), the accounting standards issued jointly by the Australian Society of Accountants and the Institute of Chartered Accountants in Australia, policy statements issued by the National Companies and Securities Commission, and also (where relevant) the listing rules of the Australian Stock Exchange.

6.29 However, the Auditor-General is suggesting that these pro-forma financial statements be adopted by all "public sector corporations" - where that term is used to encompass a wider range of public-sector entities than companies incorporated in terms of the Companies Code, or prescribed statutory corporations. To quote from his Report upon public sector corporations (February 1990):

For the purposes of this Report the term 'Public Sector Corporations' is applied to two types of bodies:

'Corporations' which encompasses those government entities which are not departments - examples are authorities, boards, commissions, educational corporations, superannuation funds and government owned companies; and

'Local Governments' which comprises the six local government councils.

6.30 The implication is that all such bodies should adopt a form of "accrual accounting" in the form advocated by the accounting profession's standards, and should follow a format for their reports which is based on the accounting rules contained in the Companies Code and associated regulations. Admittedly, the Auditor-General's advocacy of the model financial statements is

qualified:

These statements are an illustrative example only and do not show the disclosure requirements for all possible situations. Those responsible should consult the accounting standards and Schedule 7 of the Companies (Northern Territory) Regulations to determine disclosure requirements for situations not covered by the model Northern Territory Corporation financial statements.

This Office wishes to emphasise that the model financial statements are not a 'standard requirement'. They are illustrative only and need to be applied flexibly having regard to the circumstances of each corporation and the specific requirements of the Treasurer (Feb 1990, p.2).

6.31 That comment seems to suggest that the model financial statements should be considered as establishing minimum requirements for financial reporting (so that entities subject to the Companies Code would be subject to more detailed requirements). Such observations understate the wide-ranging nature of the Auditor-General's proposals. His proposals imply:

- (i) that the accounting profession's accounting standards (many of which were developed in the private-sector to complement Companies Code requirements) should be applied to all public sector entities (including superannuation funds, local government councils, and commissions);
- (ii) the application of accrual accounting techniques (as implied by the use of Australian Accounting Standards) to a number of entities which currently prepare their accounts on a cash basis;

6.32 These proposals for the wider adoption of accrual accounting and the use of a set of model financial statements may be evaluated from a number of standpoints:

- (a) whether private sector standards are necessarily the appropriate way of accounting for all entities in the public sector - in the sense that they generate information which is relevant to users of public-sector financial reports;
- (b) whether adoption of the form of financial reporting being proposed would generate information which may be relevant to users of those reports;
- (c) whether the form of financial reporting being proposed is capable of implementation by the organisations which are supposed to use it;

Criteria (b) and (c) are used to evaluate the proposals in the sections which follow an initial consideration of the question posed in (a).

Are private sector accounting standards necessarily appropriate for all public sector entities?

6.33 It should be recognised that claims about the universal applicability of private sector accounting standards to the public sector are somewhat contentious. The author of this report has explored the arguments favouring 'common standards' in some detail (Walker, 1989); the following points may be worth mentioning here:

- * on the international scene, the Australian Accounting Research Foundation appears to be the only body which has actively promoted common accounting standards for the public and private sectors;
- * most of the arguments advanced in the professional or technical literature on this issue have tended to be based on unquestioned assumptions about the advantages to the community (and the accounting profession) if accounting standards for the public sector were to be established by the accounting profession - though even those arguments do not assume that those rules would necessarily be identical with the rules established for the private sector;
- * the argument that the same standards are applicable in both sectors has not followed from any analysis of the information needs of users of financial statements; it is merely assumed that the kind of information which is relevant to (say) the shareholders and creditors of a publicly-listed corporation is the same as the information which would be relevant to parliamentarians or taxpayers reviewing the activities of an organisation established to provide community services;
- * recent developments overseas have highlighted the controversial nature of claims that private-sector accounting standards should be automatically translated to the public sector. In the USA in particular, there has been substantial resistance to the mandatory application of rules produced by the private-sector's Financial Accounting Standards Board (FASB) to government and semi-government bodies.

A particular concern was the proposal that universities, hospitals and schools which received donations or grants which were earmarked for the construction of buildings should be required to "depreciate" those assets and simultaneously amortise the "grant" as an offsetting revenue item over the projected economic life of the asset so acquired. Such a treatment would have been mandatory in terms of the FASB's standard FAS 93 "Recognition of profit by not-for-profit organizations" (1987). The proposal was strongly criticised by some leading accountants as 'worthless bookkeeping'. The dispute was resolved when it was determined that the Government Accounting Standards Board (GASB) would remain in existence and that the GASB rather than the FASB would establish accounting standards for the entities at the centre of the dispute.

6.34 In short: proposals for the widespread adoption of accrual accounting in the form currently advocated by the Australian accounting profession are highly contentious. While the use of "accrual accounting" techniques may be improve financial reporting, the wholesale adoption of accrual accounting (and the abandonment of eexisting cash-based reporting methods) may not provide a net improvement. Certainly some commentators remain unconvinced that the use of full-scale accrual accounting is appropriate for the public sector. Indeed, the commonwealth does not yet employ full accrual accounting for its statutory authorities; nor does the commonwealth employ any form of accrual accounting for reporting by departments.

6.35 Perhaps the government most supportive of the use of accrual accounting is the current government in NSW, which has announced a commitment to introduce accrual accounting for all major government departments over the next five years. Even so, the NSW government has not adopted the accounting profession's standards for reporting by departments. Rather, it has prepared and issued its own guidelines for the recording of "community" assets. It is envisaged that parks, monuments, works of art and so forth may be recorded at the nominal value of \$1. To underline the controversy surrounding such topics, the Victorian Auditor-General has recently issued a series of audit qualifications on the financial statements of government enterprises which have not provided up-to-date valuations of the economic worth of community assets. In effect, practices which are advocated in NSW are the being the subject of audit qualifications in Victoria.

6.36 A more general point to be made is that no other Australian government has yet embraced the use of accrual accounting and the adoption of accounting profession's Australian Accounting Standards in such a wide-ranging manner as is being advocated by the NT Auditor-General.

The model financial statements - considered in detail

6.37 There are a number of points about the contents of the model financial statements which are either contentious, or which take positions on unsettled issues. The Public Accounts Committee and indeed the government may wish to consider these matters in more detail.

Note 1 Statement of significant accounting policies

6.38 This note paraphrases the requirement that prescribed statutory corporations must "keep proper accounts and records ... in accordance with the accounting principles generally applied in commercial practice". It then proceeds:

Therefore, the financial statements have been drawn up generally in accordance with the accounting standards and disclosure requirements of the Australian accounting bodies, applicable Approved Accounting Standards, the provisions of Schedule 7 to the Companies (Northern Territory) Regulations and the requirements of Law relating to public companies (emphasis added).

6.39 It was noted above that there are various sets of disclosure rules in Australian companies legislation and regulations: including those applicable to proprietary companies, those applicable to public companies, and those applicable to listed public companies. The legislation is silent about which level of disclosure is appropriate for a prescribed statutory corporation; the Auditor-General has taken a somewhat inconsistent position on that question (as explained below).

6.40 The wording of the statement of accounting policies deserves some polishing. The reference to the "accounting standards and disclosure requirements of the Australian accounting bodies" suggests there are two bodies of rules: standards and disclosure requirements. In fact the profession's "disclosure requirements" are embodied in the "standards". The statement that accounts have been prepared "generally in accordance with ... accounting standards" is unacceptably vague: either they have been prepared in accord with those standards, or they have not.

Note 1(b) Government appropriations and grants

6.41 The treatment advocated by the Auditor-General for the treatment of government appropriations and grants - and the assets acquired thereby - is one of the most contentious in public sector accounting.

6.42 According to the statement of accounting policies in the model financial statements:

Government appropriations and grants are recognised in the revenue and expense statement over the periods necessary to match them with the related costs which they are intended to compensate, on a systematic basis.

6.44 It also has to be said that the inclusion of this "accounting policy" within the model financial statements is hardly consistent with either the statement in the preamble of the report that the treatments adopted in the model financial statements are consistent with "professional accounting requirements". There are no Australian Accounting Standards (or guidance releases, technical bulletins, or recommendations on accounting practice) which support this particular accounting treatment. Indeed, the treatment of government grants as items of deferred revenue, to be brought to account over the estimated useful life of assets acquired with those funds, has no direct parallel in accounting for private sector commercial organisations.

6.45 Authority for this treatment is listed as IAS 20 - referring to International Accounting Standard 20 "Accounting for government grants and disclosure of government assistance (1983). The Australian accounting bodies agreed to support the International Accounting Standards Committee. However it can not be said that international accounting standards have any particular status in Australia. Nor has the profession given priority to the reissue of international standards in Australia as soon as is practicable. For example the IASC issued IAS 7 "Statement of Changes in Financial Position" in 1977 and it was not until 1983 that the Australian profession got around to reissuing that standard for domestic application. Likewise the IASC issued IAS 3 "Consolidated financial statements" in 1976; the local profession did not issue an equivalent standard until 1990.

6.46 As previously noted, controversy over this accounting treatment of government grants and assets acquired with government grants has been followed by placing certain public-sector activities under the authority of the US Government Accounting Standards Board, which does not require amortisation and depreciation in these circumstances.

Note 1(c) Property, plant and equipment

6.47 The contents of the note make no reference to whether current replacement prices constitute a ceiling to the amounts brought to account for property plant and equipment.

6.48 Schedule 7 of the Companies Code is to be read in conjunction with the provisions of subsection 269(7)(c) which places an obligation on directors

to ascertain whether any non-current asset is shown in the books of the company at an amount that, having regard to its value to the company as a going concern, exceeds the amount that it would have been reasonable for the company to expend to acquire that asset as at the end of the financial year and, unless adequate provision for writing down that asset is made, to cause to be included in the accounts such information and explanations as will prevent the accounts from being misleading by reason of the overstatement of the amount of that asset.

It would be desirable for the accounting policies of prescribed statutory corporations to adopt the same approach.

6.49 Mention has already been made of how the Companies Codes incorporate different sets of reporting requirements for different classes of company. One of the requirements for listed public companies (which does not apply to companies generally) is that they must report the "current values" of interests in land or buildings (by way of note if the current value is not the amount at which those assets are recorded in the accounts). "Current values" represent valuations no more than three years old.

6.50 The model financial statements do not include a similar specification for prescribed statutory corporations. On the contrary, it is reported that "The corporation does not have a policy of regular revaluation".

However the model financial statements include another disclosure rule - drawn from the set of disclosure rules in Schedule 7 which are only applicable to listed companies. No reasons were given for this apparent inconsistency in selecting from one or other set of rules.

Note 1(d) Depreciation and amortisation of fixed assets

6.51 The term "non-current assets" is now more commonly used - since it avoids ambiguity about the treatment of "intangibles" which are sometimes excluded from the class of items described as fixed assets.

It will be noted that the distinction between "current" and "non-current" items is adopted elsewhere in the model financial statements.

Note 20 Superannuation commitments

6.52 The model financial statements include the following description of accounting policies:

The Corporation contributes to the Northern Territory Government superannuation funds matching contributions to the fund made by employees. Employee contributions are based on various percentages of their gross salaries. After serving a qualifying period, all employees are entitled to benefits on retirement, disability or death.

The fund provides defined benefits based on years of service and final average salary. The Corporation is under no legal obligation to make up any shortfall in the fund's assets to meet payments due to employees.

An actuarial assessment of the fund as at 30 June 19x5

was carried out by Mr. E Actuary, FIAA, on 31 August 19x5. The assessment concluded that the assets of the fund are sufficient to meet all benefits payable in the compulsory termination of employment of each employee.

6.53 It must be acknowledged that the treatment implicitly advocated by the Auditor-General is consistent with the requirements of Schedule 7 of the Companies Code (as applicable to listed companies). For private-sector companies, estimates of the sums payable on termination of the employment of all employees may be of some concern to those employees - though such an event is likely to be associated with corporate failure, and in that event (depending upon the terms of the trust deed) such obligations may not crystallize of liabilities when the company goes into liquidation. However it is arguable whether information of the type proposed is relevant to the circumstances of public-sector entities. There is a reasonable expectation that governments would not allow statutory authorities or wholly-owned companies to fail to meet their obligations to creditors; correspondingly there is a reasonable expectation that governments would meet the superannuation commitments entered into by those entities.

6.54 Of greater relevance would be estimates of the present value of the unfunded liabilities for superannuation commitments that is attributable to the past service of employees of a statutory corporation.

6.55 NSW statutory authorities have been required to disclose these figures on the face of their balance sheet since 1986. The commonwealth Department of Finance has recently issued revised Guidelines for the form and standard of financial statements of commonwealth undertakings which will require disclosure by statutory authorities of such "unfunded liabilities" in financial statements for the year ended 30 June 1991.

Revenue and expense statements

6.56 Australian statutory requirements and accounting standards issued by the profession do not require disclosure of a great deal of detail in "revenue and expense statements". Items to be disclosed in terms of those rules include "operating revenue", "income from operations" - and particulars of only some detail about sources of revenues, and categories of expenses. It is noted that the model financial statements propose that public sector corporations provide information in greater detail - a proposal that is commended.

Summary

6.57 The model financial statements prepared by the Auditor-General should be of assistance to those charged with the preparation of financial statements for prescribed statutory corporations - and perhaps for government-owned companies as well. They also highlight some unresolved or contentious issues about the application of certain statutory or professional rules

to private-sector entities.

6.58 Currently the Financial Administration and Audit Act provides that prescribed statutory corporations shall prepare financial statements "in such form as the Treasurer approves" (section 68); as noted above, in 1986 the then Treasurer determined that the financial statements of a PSC should include an income and expenditure statement, balance sheet, a funds statement, and notes to the accounts - with the financial statements should being prepared in accordance with "generally accepted accounting standards including Australian Accounting Standards and the Ninth Schedule of the Companies Act".

6.59 Options for handling some of the contentious issues regarding accounting practices for financial reporting by public-sector financial corporations include:

- (i) expansion of the Treasurer's Directions relating to prescribed statutory corporations so as to incorporate additional guidance on financial reporting issues;
- (ii) the introduction of legislation along the lines of the NSW State Owned Corporations Act, but adapted for Northern Territory requirements, which establishes accountability arrangements for all public sector corporations (both prescribed statutory corporations, and other government-owned or government-controlled companies.

6.60 Option (i) would ensure that control over the design of reporting arrangements was left with the Treasurer; the Treasurer's Directions can be used to codify financial reporting practices (by reference to accounting practices and standards) without the necessity for statutory amendments or the promulgation of regulations.

6.61 Option (ii) could provide a framework for clarifying the financial reporting responsibilities of different forms of government entities, and for clarifying the responsibilities of the auditor of those bodies. It would enable the parliament to define a set of accountability arrangements which are appropriate for the Territory. These could include different reporting requirements for different classes of corporations - recognising the need to balance the need for parliament to be informed about the financial performance of government business enterprises, without damaging the commercial interests of the Territory or other participants in those enterprises.

6.62 As already noted, NSW has introduced legislation governing state-owned corporations, and similar proposals were advanced by the Senate Standing Committee on Finance and Public Administration in its Government companies and their reporting requirements (1989). That Committee recommended that the commonwealth government should not acquire a direct interest in a company without legislative authority - either in the form of an enabling act, or in the form of a government companies act which was to specify procedures "which will ensure proper accountability"; that such an Act set out general provisions for

formation, reporting, audit and disposal of government companies; and that a statutory requirement be introduced for the annual reports of all directly-owned government companies to be tabled in Parliament.

Recommendations

That the Committee consider the merits of either:

(i) the expansion of the Treasurer's Directions relating to prescribed statutory corporations so as to incorporate additional guidance on financial reporting issues; or

(ii) the introduction of legislation along the lines of the NSW State Owned Corporations Act, adapted for the requirements of the Northern Territory, so as to establish accountability arrangements for all public sector corporations (both prescribed statutory corporations, and other government-owned or government-controlled companies (or trusts).

Arrangements for audit

Prescribed statutory corporations

6.63 Audit arrangements for prescribed statutory corporations are outlined in sections 67 and 68 of the Financial Administration and Audit Act. The NT Auditor-General's office has prepared a set of guidelines titled "Review of the Auditor-General's Responsibilities" (September 1986) for use by contract auditors who undertake certain field-work on behalf of the Auditor-General. The guidelines set out the objectives of both "interim" and "final" audits of a prescribed statutory corporation. In summary, the Auditor-General's Office identifies the following objectives:

- * to determine whether the corporation is keeping proper accounts and records of transactions and affairs (both financial and non-financial);
- * all payments are correctly made and properly authorised;
- * adequate control is maintained over its property, and property in the custody (but not belonging to) the corporation;
- * adequate control is maintained over the commitment of money;
- * to determine legislative and regularity compliance, and financial regularity;
- * to forthwith draw to the attention of the responsible Minister of any significant irregularity;

* to report to the Minister

- whether the financial statements are based on proper accounts and are in agreement with the accounts and have been properly drawn up so as to show a true and fair view;
- the receipt and expenditure of moneys and the acquisition and disposal of property has been in accordance with relevant legislation;
- any other matters as should be reported (including matters of legislative and regulatory compliance).

6.64 It will be noted that one of these audit objectives concerns the expression of an opinion on financial information contained in financial statements. However the responsibilities of the Auditor-General are viewed as more wide-ranging, and encompass assessments of "compliance" and "regularity".

6.65 However some ambiguity surrounds the criteria which warrant reporting to a Minister. The guidelines propose that a responsible Minister be informed "of any significant irregularity", but no indication is provided as to what might be considered "significant". Nor are there any guidelines concerning what issues might also be reported to Parliament.

Government-owned or government-controlled companies

6.66 An audit undertaken for a company incorporated under the Companies Codes may be less stringent than an audit of a government department or prescribed statutory corporation, if it is conducted in terms of the accounting profession's Statements of Australian Auditing Standards. These standards suggest that the main objective of an audit is to express an opinion on financial information. Currently, the accounting profession's Statements of Australian Auditing Standards do not include any standards concerning auditors' responsibilities to ensure that auditees have complied with relevant laws or regulations.

6.67 The NT Auditor-General supplied a copy of specimen audit guidelines for company audits undertaken under contract within the Territory. Extracts from these guidelines are reproduced below:

Audit objective

1. To provide the statutory reports required under companies legislation.

Scope of audit

2. To meet the requirements of relevant legislation and

Australian Auditing Standards.

3. This Office should be advised of any additional matters that, in the opinion of the authorized auditor, merit examination.

Permanent file

4. Should be updated during audit according to your requirements.

Methodology

5. Your firm's methodology should be used to the extent it is compatible with this Office practice.

Reporting

6. You should provide:

- (a) statutory report; and
- (b) management letter.

7. In accordance with Audit Bulletin No. 3/87 you are asked to provide concise and clearly indexed summaries in the working papers in respect of:

(a) the highlights of the audit and significant features of the Financial Statements - such as a branch or subsidiary company auditor would provide to the consolidating audit partner; and

(b) a list of pending matters - including any relevant issues already raised in (a) above - which could be germane to the planning and performance of the next year's audit.

8. Any previous work undertaken should be referred to when performing this task.

6.68 It will be noted that these guidelines describe the audit objective as to provide "statutory reports required under companies legislation" and that the scope of the audit is to be determined by "relevant legislation and Australian Auditing Standards". While the contract auditor is to advise the Auditor-General of "any additional matters that, in ... [his] opinion, merit examination" no guidance is provided as to what those matters might be, and it is reasonable to suppose that in the absence of any explicit guidelines, contract auditors would adopt the same approach as for "commercial", private-sector audit work.

6.69 The accounting bodies have recently issued a draft "statement of auditing practice" (a document of lesser status than an auditing "standard") on "Compliance auditing" (ED 30, August 1989). The draft statement suggests that auditors should consider the "materiality" of instances of non-compliance when deciding what to report. The criteria for determining "materiality" in this context are not explained. Reference to

this draft statement will thus still leave some ambiguity surrounding the responsibilities of contract auditors or the Auditor-General in reporting on failures of auditees to comply with laws regulations or other requirements concerning the maintenance of internal controls.

6.70 At the risk of some repetition, it is noted that these limitations on the scope of audits undertaken for government-owned or controlled companies, or for statutory authorities, have been criticised in several reports of parliamentary committees in recent years:

- * the Senate Standing Committee on Finance and Public Administration in its report Government companies and their reporting requirements (1989) recommended that all government companies "be audited in accordance with the requirements of the Audit Act as well as those of the Companies Code";
- * the Joint Committee of Public Accounts in its Report 296, The Auditor-General: Ally of the Parliament and the People (1989) observed that the implications for accountability to Parliament of the audit of a government instrumentality being conducted under the Companies Code rather than the Audit Act included: no requirement of the minister to table in Parliament the instrumentality's annual financial statements and the audit report on the financial statements; if government enterprises are incorporated as exempt proprietary companies there may not be any public disclosure of financial information; Parliament would no longer receive reports on waste, misappropriation, lax management or inefficiency within government enterprises as a matter of course - "even ministers may not receive such information"; Parliament would be less likely to receive reports on whether government bodies had broken their own legislation or other laws.
- * the WA Commission on Accountability plainly envisaged that an audit of a government-owned company should encompass more than the matters specified in the Companies Code: it recommended that "where a subsidiary company is incorporated outside Western Australia, the appointed auditor "shall, in addition to the audit requirements under the statute of the jurisdiction in which it is incorporated, perform such other audits and/or examination as the Auditor General may direct" (pp. 23-4).

6.71 By way of comparison with the accounting profession's statements, Australian Audit Office Auditing Standards (1987) make clear that public-sector audits do involve "regularity" auditing:

The Auditor-General's comprehensive audit mandate encompasses the following functions:

- (a) Regularity auditing
 - (i) attestation of financial accountability of the Commonwealth administration, involving examination and evaluation of accounting records of departments of State and expressions of opinions on financial statements prepared by the Minister for Finance;
 - (ii) attestation of financial accountability of other Commonwealth bodies, involving examination and evaluation of accounting records and expressions of opinions on financial statements;
 - (iii) other regularity audits of departments and other bodies involving:
 - (a) examination of financial systems and transactions, including an evaluation of compliance with applicable statutes and regulations;
 - (b) review of internal control and internal audit arrangements;
 - (c) examination of the probity and propriety of decisions taken with respect to all aspects of the administration of the auditee; and
 - (d) reporting of any other matters arising from or relating to the Auditor-General's activities that the Auditor-General considers should be brought to attention (clause 1.3.5).

Where the commonwealth Auditor-General is appointed auditor of a government-owned or controlled company, the appointment is both under the Companies Code and the Audit Act 1901, and this dual appointment "extends the scope of the audit beyond the financial attest audit to embrace the full range of regularity audits" (clause 4.2.3.2).

Reporting on compliance audits and internal control weaknesses

6.72 The following discussion should not be interpreted as implying that the author of this report is aware of any instances of illegal activity, breaches of governmental guidelines, internal control weaknesses or mismanagement within the NT public sector. The comments with the aim of indicating ways in which accountability arrangements could be "improved" (in some of the senses referred to in section 3 of this report). They are also offered having regard to circumstances which have come to light in other jurisdictions.

6.73 As already noted, currently-issued Statements of Auditing Standards and Statements of Auditing Practice place less significance on "compliance" auditing than is customary in the public sector.

6.74 For example, the task of assessing internal controls is only a means to an end (i.e. expressing an opinion on financial information) rather than an end in itself; likewise little significance is placed on reporting on any identified internal

control weaknesses. Such reporting is undertaken "for the benefit of the client" (see AUP 12, clause 28) - rather than being a major outcome of the audit.

6.75 Such reporting takes place through what are known as "management letters". Several points might be made about existing arrangements for the preparation of these documents for transmission to government-owned companies:

- (i) there have been some recent instances in the private sector where it appears that such letters were not acted upon by senior executives; nor were the contents disclosed to all members of a corporation's board, who bear ultimate responsibility for the conduct of that company.
- (ii) in some jurisdictions there has been a risk that Ministers or senior public servants may be left uninformed about issues which are financially (and politically) significant;
- (iii) if "management letters" are not responded to positively there is a risk that this lack of response may remain known only to the parties involved.

6.76 Such concerns have been the subject of some discussion recently. For example, several years ago the NSW Auditor-General foreshadowed his intention to commence reporting to Parliament about such matters as internal control weaknesses which had not been rectified by management. In Queensland there is provision for the Auditor-General to report to parliament about such matters after they have been the referred to and commented upon by the relevant minister. However such procedures may lead to considerable delays before matters are before parliament. An auditor-general may only advise a minister of an on-going problem after he has informed management of the issue, and given management time to respond; likewise a minister may be given time to respond before the Auditor-General reports to parliament. Under such arrangements, the time taken between when audit staff become aware of a problem, and when the Auditor-General actually notifies parliament, could be two to three years. Further, if an Auditor-General is only empowered to report to parliament after a minister has responded to a report from the audit office, the delays in reporting publicly could be indefinite. Commentators have seen the need to clarify arrangements for reporting on the findings of compliance audits (or, on occasion, on concerns relating to the performance of public sector bodies).

6.77 Accordingly, there has been some debate about the desirability of introducing different arrangements for the follow-up of matters raised in letters from the Auditor-General to public service managers, and ministers. For example, the NSW Public Accounts Committee has recently proposed that Treasury develop procedures for the review and follow-up of certain reports from the Auditor-General; further it has been proposed that Treasury in its annual report to the NSW Parliament should identify details of action taken on those audit reports. The choice of a suitable procedure may depend on the volume and type of matters raised by the Auditor-General.

Recommendations:

That the Auditor-General be encouraged to develop or adopt a set of auditing standards dealing with the conduct of "compliance" auditing, and with reporting the findings of that audit work to management, boards of public sector corporations, Ministers and parliament.

That the Auditor-General consider the introduction of guidelines for the reporting to Parliament (perhaps through the Public Accounts Committee) of any matters raised in management letters which have not been rectified or attended to within six months from the date of those letters.

7. ACCOUNTABILITY ARRANGEMENTS FOR CORPORATIONS FORMED OTHER THAN IN TERMS OF COMPANIES LEGISLATION

7.1 As noted in the preceding section, companies may be incorporated in terms of the NT Companies Code (or comparable legislation in other jurisdictions) or by virtue of the operation of particular statutes. This section discusses accountability arrangements for statutory authorities, local government councils, community government councils, school councils - together with superannuation funds (which the Auditor-General suggested should use the "model financial statements" set forth in his February 1990 report).

Government-owned companies and public sector corporations

7.2 However the February 1990 report from the Auditor-General referred to "corporations" in a very wide sense:

For the purposes of this Report the term 'Public Sector Corporations' is applied to two types of bodies:

'Corporations' which encompasses those government entities which are not departments - examples are authorities, boards, commissions, educational corporations, superannuation funds and government owned companies; and

'Local Governments' which comprises the six local government councils.

7.3 The Auditor-General has added several categories not normally considered as "corporations": educational corporations, superannuation funds, and local government. (The Treasury is also a "corporation sole" but it was not suggested that Treasury prepare financial statements in terms of the model financial statements - so that subject is not pursued).

Educational corporations

7.4 No doubt the term "educational corporations" would encompass universities and colleges. The application of the model financial statements to those institutions does not appear to be contentious, save in regard to some of the accounting issues already review in section 6.

7.5 However one implication of the Auditor-General's recommendation is that School Councils would also be required to conform to the format of the model financial statements, since the Education Act provides that a school council shall be "a body corporate with perpetual succession" (Education Act, as amended 1989, subsection 71B(1)).

7.6 Presently the Education Act provides for School Councils to receive and administer the allocation of government funds. Subsection 71C(1) of the Act provides that a council shall inter alia

within the scope allowed by the functions and powers conferred or imposed upon it, determine the purposes for which moneys allocated by the Department of Education to that Government school are to be expended and to expend those funds accordingly.

7.7 A school council may receive funds from various sources:

- (a) moneys allocated by the Department of Education to the Government school in respect of which the school council is established;
- (b) moneys raised in pursuance of section 71C(1)(n) of the Act (which empowers a school council to "carry out such activities as are approved by the Secretary for the purpose of raising funds to be expended on or in relation to that Government school");
- (c) moneys granted by the Minister "upon such terms and conditions as he thinks fit" (section 71F).

7.8 Section 71H of the Education Act provides that school councils shall prepare accounts:

(1) A school council shall cause accounts to be kept in the prescribed manner, or in such manner not inconsistent with the Regulations as is specified in writing by the Secretary acting with the advice of the Treasurer, of any moneys received by it and any dealings with those moneys.

(2) The secretary, or a person authorized in writing for that purpose by the secretary, may, at any time, inspect or audit the accounts of a school council.

7.9 The Education Act also provides (section 71J) that the Minister may publish guidelines for school councils in relation to their various functions, including "the manner in which a school council shall cause proper accounts to be kept of any moneys received by it and dealings with those moneys and of the auditing of those accounts". Guidelines were prepared by the Department of Education in 1987, and are incorporated in a loose-leaf binder titled A practice guide for school councils which is distributed to schools in the Territory. Another document distributed to schools and interested parties is titled School Councils and Administrative Devolution (April 1990).

7.10 Before reviewing these documents, it may be worth noting that section 71J of the Education Act implies that those accounts shall be prepared on a "cash" rather than on an "accrual" basis, since it refers to "dealings" with moneys, and makes no reference to other assets or liabilities. The 1987 Guidelines also state that "Accounting systems in schools are operated on a cash basis".

7.11 The Auditor-General's recommendations would impose an obligation on school councils to maintain their records on an accrual basis. This recommendation may therefore not be consistent with the current provisions of the Education Act and/or the current policies of the government.

7.12 It is understood that there are around 170 schools in the Territory, of which around 70 have established School Councils. Of these, around 45 have accepted the responsibility of "financial devolution". It is understood that the current policy of the NT government is to encourage greater involvement of local communities in the management of local schools, including involvement in the management of physical and financial resources.

7.13 It is recognised that the adoption of an accrual accounting system by school councils which have accepted "administrative devolution" may enhance accountability, and maintain tighter controls over the handling of government funds. Moreover, since the adoption of accrual accounting would also indicate the need to establish more comprehensive records, this might also provide greater assurance that the assets being purchased with government grants are adequately safeguarded.

7.14 However the introduction of more extensive financial keeping would also involve costs which may be a significant burden on the finances of some schools, and on the time of members of the community who volunteer their time and energies to assist their local school and to develop its facilities. The task of record-keeping may be burdensome to those school councils, and it seems likely that the majority of Schools would have difficulty in maintaining records on accrual basis. Few of the administrative staff employed in primary and high schools, nor school principals, would have the skills and training required to maintain accounting records on an accrual basis.

7.15 Currently there is no requirement that school councils employ a professional auditor to audit their annual financial accounts. To quote from Department publications:

School councils are encouraged to seek out suitable persons within their communities to appoint as auditors. This would be consistent with the Regulations and would eliminate the high costs of commercial audits and this represent a saving to the council, even if the appointed auditor was paid some form of gratuity.

Auditors appointed by the school council need to be approved by the Secretary of the NT Department of Education. Approval can be gained by writing a letter, naming the person and indicating their expertise as an auditor, to the Secretary (Annual Financial Statements - 1, Nov. 87).

The council is free to seek the services of any person able to carry out the task of auditing. This may be done

by a member of the community for no cost to the school. The council is only required to seek the approval of the Secretary of the Department of Education for the appointment. (School Councils and Administrative Devolution, 1990, p.10)

7.16 The task of auditing a set of accounts prepared on an accrual basis may also require the services of an accounting professional; enquiries suggested that some schools had received quotes of around \$2,500 - \$3,000 for assistance in the finalisation of the accounts and the conduct of an audit. As indicated in the Guidelines, for most schools, this expenditure might be hard to justify.

7.17 On the basis of a preliminary review of existing arrangements, the case for requiring School Councils to adopt accrual accounting and to follow the form of reporting outlined in the Auditor-General's "model financial statements" is far from compelling. In any event, as noted above, the proposal does not seem consistent with the current policies of the government

7.18 In the course of reviewing current arrangements for the accountability of School Councils, it became evident that there may be room to improve those arrangements without adding greatly to administrative costs or imposing undue burdens on either the Department of Education or on those who give their time to School Councils. The following comments and suggestions are advanced for consideration by the Public Accounts Committee:

- (i) it was noted that the discussion of accounting matters in the Department's A practical guide for school councils indicates that only cash-based accounting methods are required - but then uses terminology which is more commonly associated with the use of accrual accounting systems. For example, the manual refers to "income" and "expenditure". The manual also refers to a "chart of accounts" - a record of account classifications which is commonly associated with the use of double-entry records (when elsewhere the text suggests the use of various headings in multi-column records of cash receipts and payments). Admittedly, these terminological infelicities may be more offensive to accountants than to lay persons, but they may be a source of confusion.
- (ii) there are no formal arrangements for school councils to be accountable to the Department of Education for the manner in which they have handled moneys received for certain types of government grants, other than via the presentation of annual audited financial statements.

The guidelines covering financial controls over the funding of minor repairs appear to be adequate; for other grants, the manual includes some suggested formats for reports to the Secretary of the Department of Education, while leaving the actual mode of presentation to "the discretion of the auditor".

Given the scale of the sums involved in these grants,

there may be a case for reviewing existing procedures for the preparation and review of acquittal statements.

- (iii) A consequence of the use of simple cash-based accounting systems is that no formal records are required to be maintained of what durable assets were acquired with school funds. It is recognised that the task of maintaining such records might be burdensome, particularly for the smaller schools. On the other hand, annual financial statements could merely list the assets acquired with the aid of government-grants or self-generated funds which were on hand at year-end - together with a list of items which had been lost, stolen, destroyed or abandoned during the year. This step might enhance controls over such items.
- (iv) the Department's guidelines do not include a separate section outlining the form of an audit report and the responsibilities of auditors. Some persons carrying out the audit task may not be aware of the existence of the guidelines, or of the suggestions in those guidelines that they sign financial reports and statements of acquittals in a particular form.

An appropriate form of audit report for school councils could include:

- * statements as to whether the auditors had inspected physical assets listed in a note accompanying the financial statements;
 - * comments or suggestions regarding deficiencies or possible improvements in the financial records;
 - * statements as to material variations (say, 10% or more) between amounts received for grants for particular purposes and the amounts actually spent during the financial year.
- (v) there may be merit in requiring the appointment of qualified accountants as auditors of School Councils handling government grants in excess of some stated nominated sum (say, \$250,000 per annum).

7.19 It is recognised that it is desirable to retain a degree of flexibility in funding and financial reporting arrangements for schools: indeed, these observations are predicated on the belief that the cost of introducing tighter financial controls may outweigh the benefits - particularly by diverting school councils from their primary tasks. On the other hand, the accountability arrangements currently operating may not be providing adequate safeguards that government grants are being expended for the purposes for which they were intended.

7.20 Moreover, informal enquiries suggest that some large schools may be receiving funding for special purpose grants and programmes (excluding payments for salaries) in excess of \$1 million per annum.

Recommendation:

That the Auditor-General's recommendations that all corporations should comply with the proposed model financial statements should not apply to incorporated school councils.

That the Public Accounts Committee consider reviewing how the accountability arrangements for school councils established by the Education Act and accompanying guidelines are operating in practice.

Superannuation funds

7.21 The Auditor-General has advocated that the style of accounting illustrated in the "model financial statements" should also be adopted by public sector superannuation funds.

7.22 In this connection it is noted that the NT Superannuation Act as in force at 1 January 1988 provide that sections 67 and 68 of the Financial Administration and Audit Act

apply to and in relation to the Investment Board and the Fund as if the Investment Board were a prescribed statutory corporation within the meaning and for the purpose of those sections.

Section 67 of the Financial Administration and Audit Act provides for audit by the Auditor-General; section 68 provides for the preparation of an annual report on operations and financial statements "in such form as the Treasurer approves". Subsection 43(3) of the Superannuation Act makes clear that the only financial statements required are "statements relating to the Fund".

7.23 It is common practice for superannuation funds to adopt accrual accounting - though not necessarily in the form currently prescribed in the accounting standards issued by the Australian accounting profession, or in approved accounting standards issued by the Accounting Standards Review Board.

7.24 The accounting practices currently adopted by the Northern Territory Government and Public Authorities Superannuation Trust Fund (NTGPASS) record certain investments at market value. This practice, which is widely adopted by superannuation funds, leads to appreciation in the market value of those investments being treated as increases in the residual interest of beneficiaries of the fund. The treatment of appreciation of investments as revenues is not currently acceptable by the accounting standards issued by the accounting profession; rather such gains are to be treated as "unrealised" gains (and may be added to the residual interest by way of "reserves"). In the case of the NTGPASS, the financial statements do not describe that appreciation as a "revenue" but simply as an "addition" to the balance of the fund in a "Statement of movements in accumulated funds". Nevertheless the point can be made that the accounting treatment commonly used by superannuation funds whereby investments are formally revalued on an annual basis is not prescribed by accounting standards; nor

is it common among corporations or other entities preparing financial statements on an accrual basis.

7.25 A similar observation can be made about the valuation of properties owned by superannuation funds. Australian accounting standard AAS 10 and approved accounting standard ASRB 1010 both prescribe that when an entity revalues non-current assets it should revalue all assets of the same type at the same time.

the carrying amount of a non-current asset shall not be changed by revaluation except as part of a revaluation of the class of non-current assets to which it belongs.

7.26 At present the NTGPASS does not invest in property, though other public sector superannuation funds commonly do so. If the NTGPASS did invest in real estate, and if it was to conform to the accounting standards currently on issue, it would be obliged to revalue all of those assets within the one accounting period. However this would be contrary to the usual practices of superannuation funds, which customarily revalue individual properties on a regular cycle (e.g. every three years) without seeking formal valuations from qualified valuers at the one time. Industry practice has several advantages: it avoids the difficulties of imposing an excessive workload on qualified valuers over a short period of time; it also dampens the volatility of the recorded values of fund assets over time, so as to establish a more equitable basis for distributions to contributors in accumulation-style schemes.

7.27 The annual reports of NTGPASS, and other funds (such as the Police Supplementary Benefits Scheme, the Legislative Assembly Members' Superannuation Trust, etc.) presently conform to the accounting standards issued by the accounting bodies, by providing a Statement of Sources and Application of Funds. It is suggested that these statements are difficult to interpret and convey little (if any) information of relevance to the readers of financial statements. A statement of cash flows may be of greater assistance to readers of those annual reports.

Recommendations:

That the Auditor-General's recommendations be not accepted in their present form for application to superannuation funds.

That Treasury be advised that in exercising discretions in terms of section 68 of the Financial Administration and Audit Act, it would be appropriate for NT superannuation funds to adopt only those Australian Accounting Standards which are appropriate for public sector superannuation funds.

That it be suggested to Treasury that consideration be given to requiring that the annual reports of superannuation funds include a Statement of Cash Flows (rather than a Statement of Sources and Applications of Funds).

Local government and community government councils

7.28 Section 12 of the Local Government Act 1985 provides that "a council shall be a body corporate with perpetual succession". Section 255 of the Local Government Act also provides that a community government council "shall be a body corporate with perpetual succession". Since both councils and community government councils are "corporations" and as such the Auditor-General's recommendations for the application of model financial statements must be considered in relation to those entities. It is understood that there are also 30 local government bodies, most of which are incorporated under the Associations Incorporation Act (with some being incorporated under commonwealth Associations Incorporation Act).

7.29 The Office of Local Government has prepared a manual of Accounting and Procedural Guidelines for Community Government Councils for the Financial Year ended 30 June 1990. This manual includes the following directives:

1.3 Books of account

A Council shall prepare and maintain books of account so as to sufficiently explain the transactions to enable annual, quarterly and monthly statements of account to be prepared.

1.4 Exemptions from accounting and guidelines

If a Council is unable to put into place parts of these guidelines, the Director may, upon such terms and conditions as he thinks fit, exempt the Council from compliance with such part of the guidelines.

2.1 Annual financial statements

* * *

The financial statements should be prepared in a format to be advised by the Director.

2.2 Appointment of auditor

* * *

The Council shall appoint only a person who is a member of an institution or association of accountants.

7.30 It is understood that certain community councils are finding it difficult to comply with these existing requirements for cash-based reporting. It would appear that application of the model financial statements (and accrual accounting) to community government councils would be inappropriate, as it would impose a reporting requirement which would be unreasonably burdensome.

7.31 Section 138 of the Local Government Act 1985 provides that

A council shall establish and keep, or cause to be established and kept, in the prescribed manner accounts of the income and expenditure of the council.

The Act also provided that a council shall establish and operate through three types of funds: a general fund, a trading fund in relation to each trading undertaken by the council, and a trust fund. It defines "income" as "all moneys received or receivable by the council" - a concept rather at odds with general usage (since the gross proceeds of asset sales are not generally regarded as "income").

Accompanying regulations provide for councils to keep their accounts on an income and expenditure basis.

7.32 The Auditor-General has noted the efforts of the accounting profession to introduce an accounting standard dealing with local government accounting. To date, only an exposure draft has been produced. Publication of this exposure draft has generated some controversy. It would seem premature to suggest that the accounting issues have been resolved, or that the style of "accrual accounting" implied by the model financial statements would be appropriate for local government councils in the Territory.

Recommendation:

That the Auditor-General's recommendations for the adoption of model financial statements not be accepted as appropriate for community government councils.

That the Auditor-General's recommendations for the adoption of model financial statements (implying the use of accrual accounting) not be supported as appropriate for local government councils at this stage.

8. REVIEWS OF ECONOMY, EFFICIENCY AND EFFECTIVENESS

8.1 The Auditor-General's 1989 report contained the following recommendations:

1. That a process of progressive review of the efficiency and effectiveness of the financial management processes and systems employed in managing the public sector overall be incorporated in appropriate programs undertaken by Treasury.
2. That a programme of review be instituted to identify likely efficiency gains in the financial management processes and systems employed by departments.
3. That in revising the Treasurer's Directions, the philosophy and concepts required to improve departmental financial management be considered for inclusion.

Recommendation that Treasury be responsible for reviews of efficiency and effectiveness.

8.2 At first sight the wording of Recommendation 1 above suggests that officers of the NT Treasury have not been engaged in reviewing "the financial management processes and systems employed in managing the public sector overall". However this interpretation does not appear to have been intended, as the report also acknowledged that

many improvements [in financial management] have taken place in recent years. Treasury has been particularly active in promoting a reformist policy to this overall process and has achieved a number of significant advances. Although my Office has not reviewed all headings, some of the more notable developments by Treasury have been:

- * appropriation by activity rather than category of cost
- * further development of an Economic Transactions Framework in conjunction with the Australian Bureau of Statistics
- * introduction of computerised Purchase Order and Accounts Receivable procedures
- * format of financial information for departmental reporting
- * reformat of presentation of budget information to link receipts and expenditures
- * expansion of budget papers to include details of intrasector transfers

Interviews with the Under-Treasurer Dr. N. Conn and certain of

his staff indicated that they would regard one of their major achievements as being the redesign and computerisation of accounting systems - which are centrally maintained by Treasury for all government departments and most statutory authorities. Another has been the development of programme reporting in the budget; programme reporting is seen as a precursor to the adoption of programme budgeting.

8.3 Further, a fixed assets module and an accounts receivable module have been developed as part of the centralised computerised government accounting system. The fixed assets module records such data as acquisition prices, the estimated useful life of assets, current replacement values or current costs, written-down value, and the location or programme for which the asset was purchased. Initial users of this model were the Royal Darwin Hospital, the Northern Territory Conservation Commission and the Racing, Gaming and Liquor Commission. Other agencies will be using this recording system during 1990, though it is understood that it will be some time before the assets employed in departmental operations are fully recorded in this system. The accounts receivable module is being used by the Department of Health, the Department of Law and the Treasury, with several other agencies scheduled to convert to the module during 1990.

8.4 Of course, these various initiatives are predominately concerned with refinement of accounting and financial reporting systems. The availability of accurate and relevant information is essential if public sector managers are to be able to review the efficiency and effectiveness of public sector activities. Further, requirements to provide financial reports make certain matters "visible": the requirement for departments to provide particulars of accounts receivable (dissected in terms of the period outstanding) may in itself encourage managers to give greater attention to the management of those assets.

8.5 However, the Auditor-General has suggested that Treasury should be more active in monitoring the financial management processes and systems being employed by departments. During the course of an interview with the Auditor-General and several of his senior staff, it was suggested that this could mean that Treasury might need additional resources and staffing.

8.6 The role of central agencies vis a vis other budget-sector departments varies from jurisdiction to jurisdiction, since different governments design their administrative arrangements in different ways. For example, some governments may give Treasury the responsibility for management and efficiency reviews. Others may assign that responsibility to a department of "finance", to management consulting units working responsible to a premier's (chief minister's) department, or to an internal audit bureau. Some governments may assign responsibilities to more than one agency: having one unit handle routine reviews of internal controls, and the economy and efficiency of government operations, while other units handle special projects (e.g. troubleshooting, or ad hoc reviews of the effectiveness of government policies). Some governments use special project work as a staff-development activity for an elite group of staff who

are assigned to working parties, or seconded to particular departments or agencies. Most governments employ a mix of approaches.

8.7 Correspondingly, different people may hold different views as to what arrangements are optimal. An arrangement which might work well in one setting might, in another setting, be unwelcome (because of preferences shaped by the history of other organisational arrangements) or unworkable (because of differences in the volume and range of matters to be considered) or relatively unsuccessful (because of the quality of the staff running those departments, or differences in the talents of relevant ministers).

8.8 Ultimately, decisions as to whether Treasury, or some other department or unit should bear primary responsibility for ongoing reviews of the efficiency and effectiveness of "financial management processes and systems" may be matters for government policy. It is not necessary for central agencies to undertake such tasks. A government may prefer to leave such matters to the heads of individual departments ("letting the managers manage"), or to use a mix of decentralised responsibility and central-agency oversight. It may be that particular departments take major responsibility for certain tasks: as a case in point, it was learnt that an Asset Management Working Group has been established in the Territory, with the chairman being drawn from the Department of Transport and Works.

8.9 For these reasons, it would seem inappropriate for the Public Accounts Committee to endorse the Auditor-General's recommendation that Treasury (rather than some other agency or agencies) undertake a progressive review of the efficiency and effectiveness of the financial management processes and systems employed in managing the public sector overall. Further, it is not self-evident that there is a need for a wide-ranging "progressive" review for the overall public sector; nor was such a need established by the matters reported in the Auditor-General's report.

Recommendation:

That the Public Accounts Committee support proposals that government departments and statutory authorities should review the efficiency and effectiveness of the financial management processes and systems they employ in managing the public sector - but that it not support suggestions that monitoring those activities should necessarily be the responsibility of Treasury.

Recommendation that there be a review of likely efficiency gains obtainable in the financial management of departments

8.10 The Auditor-General's second recommendation - "That a programme of review be instituted to identify likely efficiency gains in the financial management processes and systems employed

by departments" - seems to overlap the first recommendation - except for the fact that it does not identify Treasury as the body which should undertake the tasks being advocated. However it does suggest some overall, centralised review of the activities of departments.

8.11 The difficulty that the Public Accounts Committee must face in responding to this recommendation is the lack of evidence to indicate that there is a "problem", or that such problems are not being addressed already. Of course, it is hard to disagree with suggestions that there be a review of financial management practices if the exercise would produce net "gains". But the Auditor-General's report has only provided text-book style descriptions of the benefits which may be derived from various forms of "financial management".

8.12 Some of the difficulties in applying these precepts arise from the process of actually identifying and quantifying the costs and benefits in practical situations. It may be possible to estimate the marginal costs and benefits associated with (say) a changed policy of collecting accounts receivable, relative to maintaining an existing policy. From the perspective of a senior manager, implementation of those procedures might require use of more-qualified staff, working at a higher rate of salary. That may produce a different array of costs and benefits. Further, the senior manager must consider whether the net benefits to be gained from pursuing that particular policy would exceed the net benefits to be gained from deploying his more senior and expensive staff in other areas. Most of these assessments by management may be undertaken without the benefit of cost-benefit analyses: such reviews also have a "cost".

8.13 For these reasons, the Public Accounts Committee may find it preferable to seek further information from the Auditor-General before endorsing that proposal.

Recommendation

That the Public Accounts Committee express the view that it encourages departmental reviews of financial management, but would not endorse the suggestion that formal reviews of financial management practices and systems be instituted across departments, pending further advice from the Auditor-General concerning substantive evidence of "problems".

Recommendation that the Treasurer's Directions incorporate material dealing with "philosophy and concepts required to improve financial management".

8.14 The Auditor-General recommended:

3. That in revising the Treasurer's Directions, the philosophy and concepts required to improve departmental financial management be considered for inclusion.

8.15 Different views are taken about the role of the Treasurer's Directions (or their equivalent). In some jurisdictions, central agencies have issued extremely detailed instructions concerning the conduct of transactions which may be considered by departmental officers. Recently, some states (such as Queensland) have taken the view that central agencies should only establish broad directives which may be interpreted and amplified by individual departments in the light of the individual circumstances. The latter approach is seen as a way of "letting the managers manage"; the former approach has contributed to some of the complaints about bureaucratic "red tape" and may have led to the proliferation of government-owned companies in some jurisdictions (since the use of those vehicles avoids the controls established by those "directions").

8.16 Staff of Treasury have advised that they view the Treasurer's Directions as establishing guidelines which are to be amplified in terms of the special circumstances of departments. Each department is required to maintain its own Accounting and Property Manual, and to establish systems of financial management and controls which are appropriate to the circumstances of individual departments. Treasury also sees advantages in consulting departments about proposed changes in the Directions.

8.17 As outlined above, there are differences of opinion about the relative role of central agencies (such as Treasury) in promoting improvements in financial management. There are also disparate views about ways of achieving "improvements". It is by no means clear that pronouncements in the Treasurer's Directions would secure "improvements" - though it might provide grounds for the Auditor-General's office to investigate and report whether certain policies or practices are being observed within Departments. However there are other ways for the Auditor-General to make constructive contributions to promoting improvements in financial management.

Role of Auditor-General in performance auditing

8.18 The Auditor-General may have a role in undertaking reviews of the economy or efficiency of government activities. Indeed, the possibility of widening the powers (if that is necessary), and of increasing the funding available to the Auditor-General to enable greater use of "performance auditing", is an option which might be considered by executive government when deciding what mix of arrangements is to be adopted for reviewing the efficiency and effectiveness of public sector management generally, and financial management in particular.

8.19 It may be useful to clarify the way in which certain terms are used here. Audit reviews of the economy, efficiency and effectiveness of government activities are commonly described as "value for money" or "performance auditing"; the combination of audit reviews of financial information, compliance or regularity auditing, and performance auditing, is sometimes referred to as "comprehensive auditing".

8.20 In recent years, the issue of whether an auditor-general has

(or should be given) powers to undertake "value for money" or "performance auditing" - and whether this indicates a need for additional funding of an auditor-general's office - have been considered by the commonwealth Joint Committee of Public Accounts (1989) and the NSW Public Accounts Committee (1990). The international trend is for a widening of the role of an auditor-general to encompass some kind of "performance auditing" - though there is some sensitivity about whether reviews of the "effectiveness" might be construed as criticisms of government policy. In broad terms, it is accepted that an auditor-general has no mandate to criticise government policies. It is argued that an auditor-general with a mandate to undertake performance auditing may assess whether there are adequate administrative arrangements in place to review the effectiveness with which government policies have been pursued.

8.21 In Australia, there have been few (if any) audit reviews which have dwelt on the overall "effectiveness" of policies or programmes; most of the work undertaken to date has been concerned with assessing the economy or efficiency of particular activities. Nevertheless in the commonwealth and several states it has been acknowledged by parliamentary committees and executive government that the audit office has a role to play in these aspects of "performance auditing".

8.22. In the NT Auditor-General's 1988 Annual Report, the responsibilities of the local audit office to undertake "value for money" auditing was discussed in the following terms:

Value for money auditing

Much audit emphasis in the past has been on compliance auditing - that is, establishing whether auditees comply with the various rules and regulations governing their financial operations. At the time the Financial Administration and Audit Act was introduced that legislation was understood to also allow for efficiency audits or "value for money" audits.

An Explanatory Memorandum on the then proposed legislation tabled in the Legislature stated: "While recognising that in time, audits undertaken by the Auditor-General for the Northern Territory should include efficiency audits, it is not possible, because of costs and staffing constraints, to follow that course in the early years of self-government. Nevertheless, the audit provisions in the Ordinance are drawn in such terms as would not preclude the Auditor-General applying efficiency audit techniques where his resources permitted such an approach.

It has been the intention of the Office that value-for-money audits would commence on a small scale in the 1988-89 year. In addition, the Public Accounts Committee Report Number 3 expressed an expectation that the Audit Office will be performing such audits.

I have recently been advised, however, that a clear legislative expression would be preferable before audit work extends into the area of value-for-money.

8.23 Despite these reservations, the Auditor-General did proceed towards undertaking limited reviews of the economy or efficiency certain areas of government financial management. Reports of this work were included in the 1989 Annual Report and formed the basis of the recommendation that Treasury should itself undertake reviews of efficiency and effectiveness.

8.24 It must be noted that the Auditor-General's recommendation for a progressive review of [all] management processes and systems implies that (all, or major) management processes and systems be scheduled for formal external review over the coming years. Of course it would be unrealistic to suggest that all of the Territory's public sector financial management systems are operating perfectly. Even so, it could be argued that priorities should be established in terms of the financial significance of the matters under review, and the risk of losses associated with those activities. Further, subject to resolution of concerns about the powers of the Auditor-General to conduct performance auditing, it could be argued that the audit office could itself undertake performance audits.

Recommendation:

That the Public Accounts Committee support the efforts of the Auditor-General to undertake "performance audits" of public sector activities or organisations.

Basis of the Auditor-General's recommendations

8.25 The following discussion examines the structure of the Auditor-General's arguments, and the evidence presented in support of his recommendations. This approach is adopted to draw attention to ways in which the Auditor-General's office might perform a greater role in offering comments about the economy, efficiency and effectiveness of public-sector operations - while also maintaining the status of the office as an independent source of advice to Parliament.

8.26 Under the heading "observations on opportunities for cost savings" in the Auditor-General's 1989 Annual Report, it was noted that "financial management is a complex process involving a number of specific activities", including

- * Cash management
- * Receivables management
- * Inventory management
- * Fixed asset management
- * Current liabilities management
- * Long-term debt management

and in a wider context, the broader policy areas of

- * tax administration
- * major programs
- * State/Commonwealth financial arrangements, etc

8.27 Having acknowledged some of the steps taken by Treasury in promoting improvements in financial management (quoted in clause 8.2 above) the Auditor-General then expressed views about the adequacy of existing arrangements for managing the NT public sector:

A major audit observation is that if government departments were given additional guidance as to broader government objectives in all of the financial management activities listed, a more regulated, uniform and effective process could result. The present concentration is on cash management. Individual departments are generally let to develop their own approach to most of the other financial activities (receivables, inventory etc). Whilst this approach is consistent with the philosophy of "Let the managers manage" there is evidence, particularly in the Northern Territory, of a need for tighter and more uniform management of these other aspects.

The present system results in departmental procedures ... having generally evolved without regard to their cost-effectiveness.

The Auditor-General later observed:

The comments made above in respect of financial management systems have been given in the belief that there are certain improvements which could be made to broaden the range of information available to the policy-makers and to achieve economies and efficiencies of scale in financial management processes.

8.28 Note the content of the argument:

- (i) the suggestion that "there is evidence, particularly in the Northern Territory, of a need for tighter and more uniform management" of financial activities such as the handling of receivables, inventories, fixed assets, current liabilities, and long-term debt;
- (ii) the claim that there may be "economies and efficiencies of scale [may be achieved] in financial management processes" - presumably through intervention by a central agency.

8.29 The starting point is the assertion that there is "evidence" of a problem. But what is that "evidence"? None was provided. Two appendices to the report deal with the management of "accounts receivable" and "leasing", but these appendices do not contain any evidence of any problems in the financial management of these matters in any departments or other unit. Rather, the appendices describe the benefits and costs of "managing" assets and

liabilities, and provide a very general description of "audit findings".

8.30 To illustrate, consider the Auditor-General's findings:

- * that a number of departments do not have an accurate idea of the total amount owed to them or how long it has been owing.
- * that collection procedures are inadequate leading to accounts becoming long overdue (p.35).

8.31 The Auditor-General may or may not be right in his assessment that there is a "problem" - but the reader of the report is unable to make any assessment on the basis of the information supplied, or to appreciate the sources of the evidence obtained by the Auditor-General, and how it was evaluated. The report did not indicate:

- (i) the objectives of the audit of accounts receivable - and what issues were investigated;
- (ii) the scope of the audit undertaken. For example:
 - were the activities of all departments reviewed, or only a sample?
 - did the review deal with systems for handling all of the accounts receivable for each department, or only some of them?
 - were audit reviews undertaken on every site where such systems might be implemented - or only a sample?
 - if a sample was used, what was the basis of selection? Why was that sampling procedure chosen?
- (iii) what were the criteria used to evaluate performance?
 - what is meant by the failure of "departments" to have an "accurate idea" of amounts owing?
 - in what way were collection procedures "inadequate"?
- (iv) what evidence was collected about the significance of the "problem"?
 - e.g. did the audit produce any evidence about the value of accounts receivable in the departments or sites which were subject to review? What evidence was obtained about delays in collection procedures? Were there any other factors which might have explained those delays?
- (v) were audit conclusions based on the use of unverified data?
 - e.g. what was the basis of the statement that some departments did not have an "accurate idea of the total amount owing to them"? Were those statements made by individuals who may have been unaware that such information was available on request?

- (vi) what was the basis of the conclusion?
e.g. how were assumptions about evaluative criteria, and evidence, assembled to reach the conclusion that 'inadequate collection procedures' were the source of a "problem"?

8.32 The report also failed to indicate the basis of the recommendation that there should be intervention from a central agency. There may be other alternatives: greater attention to such "problems" within individual departments; the assignment of better-qualified staff to the task of managing accounts receivable - and so forth. Again, the Auditor-General's recommendations may or may not have been soundly based - but without any indication of the evidence obtained from the audit review it is impossible for the external reader of the report to comprehend the nature of the problem.

8.33 Possibly the Auditor-General's office did collect evidence which indicated that there is "a need for tighter and more uniform management of ... financial activities [such as] receivables, inventory etc" - but simply did not report it. The Public Accounts Committee may wish to investigate the background to that recommendation in greater detail; however that task is considered to be outside the brief for this report.

Standards for "performance auditing"

8.34 The foregoing discussion was intended to illustrate the difficulties which are faced by the Public Accounts Committee or senior public servants in endeavouring to respond to the Auditor-General's suggestions, in light of the approach he has taken to report concerns about the performance of some public-sector managers.

8.35 Some public sector audit institutions have developed "audit standards" for performance auditing. The Australian National Audit Office has published "Australian Audit Office Standards" (1986, revised 1987) which included some material on performance auditing. The NSW Public Accounts Committee has recently (July 1990) produced a series of recommendations concerning the conduct of performance audits. These recommendations include: proposals for statutory amendments to clarify the Auditor-General's mandate; the establishment of a task force to undertake the planning and development of performance auditing; the publication of "a comprehensive Statement of Auditing Standards"; the proposal that urgent consideration be given "to defining and publishing standards for reporting on performance audits of commercially oriented statutory bodies which address the issues of commercial confidentiality and the role and format available to the auditee to comment on such audit findings".

8.36 Probably the most detailed set of guidelines currently available was issued by the United States General Accounting Office: Government Auditing Standards (1988 revision). This document includes 73 clauses on "reporting standards for

performance auditing". It will be noted that many of the reservations offered (in paragraph 8.31 above) about the content of the NT Auditor-General's report have been addressed in the GAO's standards. The following are extracts from the GAO's rules:

2. Written audit reports are to be prepared communicating the results of each government audit.

10. The report should include a statement of audit objectives and a description of the audit scope and methodology.

12. The statement of objectives being reported on should explain why the audit was made and state what the report is to accomplish....

14. The statement of scope should describe the depth and coverage of audit work conducted to accomplish the audit's objectives. It should, as applicable, explain the relationship between the universe and what was audited, identify organizations and geographic locations at which audit work was conducted and the time period covered, cite the kinds and sources of evidence used and the techniques used to verify it, and explain and quality or other problems with the evidence. If unverified data are used, this needs to be stated. Any constraints imposed on the audit approach by data limitations or scope impairments ... are to be disclosed.

15. The statement on methodology should clearly explain the evidence gathering and analysis techniques used to accomplish the audit's objectives. The explanation should identify any assumptions made in conducting the audit, describe any comparative techniques applied and measures and criteria used to assess performance, and if sampling is involved, describe the sample design and state why it was chosen.

16. Every effort should be made to avoid any misunderstanding by the reader concerning the work that was and was not done to achieve the audit objectives, particularly when the work was limited by relying on internal controls or because of constraints on time or resources.

17. The report should include a full discussion of the audit's findings, and where applicable, the auditor's conclusions.

18. The report should present the findings and finding elements developed in response to the audit objective. Sufficient, competent and relevant information about findings should be included to promote adequate understanding of the matters reported and to provide convincing, but fair presentations in proper

perspective. Appropriate background information that readers need to understand the findings should also be included.

21. The report should include the cause of problem areas noted in the audit, and recommendations for actions to correct the problem areas and to improve operations, when called for by the audit objectives.

26. Reports which contain constructive recommendations can encourage improvements in the conduct of government programs and activities. Recommendations are most constructive when they are directed at resolving the cause of identified problems, are action oriented and specific, and are addressed to parties that need to act. Recommendations also need to be feasible and cost-effective.

43. The report should include the pertinent views of responsible officials of the organization, program, activity, or function audited concerning the auditors' findings, conclusions, and recommendations, and what corrective action is planned.

8.37 The NT Auditor-General's office has developed some guidelines for use within the audit office, and by private-sector auditors working under contract. This document, "Review of the Auditor-General's Responsibilities" (September 1986) includes some reference to "performance auditing". For example, it regards the minimum audit objectives as being to determine "legislative and regulatory compliance" and "financial regularity", and then adds that an audit "should be planned so that there is a reasonable expectation of detecting significant diseconomy, inefficiency or ineffectiveness" (section 1, p.13).

8.38 Clarification of the Auditor-General's mandate, and the development of more extensive guidelines for use by the staff of the Auditor-General, should lead to the reports on performance audits being more informative and useful to Parliament, and the Public Accounts Committee.

Recommendation:

That the Auditor-General be encouraged to develop or adopt standards dealing with the conduct of "performance auditing" and with reporting the findings of that auditing work to public service managers, Ministers and Parliament.

8.39 It is recognised that the Auditor-General has a responsibility to apply the highest professional standards to the conduct of his tasks. It is also recognised that the Auditor-General and the Public Accounts Committee have some common interests in endeavouring to promote improvements in

"accountability" (in many of the senses outlined in section 3 of this report). Accordingly, it is suggested that the Committee seek discussions with the Auditor-General about any draft standards on performance auditing (and compliance auditing) prior to their adoption. The support of the Public Accounts Committee in these endeavours may well be valued by the Auditor-General.

Recommendation

That the Auditor-General be encouraged to discuss draft standards on compliance auditing and performance auditing with the Public Accounts Committee.

8.40 If the Public Accounts Committee were to support proposals for the Auditor-General's office to undertake a series of systematic "performance audits" of particular programmes or activities being conducted by departments or statutory authorities, then questions may well be raised about whether the Auditor-General's office is adequately funded for this type of work. Questions might also be raised about whether the cost of certain efficiency audits should be borne by individual auditees. Such issues have been raised extensively in reports produced by the commonwealth Joint Committee on Public Accounts (1989) and the NSW Public Accounts Committee (1990). However it may be premature to consider such issues in detail, before there has been further experience with performance auditing in the Northern Territory.

Recommendation

That at a later date the Public Accounts Committee review the activities of the Auditor-General's office in performance auditing, with a view to considering whether the office is adequately funded for such activities.

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CONSULTANT'S REPORT
by
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**THE ADEQUACY OF FINANCIAL REPORTING
IN THE NORTHERN TERRITORY:
ACCOUNTABILITY AND MANAGEMENT ISSUES**

on behalf of

**THE PUBLIC ACCOUNTS COMMITTEE OF
THE LEGISLATIVE ASSEMBLY
OF THE NORTHERN TERRITORY**

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FOREWORD

In April 1990, Nicholas Clark and Associates was commissioned by the Public Accounts Committee of the Legislative Assembly of the Northern Territory to:

1. Assess the appropriateness and adequacy of the presentation and content of the Treasurer's Annual Financial Statements, especially in relation to debt disclosure and actual and contingent liabilities.
2. The relevance of matters raised in the Auditor General's report for the year ended June 1989, especially the recommendations to the Legislative Assembly, and particularly "That a review be undertaken to adopt any appropriate measures from developments elsewhere which can improve the financial accountability arrangements of Northern Territory government operations".

The research for this project was undertaken by Dr Chris Hall, Senior Lecturer in Economics at the University of Technology, Sydney (Kuring gai Campus), who also prepared the report.

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SUMMARY

The supply of financial reporting information serves two main types of functional demand:

- . a demand for information relevant to the management of resources; and
- . a demand for accountability of officers and organisations.

In recent years there has been a steady improvement in public sector financial reporting in the Territory and elsewhere. The main focus of this study is:

- . to identify areas where further improvement is warranted in Territory financial reporting, by reference to problems, potential problems and developments elsewhere; and
- . to establish some tentative priorities for improvements, based on a preliminary assessment of the usefulness to users relative to the costs of implementation.

There are some areas where immediate improvement is warranted and easy to implement. The financial reporting arrangements of government owned corporations (other than prescribed statutory authorities) are a case in point. Similarly, it should be relatively easy to provide a better overall picture of the Territory's economic and financial position without the difficulty and expense of adopting consolidated whole of government reporting.

There are other areas where developments are possible, but their success will depend on careful review and planning to ensure that the developments are attuned to Territory conditions and actually lead to a net improvement in the quality of financial reporting.

Improvement in financial reporting is an ongoing process. Overall improvement in financial reporting requires a balance to be struck; between improvements in broad performance accountability and narrow stewardship accountability, between specific management information and broad strategic information, and between management information and information pertinent to accountability.

The challenge in the Territory is to pick the appropriate balance, and to maintain the appropriate rate of improvement. This can best be achieved by a strategic approach.

1. INTRODUCTION AND AIM

In his 1989 Annual Report, the Auditor General made a number of recommendations. Four specific recommendations to the Legislative Assembly were:

1. That a review be undertaken to adopt any appropriate measures from developments elsewhere which can improve the financial accountability arrangements in respect of Northern Territory government operations.
2. That a review be undertaken to determine the information needs of the users of government financial reports.
3. That a review be undertaken to determine the adequacy or otherwise of current annual reporting methods by departments in terms of their appropriateness.
4. That a review be undertaken as to the adequacy or otherwise of the accountability and reporting arrangements which exist in respect of government owned companies, corporations trusts etc. The review should include consideration of such aspects as:
 - (a) The process for the creation or acquisition of such entities;
 - (b) Statutory reporting requirements; and
 - (c) Whether the Auditor-General should have an involvement in the audit function of those entities.

It is emphasised that the purpose of this report is not to carry out an in-depth and comprehensive review of the issues raised by the Auditor General. Rather, the purpose of this report is to carry out a broad preliminary assessment of the four issues raised with a view to:

identifying areas where practical improvements can potentially be made in financial reporting, bearing in mind the costs and difficulties associated with collecting, processing and presenting information, and

establishing priorities and a tentative timetable for implementing improvements, and/or more in-depth assessment of potential improvements.

2. BACKGROUND: FINANCIAL REPORTING IN THE NORTHERN TERRITORY GOVERNMENT SECTOR

For financial reporting and accountability purposes, the Northern Territory government sector can be seen as being comprised of:

- . Departments and other administrative organisations,
- . Statutory authorities,
- . Government owned corporations, trusts and companies.

2.1 Departments

There are fourteen departments and three other administrative organisations. These are listed in Table 1. These organisations are responsible for just under 60% of total appropriations in the 1989/90 budget.

All departmental accounts and transactions are centrally processed via a computer based accounting system operated by Treasury. The Financial Administration and Audit Act requires accountable officers in departments to establish and keep departmental accounts (S7). The Act does not require departments to provide financial statements, except when a department conducts any manufacturing, trading or commercial activity and then only on the Treasurer's direction (S30).

However, the Act does require the Treasurer to provide a full and particular statement in detail of expenditure and receipts of the Consolidated Fund and Trust Fund, and to transmit such statements to the Auditor General (S29).

In practice, in the past a number of departments have prepared financial reports as part of their more general annual reports. As of 1989/90 all departments are now required to provide a financial report. These follow a pro forma provided in the Treasurer's directions.

The Auditor General has also suggested a pro forma for financial reporting by departments which differs from that provided in the Treasurer's directions. The Auditor General's pro forma follows a more "commercial" approach and requires, for example, a statement of assets and liabilities, and both a cash and accrual presentation of income and expenses (or receipts and payments).

**Table 1:
Departments and Administrative Organisations**

Departments of:

- . Chief Minister
- . Treasury
- . Legislative Assembly
- . Health and Community Services
- . Mines and Energy
- . Industries and Development
- . Law
- . Lands and Housing
- . Education
- . Northern Territory Police and Emergency Services
- . Transport and Works (including Road Safety Council)
- . Labour and Administrative Services
- . Primary Industry and Fisheries
- . Correctional Services

Other Administrative Organisations

- . Office of Auditor General
- . Office of Ombudsman
- . Office of Youth, Sport Recreation and Ethnic Affairs

2.2 Statutory authorities

There are twenty statutory authorities currently operating in the Territory as prescribed statutory corporations. These are listed in Table 2.

Statutory authorities are required to provide financial statements within 3 months of the end of the financial year, in a form approved by the Treasurer. Prior to submission to the Minister, each authority must submit the report to the Auditor General.

Statutory Authorities are required to comply with the Financial Administration and Audit Act, and to provide accounts and reports in accordance with accepted commercial accounting principles. The Auditor General provides advice and assistance as to what principles are appropriate, and most statutory authorities follow model financial statements similarly provided.

**Table 2:
Statutory Authorities**

- . Agricultural Development and Marketing Authority
- . Cobourg Peninsula Sanctuary Board
- . Jabiru Town Development Authority
- . Nitmiluk (Katherine Gorge) National Park Board
- . Northern Territory Grants Commission
- . Northern Territory Totaliser Administration Board
- . Strehlow Centre Board
- . Surveyors Board of Northern Territory
- . Aboriginal Areas Protection Authority
- . Territory Loans Management Corporation
- . Power and Water Authority
- . Trade Development Zone Authority
- . Northern Territory Housing Commission
- . Museums and Art Galleries Board
- . Conservation Commission of the Northern Territory
- . Northern Territory University
- . Darwin Port Authority
- . Work Health Authority
- . Northern Territory Tourist Commission
- . Racing Gaming and Liquor Commission

There is also one organisation, the Electrical Workers and Contractors Licensing Board which is neither a statutory authority nor a department, which is nevertheless funded separately in the budget.

2.3 Government Owned Corporations, Trusts and Companies

There is no central register of corporations, trusts, companies and the like in which the Territory (or any Territory statutory authority) has some form of interest. At present, it is not possible to determine readily how many such organisations the Territory has a direct or indirect interest in.

There is no formal requirement that financial reports of such organisations be provided to the relevant minister, or to the Treasurer. Section 70 of the Financial Administration and Audit Act provides a discretionary power to the Auditor General to audit the accounts of such organisations at the request of the minister.

In practice, the financial position of some of these organisations is reported in the annual reports of the holding departments or statutory authorities, or in reports of the organisation itself (as is the case with the Territory Insurance Office).

3. FINANCIAL REPORTING FUNCTIONS

3.1 The Demand for Public Sector Financial Information

Public sector financial reports meet two main types of demand:

1. a demand for information on the accountability of public sector organisations and managers.
2. a demand for information relevant to the effectiveness of management of public sector resources in achieving economic, political and social objectives.

Accountability

The accountability function of financial reports emphasises what has already occurred; it reports what has been done in comparison with standards which are prescribed in legal (eg. statute) or quasi-legal (eg. recommended accounting standards), or moral terms.

Accountability functions rely largely on verifiability and reliability for their effectiveness. That is, they depend upon the ability of someone (eg. an auditor) to independently arrive at the same reported results.

Historically, accountability in the public sector has had a relatively narrow focus on stewardship. The focus has been on verifying that funds provided to an organisation are able to be accounted for.

In recent years, the focus of the accountability function has tended to broaden to cover performance aspects. Thus, an organisation may be accountable in terms of its ability to meet its objectives to a prescribed or target level with a given quantity of resources. This change of focus has created some problems with the verifiability and reliability aspects of accountability. It is more difficult to reliably verify performance (unless it is very well defined, which may be difficult) than it is to verify that funds can be accounted for.

Management

The management function of financial reports emphasises what can be done to improve the efficiency and effectiveness of the organisational unit.

Accountability is an important subset of the management function: without effective accountability, management has less incentive to manage in the public interest; and future management decisions usually depend to some extent on information about past performance. However, accountability is only a subset of the management function, and other aspects are also important.

Effective management requires information about the likely consequences of adopting alternative approaches or options. This usually cannot be derived from information appropriate to fulfilling accountability functions. Information which is useful in a management function is usually more rubbery (less reliable) and less certain (more difficult to verify) than is acceptable for accountability purposes.

The main user groups of public sector financial reports are:

- . The Legislative Assembly
- . Public Accounts Committee
- . Ministers
- . The Auditor General
- . Public sector managers at all levels
- . The Commonwealth Government
- . Other Governments (State, Local)
- . Those members of the public and others with some interest in the financial operation and performance of the Territory, in particular:
 - investors, potential investors, and their agents (eg. the rating agencies),
 - the business community,
 - financial institutions,
 - community groups,
 - the media,
 - taxpayers and the community generally.

Table 3 sets out some examples of the needs of users of public sector information in terms of:

- . WHAT information the users of public sector financial reports are usually looking for
- . WHY the users might look for such information
- . HOW AND WHERE they might seek to find the information

TABLE 3 - PUBLIC SECTOR FINANCIAL INFORMATION NEEDS

| WHAT might users look for? | WHY look for it? | HOW AND WHERE to look for it? |
|--|---|---|
| 1. <u>Stewardship and Compliance</u> | | |
| . records and accounts kept properly | . evidence of poor financial control, minor opportunities for fraud | . Auditor General investigation and reports |
| . timelines for reporting | . effective control of money and resources | . Accounts, records and reports |
| . reports and accounts consistent with relevant accounting standards (professional, ASA, PSASB - Govt) | . ready comparison and interpretation | . standard reporting requirements and format . Periodic review of appropriateness of standards |
| 2. <u>Waste and Inefficiency</u> | | |
| . value for money | . identify outdated inappropriate practices, encourage more efficient and effective management | . annual reports |
| . poor management and operating practices | . identify outdated inappropriate practices, encourage more efficient and effective management | . performance reporting and program budget targets |
| . specific instances where costs are excessive, revenues not recovered etc | . initiate specific investigation | . efficiency audits . cross-sector comparison of performance indices where appropriate |
| 3. <u>Non-Disclosure and Concealment</u> | | |
| . information about what Departments etc actually do, how they spend money etc | . to ensure that funds are directed in the way the Govt actually intended, and to maintain accountability of managers | . annual reports . annual report checklists and guidelines |
| . improper use of accounting practices to conceal real purpose of activities (eg. provisions, hollow logs etc) | . to identify specific areas or activities which may be potential problems | . disclosure requirements |
| . moving activities off balance sheet, etc | . limit potential for fraudulent activities, misuse of funds etc | . Auditor General checks |

| WHAT might users look for? | WHY look for it? | HOW AND WHERE to look for it? |
|--|--|--|
| 4. <u>Risks and Exposures</u> | | |
| . forewarning of all future risks, commitments and exposure to changes in circumstances (eg. to revenue base, etc) | . allow proper risk management . restrict managers from improving short term performance at expense of long term risks and commitments | . annual accounts . disclosure requirements (eg. contingent liabilities etc) |
| . comprehensive documentation of known contingent liabilities, and commitments | . encourage long term performance improvement | . annual report checklists and guidelines |
| . identify long term recurrent cost implications of capital expenditure | . discourage Departments from achieving budget allocation by stealth and future commitment . avoid possibility of major fraud and financial embarrassment | . capital budgeting checklists . financial implications reporting . Auditor General checks |
| 5. <u>Organisation Strategic Effectiveness</u> | | |
| . does actual organisation strategy/performance match stated or planned strategy? | . encourage longer term achievement of objectives of Govt, economically and efficiently | . organisation strategic or corporate plans . annual reports/accounts |
| . is strategy sustainable in longer term | . provide a counter to annual report incentive for managers to focus on short term performance . avoid black holes and potential sources of financial embarrassment | . projections and financial implications reporting |
| . what are the financial implications of the actual and planned strategy? | | |
| 6. <u>Government Strategic Effectiveness</u> | | |
| . assessment of longer term financial implications of Government strategy and objectives | . identify potential problem areas . encourage flexibility and discourage inertia: target areas which need overhaul to bring in to line with changing priorities | . Government policy statements, budget etc . summary financial statements |
| . check that resources are deployed in line with priorities and strategy | | |
| . identify specific areas which are over or under resourced | . keep pressure up for lean responsive government | |

3.2 The Supply of Public Sector Financial Information

To produce and supply information is often expensive; it usually requires significant skilled labour resources, and capital equipment in the form of computer hardware and software.

Public sector resources are limited. This means that it is necessary to make decisions as to what information should best be provided. Meeting all user needs for all types of information would be prohibitively expensive and a waste of money.

The key question is not so much a matter of knowing what user needs are, as a matter of knowing how much extra benefit will be provided at how much extra cost. In other words, there is no justification for providing more information on accountability, for example, if its extra usefulness is out of proportion with the extra cost of providing it. As a basic rule of thumb, if a considerable body of information is already provided, providing more will add little of benefit but will add significantly to the cost. An important exception occurs when the quality of the information can be improved, or the presentation simplified by relatively low cost modifications.

The key point is that improvements in public sector financial reporting requires decisions to be made, and priorities to be set. Some of the questions and decisions which must be addressed are as follows:

- . First, the accountability and management functions of public sector financial reporting are not completely complementary. Improving accountability may, in some cases, only be achieved by reducing the potential for improvements in the quality or availability of management information. The problem is more acute when the resources available to devote to improvements are limited. It is necessary to decide where given resources will have most impact and effect; on improved accountability, or improved management information.
- . Second, public sector accountability itself encompasses a range, which extends from specific stewardship issues to the broader issues of strategic effectiveness. It is necessary to decide where resources deployed on improvements will have most effect.

- . Third, public sector resource management also encompasses a range which extends from the specific and timely management of minor assets and liabilities, to the broader long term strategic management of the entire government sector. Similarly, it is necessary to decide where improvements will have most effect.
- . Fourth, information which satisfies one user's requirements (eg. specific stewardship/accountability) will not necessarily be appropriate to the requirements of other users (eg. broad strategic effectiveness). It is necessary to decide how to segment information supply, how much to provide to each group, and possibly how to charge for it.
- . Finally, given the costs and difficulties in collecting, processing and presenting information, it is not practical to attempt to fulfill all user needs all the time. Consequently it is necessary to establish priorities, and to focus on those areas where improvements in information will have the most impact. This is addressed in the next section.

4. ESTABLISHING PRIORITIES FOR IMPROVEMENT IN FINANCIAL REPORTING

Improvements in public sector financial information generally arise because of one of two reasons.

Either there are specific problems which arise (or might arise) and which need to be dealt with. Examples are the problems dealt with by Fitzgerald in Queensland, or more recently the problems in Western Australia, commented on by the Auditor General in that State.

Alternatively improvements arise as part of a general attempt to enhance the quality of financial management and reporting. Examples are the Commonwealth Government's Financial Management Improvement Program, and the NSW Government's Economic Appraisal of Assets Program.

As was argued in section 3.2, it is irresponsible simply to make improvements for the sake of improvements, or because users "need" improved information. Given the costs of producing, processing and providing information it is important that resources be deployed in such a way as to offer the greatest improvement possible. This necessitates priorities.

In order to establish at least a preliminary set of priorities for improvement it is useful to ask two questions:

1. Are there any specific problems or potential problems in the Territory which warrant attention?
2. Are there any developments which are relevant to improving the quality of financial reporting in the Territory?

4.1 Are there any specific problems or potential problems associated with financial reporting in the Territory?

Discussions with staff and members of the Auditor General's Office, Treasury, the Public Accounts Committee and a selection of other public sector organisations indicated that there were no instances where financial reports were so deficient as to pose a significant problem to the governance of the Territory, or to place any specific organisation in contravention of its statutory obligations.

There have been occasional instances when the Auditor General has had to request additional information and has had to suggest improvements in accounts submitted to him, but these do not constitute a systematic fault in the reporting processes as such.

These requests usually only reflect practical and temporary difficulties experienced by departments and statutory authorities in meeting the existing reporting requirements. These difficulties can usually be traced to a shortage of trained and qualified staff, a problem which is acute in, but not unique to, the Territory.

The significance of these observations is that there appear to be no existing problems which warrant urgent and immediate attention.

This does not mean that problem areas do not exist; it simply means that on the evidence currently available there appear to be no significant problem areas. Further, a small number of potential problems were indicated in the course of discussions with the Auditor General's Office, Treasury and the PAC, and in the course of reviewing the reports and accounts of a number of departments and statutory authorities. By "potential problem" it is implied that although there is no evidence that either accountability or the quality of resource management is presently jeopardised by inadequate financial reporting, it is possible that problems may arise in the future. Three specific issues warrant some further review, and these are dealt with below in Sections 4.1.1 to 4.1.3.

4.1.1 Government corporations, trusts etc

As noted in Section 2.3, there is at present no systematic reporting requirement for the financial status of corporations in which the Government has an interest. Nor is there at present any central register of such entities.

Any corporation in which the Territory has an interest would normally be subject to the reporting requirements of the corporate legal jurisdiction in which it is established, for example, the Territory or Singapore. However these reports are usually not much more than the minimum required, are not particularly informative, and in some cases would have to be searched. In an extreme case, it is possible that the Territory government could be unaware of a contingent interest (eg. via convertible notes) in a corporation which is incorporated outside

Australia, and which exposes the Territory to unknown liabilities in foreign currency. Even if the government were aware of such a contingent interest, it is possible that the Legislative Assembly may not be.

4.1.2 Contingent and actual liabilities

The general issues of contingent and actual liabilities appears to be well recognised and addressed in the Territory (with the possible exception of those arising from corporations, discussed in 4.1.1). The Public Accounts Committee has a standing investigation into these liabilities, and has reported on it. (Report No. 2, November 1987). A further report is currently in preparation.

It is useful to distinguish three main types of contingent liability.

- (a) Well defined future claims on Territory resources. This is best illustrated by items such as superannuation and long service leave. The amounts involved can usually be estimated reasonably accurately and dealt with by normal accrual procedures.
- (b) Legally enforceable claims which are triggered by a defined event, for example, when one of its agents or representatives commits the Territory to act as underwriter or guarantor.
- (c) Claims which are not strictly legally enforceable, but where there is a social or political obligation. For example, natural disasters or, as in Victoria's recent experience, a "thrift crisis" in a building society.

There are three issues which continue to warrant attention.

First, how should actual and contingent liabilities be reported? The perceived problem is that the practice of reporting varies from organisation to organisation, so that it is difficult to obtain an accurate, quantitative view of the overall level of liabilities, particularly contingent liabilities, of the Territory. This problem is not unique to the Territory, nor indeed to the public sector.

Second is the issue of accountability for entering into contingent liabilities. The problem here is that it appears that

some contingent liabilities have been entered into without the extent of the liability being fully understood, and without sufficient attempt to establish risk management procedures. Typically, contingent liabilities are reported simply as a note to the accounts, because it is difficult to give a meaningful quantification. This, however, should not absolve those responsible for entering into the liability from undertaking a more detailed financial analysis of the probability weighted implications, and from investigating ways to manage the risk. Part of the problem is the extent to which this information is made publicly available.

The third issue is whether actual and contingent liabilities should be provided for and funded accordingly. Typically where cash budgeting is used (as is the case in government departments in the Territory) it is not practice to provide or fund. In the case of accrual accounting (as is the case for most Territory statutory authorities) it is common to provide, but not necessarily to fund.

4.1.3 Unforeseen income fluctuations, forward estimates, and the Treasurer's advance

As is fairly common in public sector accounting, major unforeseen expenditure in the Territory is met from the Treasurer's advance. This is simply an amount appropriated in each budget, and used at the discretion of the Treasurer or the Government, subject to report to the Assembly.

The issue is that the Territory is becoming more exposed to potential fluctuations in its income base because of its increased reliance on tourism and trade.

Because of the geographic position of the Territory, there has always been something of a premium placed on attracting and keeping good people in the north. Similarly, that private sector investment which depends on public infrastructure is more likely to be attracted to the Territory if it can be planned reasonably reliably. This will actually become more important as the Territory relies less on federal funds and more on its own economic engine. The private sector typically places a premium on stability in economic policy and longer term government planning.

The problem is perhaps usefully illustrated by the recent pilots dispute; to sustain investment in human capital and resources it

was considered appropriate to tide parts of the Territory economy over the hiccup by using Government funds. In some cases existing contingency agreements led to a legal claim on the Territory. In other cases, even though there was no legal obligation there may still be a political or social "obligation" to provide assistance.

The problem is partly a policy problem and partly a reporting problem.

The policy problem is first, the extent to which forward commitments can or should be made in budget appropriations. At present appropriations are only made for one year. The second policy problem is who should get assistance, how much, and how should it be provided.

The reporting problem is just how to represent financial "obligations" to unknown clients over periods which extend beyond a normal annual budget cycle and indeed may extend beyond the life of the Government.

4.2 Are there any developments which are relevant to improving the quality of financial reporting in the Territory?

A survey of recent trends and developments in public sector financial reporting shows that there are a number of common elements. This section outlines the main trends and developments of potential relevance to the Territory. It is convenient to categorise these in terms of:

- . Departmental Reporting
- . Corporations and Statutory Authorities
- . Other Corporations
- . Whole of Government Reporting.

The survey which forms the basis of the section was undertaken during May and June 1990, and involved telephone interviews with senior government officers in all States and the Commonwealth, and a review of available documentation and literature. The survey did not attempt to cover all aspects of all developments in all areas. Rather, the focus was on the broad trends and developments relevant to the Territory.

4.2.1 Relevant trends and developments in departmental financial reporting and management

4.2.1.1 Mandatory Financial Reporting by Departments

There have been a number of recent developments in the Territory which have sought to improve the quality of departmental financial reporting and management. For example, as of 28 June 1990, the Treasurer's directions were modified to require specific financial statements in departmental annual reports for the 1989/90 financial years and on. This brings the Territory into line with other governments. Previously a department was not obliged to provide individual annual financial statements although departments' financial position was reported via the Treasurer's statements. Many departments did in fact also provide individual financial reports as part of their annual report, but there was no statutory requirement or standard, as there now is.

4.2.1.2 Basis of Accounting

There are two main types of accounting base: cash or accrual.

Administrative public sector accounting has traditionally been cash based. In recent years there has been a trend in most states to move more to an accrual base.

At this stage only NSW has adopted a full commitment to accrual accounting for departments. All departments now report on an accrual basis, but there are still some difficulties, for example in the area of asset valuations and depreciation. New Zealand has already adopted full accrual accounting as standard and South Australia is seeking to move to full accrual reporting.

Most other states, and the Territory, have adopted some form of hybrid. That is, the accounts are still cash based, but some supplementary accrual information is provided.

In the Territory, under the Treasurer's directions of 28 June 1990, additional accrual information must be provided on accounts receivable, accounts payable, and employee entitlements.

Other states require rather more supplementary information. Victoria, for example requires some intergovernment charges to be separated out, requires an estimated rental charge for buildings,

and requires a narrative, and in future an estimated value, of non current assets.

4.2.1.3 Asset Registers, Asset values and Asset Management

The required use of asset registers by departments is now widespread, although the extent and quality of coverage varies a lot.

Similarly, there has been a general move to recognise the increasing importance of asset management, which requires more than just a register of assets.

The main problem faced in public sector asset management is in the valuation of assets. Many such assets do not have fungible market values, and some, such as heritage assets, are not marketable at all. NSW is probably the most advanced in this area of valuation; a set of guidelines for reporting and valuing physical assets in budget sector organisations was released in November 1989.

In the Territory, the centralised Government Accounting System now includes an asset recording module which is progressively being used by a number of departments and statutory authorities. There is at present no specific requirement to report this information publicly.

4.2.1.4 Risk Management

Risk management is progressively being adopted as common practice in the public sector throughout Australia. However there are very different interpretations of what constitutes risk management, and practice differs considerably from area to area.

The general trend is to require public sector managers to implement programs which evaluate the levels of risk exposure accurately, and which take steps to manage that risk commensurate with the costs and benefits of doing so.

There are considerable differences in the mechanisms for managing risk, and most risk management procedures involve a portfolio approach adopted to the specific circumstances of the department concerned.

Similarly there is little commonality in the way risk management is reported. In some cases, for example it is reported annually

as part of a program budget activity, with quantitative assessment and performance indicators, while in other cases it may not be reported separately at all.

There have been some moves to introduce risk management practices in the Territory mostly focussed on issues of insurance and self insurance. There is no obligation for departments to report on risks or risk management provisions.

4.2.1.5 Contingent Liabilities

Financial reporting requirements now generally oblige departments to give some indication of the existence of contingent liabilities. As discussed in section 4.1.2, there are a number of issues relating to the way contingent liabilities are treated and reported. Practice differs widely between departments and between states.

Practice in the Territory is that the present Treasurer's directions require departments to provide supplementary information on employee entitlements outstanding, but do not specifically require inclusion of any other contingent liabilities. Superannuation is treated at a whole of Government level. These practices reflect the more general cash-accounts-plus-supplementary-information adopted in the Territory.

In addition, all departments and statutory authorities are requested by the Treasurer to provide details of guarantees, indemnities and the resulting contingent liabilities. Details are maintained on a central register, updated annually and reported in Statement 6 of the Treasurer's Annual Financial Statements.

4.2.1.6 Annual Report Checklists and Guidelines

There is a trend toward providing checklists and guidelines for the preparation of departmental annual reports. These guidelines supplement the directions usually provided by the Treasurer (or Minister for Finance in the Commonwealth's case). The main function of the guidelines is twofold:

- . first they assist departments in preparing their reports in a standard and comparable form;
- . second, they ensure that departments specifically address particular issues in their reports. Examples of specific issues or matters usually required are:

- enabling legislation
- aims and objectives
- management structure
- review of operations
- performance measures and review practices
- assets held
- ownership of corporations.

There is no standard set of guidelines for departmental annual reports in the Territory. Departments have variously used guidelines provided by the Northern Territory Public Sector Annual Reports Awards scheme, by the Royal Institute of Public Administration, and by the Commonwealth Department of Finance.

We note that it is sometimes difficult to interpret financial information provided by Territory statutory authorities because of a lack of clarity of explanatory notes.

4.2.1.7 Strategic Plans and Forward Estimates

In the last ten years or so, it has become general practice for departments to prepare strategic plans.

At this stage, only in NSW are these plans linked to appropriations by means of a forward estimate. All other governments in Australia appropriate on an annual basis. NSW has been experimenting with forward estimates up to three years ahead, so that departments can, in principle, plan their activities in line with a more strategic, long term view.

The Territory faces special difficulties in moving to such forward estimates, because of its reliance on Commonwealth funding. While the Commonwealth continues to appropriate on an annual budgetary basis, the Territory tends to be obliged to to the same.

4.2.1.8 Reporting on the Future Financial Impact of Decisions

A number of governments now require departments to assess and report on the future financial implications of proposed decisions, particularly major capital investment decisions. In some states (NSW, SA for example) the final approval is left to a ministerial capital works committee which reviews the reported information. In other cases (eg. the Commonwealth) the emphasis is more on voluntary improvements in financial management by departments.

These moves have generally been accompanied by the development of guidelines, manuals and training programs designed to assist departmental managers acquire improved financial and asset management skills.

At present the Territory requires some major decisions (eg. those pertaining the computers) to be subject to prior appraisal and review, but not all. There are no procedures in place to check that major projects do in fact deliver the benefits promised in the a priori decision making process.

4.2.1.9 Program Budgeting and Reporting

Program budgeting is now widely adopted for departmental reporting. In the Territory the use of program budgeting commenced in the early 1980's. Budget information for appropriation has been prepared on an activity or program basis since 1989/90, and departments are now required to report on actual program expenditure by activity.

The main practical difficulty with program budgeting is the development of appropriate performance indicators. This is a prerequisite to performance evaluation and audit, which is the principal advantage of program budgeting.

Although considerable effort has been devoted to the development of performance indicators in other states, the results remain equivocal. There are two related problems.

One is the separation of outputs and outcomes. An output is what an organisation produces, such as bed days, or megalitres of water. An outcome is the effect this has clients, and the way it adds value, such as improved health and quality of life. Program performance indicators tend to emphasise outputs, which are easier to measure, rather than outcomes. The other is the flexibility of an organisation to adapt its programs and modify its outcomes to meet changing social and political imperatives. Performance measures often tend to create rigidities.

4.2.2 Relevant trends in Statutory Authority financial reporting and management

As is the case in the Territory, statutory authorities are usually required to report along "commercially accepted principles" promulgated by the various accounting bodies. Whilst

these principles may provide adequate standards of accountability they do not necessarily ensure efficient economic management. The main trends in statutory authority reporting tend to focus on this latter aspect.

4.2.2.1 Rate of Return Reporting

Rate of return reporting is increasingly required of statutory authorities and government business enterprises. The basic thrust of such reporting is to replace detailed controls over authorities' activities with commercially oriented performance targets.

Measuring rates of return, particularly in enterprises with ownership of, or responsibility for, substantial amounts of public assets, is often difficult simply because of the difficulties in valuing the assets. This has led to the development of specific guidelines (eg. the Commonwealth, Victoria) on the application of rate of return reporting to the public sector.

In some states this is reinforced by the requirement that the authorities pay "dividends" based on a nominated rate of return on assets used.

The Territory does not currently set rate of return targets for statutory authorities. Many of the Territory's statutory authorities are not public trading enterprises, and so the usefulness of rates of return as a performance measure may be questionable. Nevertheless, there is a case for setting performance criteria and monitoring performance.

4.2.2.2 Community Service Obligations

In a move to increase the financial responsibility and independence of statutory authorities, some states (eg. NSW) now "contract" for the provision of community service obligations. This is an alternative to providing blanket funding, and allows the relevant authority to report its result in terms of rate of return or profit in providing commercial versus community services.

Whilst the concept is appealing, there are numerous practical difficulties in measuring and thus contracting for community service obligations.

The Territory does not at present engage in the practice of separately paying for community service obligations.

4.2.3 Relevant trends and developments in other corporations financial reporting and management

"Other corporations" refers to corporations, other than statutory authorities and government business enterprises (GBEs), in which the government holds some equity, either directly or indirectly. The distinction between "other corporations" and statutory authorities and GBE's is usually that the latter are incorporated or established by an act of parliament. The former are incorporated through normal commercial processes of incorporation, and part of the equity is held by a minister, a department (presumably on a minister's behalf, even though he or she may not be aware of it) or by a statutory authority. Sometimes a departmental officer may hold the equity as nominee for the department or minister.

Perhaps the most significant trend has been in the growth of "other corporations". The Commonwealth Senate Standing Committee on Finance and Public Administration identified at least 388 such companies in its 1989 report. Because of the difficulties in identifying such corporations, it is uncertain just what the growth rate or level actually is.

There are three main trends of relevance to the Territory.

4.2.3.1 Mandatory Reporting of Status of Other Corporations

Some states now require departments and statutory authorities to report annually (or more frequently, eg. every 6 months in Victoria) the existence of any interest in other corporations. In some cases, only a controlling interest (above 50% of equity) must be declared.

There is then a separate issue as to whether this information is reported to parliament, eg. in the form of a register. There is a trend toward such reporting but it is not widespread as yet.

4.2.3.2 Restrictions on the ability to establish other corporations

Some states (eg. South Australia) are considering placing restrictions on the incorporation of other corporations. The argument is broadly that corporatisation in the form of statutory authority is quite adequate, and that incorporation offers no substantial benefit to the public or to parliament. In particular, other corporations pose a problem for effective ministerial control, because the minister's discretionary control is limited to the appointment and removal of directors.

4.2.3.3 Accounts and Audit

There is also an issue as to how the accounts of other corporations should be presented, and who should audit those accounts.

Although there is no clear trend, on the first issue there appears to be an emerging balance of opinion that there should be equity accounting and that the accounts should clearly appear as part of the accounts of the holding department or statutory authority. Similarly, the balance of opinion seems to favour compulsory auditing by the Auditor General where there is government control. Where the government holds only a minority interest there is no clear body of opinion as to the role of the Auditor General.

4.2.4 Relevant developments in whole of government financial reporting

Whole of government reporting is not a precise concept. Traditionally, the overall financial position of government has been reflected in the budget papers and various financial statements, such as the Treasurer's financial statements and ultimately in the Territory and national economic accounts.

More recently there has been moves to provide whole of government accounts along semi-commercial lines, by producing the equivalent of a government balance sheet and profit and loss account. To date, only NSW (and New Zealand) have progressed very far along this path. South Australia and Victoria have provided a limited version of a State "balance sheet" for some time, but it is not published; it is produced and provided largely for rating agencies.

There are then two main trends of relevance to the Territory: incremental improvements, and a more commercial whole-of-government approach.

4.2.4.1 Incremental Improvements

There is a general trend to provide more useful information on the governments' overall financial position, but without necessarily going to a full commercial approach.

Developments of relevance are as follows:

- . The Commonwealth has generally encouraged the states to adopt an economic transactions framework, in line with classifications used by ABS in the national accounts. The Territory has moved to standard classifications from 1990/91 and integrated these in the centralised government accounting system.
- . All states can now produce figures on their overall net indebtedness and contingent liabilities, although the basis for calculation, and the provision and funding of such items varies considerably.
- . Most states are improving the quality of their asset management practices, as noted in section 4.2.1.3. In the 1970's and 1980's it became important for governments to be able to monitor their overall position of indebtedness. In the 1990's, it will be increasingly important for governments to be able to monitor their asset portfolio. The main problem in doing this is to obtain meaningful valuations of assets.

4.2.4.2 Consolidated Whole of Government Accounts

A move to producing consolidated whole of government accounts poses three main problems.

First, it requires a consistent basis of accounting across all government organisations. This means that all departments must usually adopt full accrual accounting.

Second, it is a time consuming and expensive consolidation exercise which requires considerable accounting resources, and which involves a significant number of discretionary decisions by accountants.

Third, there is some philosophical question as to what the final result actually means in terms of accountability and management information. The key issue is that commercial balance sheets are predicated on the concept of residual equity, or net worth available (even though recent commercial experience suggests the balance sheets provide little guidance to the real net worth on liquidation). At a whole of government level it is not clear what net worth represents, or indeed whether it means anything given the problems of valuing community assets.

5. CONSIDERATION OF THE AUDITOR GENERAL'S SPECIFIC RECOMMENDATIONS TO THE LEGISLATIVE ASSEMBLY

As noted in section 1, the purposes of this report are:

- . to identify areas where practical improvements can potentially be made in financial reporting in the Territory, and
- . to establish priorities and a tentative timetable for implementing improvements, and/or a more in depth assessment of potential improvements.

The purpose of this section is to briefly consider the four specific recommendations made by the Auditor General to the Legislative Assembly in the light of the material presented in section 4.

5.1 That a review be undertaken to adopt any appropriate measures from developments elsewhere which can improve the financial accountability arrangements in respect of Northern Territory government operations

Section 4 provides a broad preliminary assessment of a number of trends and developments in financial reporting of relevance to the Territory. These observations address the two main aspects of financial reporting;

- . accountability, and
- . management.

Whilst the accountability aspect are of prime concern to the Auditor General, we believe that it is important to keep both of these aspects in mind when assessing the relevance of trends and developments elsewhere.

From the observations made in section 4, it is apparent that in recent years there has already been a number of significant improvements in both accountability and management aspects of Northern Territory government financial reporting. It is also apparent that there is still room for improvement.

In section 4 we have focussed on those developments which appear to offer the greatest potential for further improvement in financial reporting. In section 7 we attach some priorities to these developments.

To specifically address the Auditor General's recommendation:

- . This preliminary review has been useful in identifying relevant developments and attaching some priority ordering to them.
- . We believe it is important that those priorities be based not just on the likely effect that the development might have on accountability, but rather that other aspects (such as management reporting, and the costs and benefits) be taken into account as well.
- . Any further and more detailed review of relevant developments should focus on those given priority for implementation by the Territory government and the Legislative Assembly.

5.2 That a review be undertaken to determine the information needs of users of governmental financial reports

This recommendation is made in the context of reporting the financial status of the whole of government, and is not intended to suggest a comprehensive review of the needs of all users of all government financial reports.

As noted in section 4.2.4, whole of government reporting is not a precise concept. At present, the main sources of information about the Territory's overall financial position are the budget papers, the Treasurers' annual financial statements, and various Australian Bureau of Statistics economic and financial reports.

It is difficult to disagree with the underlying sentiment of the Auditor General's recommendation, but we do not agree that a review of user needs per se is a satisfactory solution. There are two reasons for this.

First, because users do not usually pay for government financial information, a review of their needs may well give a misleading indication as to what they really would find useful. In other words, it is in the interest of users to overstate their needs, because there is no cost attached. It is important to note that

a move to consolidated whole of government reporting could be very expensive for the Territory, particularly if the reports are to be audited in any meaningful sense.

Second, the likely users of whole of government information are widely dispersed, both geographically and by type of user. For example, the Auditor General cites potential users ranging from members of the Legislative Assembly, to investors, analysts, and the general public. Some corporate investors may be located anywhere in the world. Reviewing the needs of such a diverse group of potential users is likely to be difficult and expensive. It is also likely to reveal that there are as many differences as there are commonalities.

We believe that the best way of retaining the underlying spirit of the Auditor General's recommendation is to:

- (a) Establish a preliminary set of priorities for improving financial reporting across the board (not just in the whole of government area, and not just pertaining to accountability). These priorities should be based on approximate benefits and cost.
- (b) Invite users to comment on the priorities, and on ways that the information provided could be made more useful to them. It is possible that some specific segments of users (eg. investors or rating agencies) may be willing to contribute to the cost of providing information which would otherwise be too expensive to justify its development for general publication.
- (c) Establish informal, or formal, procedures for continuing to monitor the usefulness of financial and other report information.

5.3 That a review be undertaken to determine the adequacy or otherwise of current annual reporting methods by departments in terms of their appropriateness

We concur with the Auditor General that the situation whereby departments are under no obligation to report their financial position is an unsatisfactory one, although we note that departments always have provided some financial information and that this has been reported via the Treasurer's Annual Financial Statements. Recent changes in the Treasurer's directions,

effective for 1989/90, mean that departments are now required to report details of their financial position or activities. This to a large extent overcomes the main problem of lack of direct accountability.

We also concur with the implied view that there is still room for improvement in departmental reporting. However, what priority is given to which improvements, and what implementation timetable is adopted needs to be the subject of ongoing review in the light of circumstances.

To specifically address the Auditor General's recommendation:

- . Without clear criteria as to what constitutes "adequate" and "appropriate" we believe that any review would have difficulty in providing meaningful results.
- . Accordingly, we suggest that the best way of maintaining a steady improvement in departmental (and other government) reporting is to establish a priority list, a timetable, and an ongoing review mechanism. This is dealt with in section 7.

5.4 That a review be undertaken as to the adequacy or otherwise of the accountability and reporting arrangements which exist in respect of government owned companies, corporations, trust, etc. The review should include consideration of such aspects as:

- (a) the processes for the creation or acquisition of such entities,
- (b) statutory reporting requirements, and
- (c) whether the Auditor General should have an involvement in the audit function of those entities.

It is our understanding that the Public Accounts Committee has separately investigated issues associated with government owned trusts, companies, corporations etc.

Given the potential problems in accountability and management which could arise with the present financial reporting practices of these other corporations we concur with the Auditor General that a review would be useful. However, we suggest that some relatively simple steps to improve accountability in "other

corporations" should be implemented as a matter of high priority. In brief these are:

- . that all interests in all other corporations should be declared in annual reports
- . that any changes in interests in other corporations be notified to a central register and to the Legislative Assembly within, say, 10 days.

We also suggest that the recommendations of the Burt Commission in Western Australia should be considered for application to the Territory. In particular,

- . that government agencies not be constituted as limited liability companies but should possibly be incorporated under separate Territory legislation, and
- . that the powers of any company in which the government has control be limited to the powers necessary to achieve the objectives of the parent or holding department or authority.

6. THE ADEQUACY OF THE TREASURER'S ANNUAL FINANCIAL STATEMENTS, WITH PARTICULAR REFERENCE TO DEBT DISCLOSURE AND CONTINGENT LIABILITIES

To assess the adequacy of the Treasurer's annual financial statements it is necessary to take account of:

- . statutory obligations
- . their purpose, context, and recent improvements.

6.1 Statutory obligations

The Treasurer's annual financial statements are required under S29 of the Financial Administration and Audit Act to provide details of expenditure and receipts of the Consolidated Fund and Trust Fund. In fact the statements provide rather more than they are statutorily required to.

6.2 Purpose, context and recent improvements

The main purpose of the Treasurer's annual financial statements (TAFS) is to meet a statutory reporting obligation. This however should not preclude the statements being useful.

The principal use of the TAFS is to provide a summary of the main transactions undertaken at a Territory level. Supplementary material in Statements 5 and 6 gives an overview of Territory borrowings and contingent liabilities. This needs to be seen in the context of the material provided in the Budget Overview. It also needs to be seen in the context of recent changes in the methods of accounting and reporting, particularly

- . the use of economic transactions framework and general purpose classification in preparing expenditure and receipt reports,
- . the recent Treasurer's directions relating to reporting by departments.

Both of these changes will allow improvements to the way the TAFS are presented.

6.3 The adequacy of the Treasurer's annual financial statements

There is no question that the TAFS are adequate, the main issue is whether their usefulness could be improved in a cost effective way.

One way of doing this would be to move toward consolidated whole of government reporting. We do not believe that this is currently justified in the Territory. The costs would be significant, and the benefits difficult to identify in terms of improvements in management and accountability.

The main usefulness of the TAFS is to provide the basis of an overview of major transactions in the Territory. We believe that the presentation of this can be extended and improved. The Auditor General has noted the demand for a simple summary, or overview of key financial (and we add, economic) information about the Territory. Much relevant information is already published in various places, but it is not brought together in a single short document. We offer as guidance the following content, presented in figures and pictorial form where possible:

- . Gross Territory product, investment and consumption (public and private) and changes in these aggregates
- . Aggregate government receipts and expenditures and financing transactions. Some separation between different accounting regimes may be inevitable, but we would not see this as a major obstacle to giving a broad picture
- . A breakdown in terms of major programs
- . Overall Territory government indebtedness and changes or trends. Similarly, it may be necessary to distinguish between organisations accounting on accrual, and those on cash accounting
- . Performance (eg. in rate of return terms) of statutory authorities (this may be difficult since most appear currently to have negative rates of return)
- . A summary of the major contingent liabilities and any changes therein

- . When it becomes feasible to do so, changes in the holdings of major Territory assets
- . Longer term strategic targets and objectives of the government compared with actual indicators of performance.

This information would provide a mixture of economic and financial information in a simple concise summary form. It would be difficult to "audit" in a stewardship sense, but its availability would achieve the underlying objective of improved information on how the Territory government sector and economy are managed, and the accountability of the Government for that.

6.4 Contingent Liabilities

The present practice in the Territory is for the Treasurer to maintain a register of contingent liabilities of departments and statutory authorities based on requests for information, and to report on this annually in statement 6 of the TAFS. The Auditor General is reliant upon the register in auditing the TAFS as they relate to contingent liabilities.

We believe that the following would improve the present practices in terms of management and accountability.

- . The requirement to report should be immediately extended to other corporations
- . There should be a requirement to report any change or alteration in contingent liabilities within, say, 10 days
- . The chief executive or accountable officer should be required to provide a statement in the annual report to the effect that adequate risk management or other measures are in place to deal with contingent liabilities and, where appropriate, outline what those measures are.
- . Finally, it is not clear from statements 5 and 6 of the TAFS as to the intended extent of the coverage provided. It would be useful if some qualitative (or, if possible, quantitative) assessment could be provided which indicates whether the figures cover all Territory government indebtedness and liabilities, or, if not, which debts and liabilities are not included.

7. RECOMMENDATIONS

There is a continuing process of improvements in financial reporting and management in the Territory. The main thrust of our recommendations is to build on what has already been achieved, by:

- . identifying areas where further improvements can be made cost effectively, and
- . establishing tentative priorities for the implementation of improvements.

The priorities indicated are based on the following broad criteria.

- HIGH:**
- . Change able to be implemented relatively easily with minor disruption
 - . relatively low cost of implementation
 - . significant potential benefits which are relatively clear.
- MEDIUM**
- . Change requires some planning to implement
 - . costs of implementation may be significant
 - . benefits likely to outweigh costs, but may need additional review and design to ensure that this is achieved.
- LOW**
- . Change will require significant prerequisite changes or is otherwise difficult
 - . costs of implementation are likely to be significant.
 - . benefits may not outweigh costs in the Territory's case, and care should be taken to investigate the feasibility of the concept before proceeding to implement it.

The following priority listing is only intended to be indicative. Coordinated improvements in financial reporting in the Territory will best be achieved by the development of a strategic plan which has the general support of the major parties responsible for financial reporting, management and accountability. The following listing provides a basis for such a plan.

**PRIORITY LISTINGS OF POTENTIAL IMPROVEMENTS IN
MANAGEMENT AND ACCOUNTABILITY REPORTING**

| Item | Priority | Improvement | Comments |
|-------------------------------|-----------------|--|---------------------|
| <u>Whole of Government</u> | | | |
| 1. | High | Introduce a general summary statement of economic and financial conditions | See 6.3 |
| 2. | Medium | Development of Territory wide register of assets and asset valuations | See 4.2.4.1 |
| 3. | Low | Consolidated Whole of Government accounts | See 4.2.4 |
| <u>Departmental Reporting</u> | | | |
| 4. | High | Introduction of standard guidelines and checklists for Annual Reports | See 4.2.1.6 |
| 5. | Medium | Compulsory asset management and reporting procedures | See 4.2.1.3 |
| 6. | Medium | Compulsory risk management and reporting procedures | See 4.2.1.4 |
| 7. | Medium | Compulsory reporting on future financial impact of decisions | See 4.2.1.8 |
| 8. | Low - medium | Full accrual accounting | |
| 9. | Low - medium | Move to forward estimates | See 4.2.1.7 |
| <u>Statutory Authorities</u> | | | |
| 10. | Medium | Rate of return targets | See 4.2.2.1 |
| <u>Other Corporations</u> | | | |
| 11. | High | Compulsory reporting | See 4.2.3 and 5.4 |
| 12. | High | Auditing by Auditor General | See 4.2.3.3 and 5.4 |

APPENDIX C

RESPONSES
from
DEPARTMENTS AND ORGANISATIONS

The Institute of Chartered Accountants in Australia

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11 September 1990

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Mr M Palmer
Chairman
Public Accounts Committee
Legislative Assembly of the Northern
Territory
GPO Box 3721
DARWIN NT 5794

RGE/SB:0240s

Dear Mr Palmer,

Auditor General's Report 1988/89

Thank you for your letter dated 5 September 1990, together with copy of the abovementioned report, the report for the 1989/90 year and the reports from the two independent consultants appointed to review and comment upon the Auditor General's report for the 88/89 year.

As you would be aware, the Australian Accounting Research Foundation is the technical and research arm of both this Institute and the Australian Society of Certified Practising Accountants.

I have taken the liberty of providing the Foundation with your letter and the additional information provided, with the request that comment thereon be provided at the earliest convenient opportunity.

Thank you for seeking the Institute's advice and comment.

Yours sincerely

A handwritten signature in cursive script, appearing to read 'V A Prosser'.

V A Prosser
Executive Director



AUSTRALIAN ACCOUNTING RESEARCH FOUNDATION

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8 March 1991

Mr M Palmer
Chairman
Public Accounts Committee of the
Legislative Assembly of the N.T.
GPO Box 3121
DARWIN N.T. 5794

Dear Mr Palmer

**re: Comments on Auditor-General's Report 1988/89
and Consultants' Reports**

Please find attached a submission by the Australian Accounting Research Foundation on the abovementioned matters.

The submission was originally requested in a letter by you dated 5/9/90 to Mr V Prosser, Executive Director of The Institute of Chartered Accountants in Australia. It is normal practice for the Foundation to prepare submissions on accounting and auditing matters on behalf of The Institute and the Australian Society of Certified Practising Accountants.

We trust that the submission will be of use to the Committee.

Yours sincerely

W J McGregor
Executive Director

cc. R Ellis - Technical Director, ICAA

**AARF SUBMISSION ON CERTAIN RECOMMENDATIONS MADE IN
CONSULTANTS REPORTS BY R.G. WALKER AND C. HALL TO
THE PUBLIC ACCOUNTS COMMITTEE OF THE LEGISLATIVE
ASSEMBLY OF THE NORTHERN TERRITORY**

1 INTRODUCTION

- 1.1 This submission has been prepared by the Australian Accounting Research Foundation (AARF). The AARF was jointly established by The Institute of Chartered Accountants in Australia and The Australian Society of Certified Practising Accountants and has a range of objectives relating to improved financial reporting in Australia. The Public Sector Accounting Standards Board (PSASB) of the AARF was established in 1985 with the main objective of improving the financial reporting practices of public sector reporting entities.
- 1.2 The submission reviews and comments upon certain recommendations made in the N.T Auditor-General's 1988-89 Annual Report and the reviews of the recommendations in that report in consultants' reports by R.G. Walker and C. Hall. The submission concentrates on the matters arising in both the Auditor-General's and the consultants' reports that are related to issues of financial reporting.
- 1.3 This submission has been prepared under the following brief:
- 'As some of the issues raised in the Section [of the N.T. Auditor-General's Report 1988-89] "Summary of Audit Matters Arising" (p. 16 and 17) have attracted considerable interest in other states the Committee would appreciate your comments on the contents of both the Auditor General's Report and the Consultants reviews and recommendations.' (letter to Mr. V. Prosser, National Director, The Institute of Chartered Accountants in Australia, 5 September, 1990, from Mr. M. Palmer, Chairman - Public Accounts Committee of the Legislative Assembly of the Northern Territory)

**2 MEASURES WHICH CAN IMPROVE THE FINANCIAL
ACCOUNTABILITY ARRANGEMENTS IN RESPECT OF NORTHERN
TERRITORY GOVERNMENT OPERATIONS (p. 16, 1988-89 Auditor-
General's Report and pp. 7-10, Report by R.G. Walker).**

- 2.1 AARF agrees with the N.T. Auditor-General's recommendation to encourage the active examination, and adoption where appropriate, of any techniques which will assist the N.T. Government in better discharging its accountability obligations. Indeed the pace of reform of measures relating to accountability, both internationally and in respect of the various Australian Governmental jurisdictions, has been relatively rapid during the past decade.
- 2.2 In respect of financial reporting, the PSASB has recognised the need for information which addresses accountability. Statement of Accounting Concepts (SAC) 2 "Objective of General Purpose Financial Reporting",

recognises the central role that general purpose financial reports (g.p.f.r's) play in assisting the discharge of accountability:

'Managements and governing bodies shall present general purpose financial reports in a manner which assists in discharging their accountability.' (para. 44)

- 2.3 Therefore, any measures taken by the N.T. Government which assist in increasing the availability and usefulness of g.p.f.r's for Parliament and other interested parties (including the public) are supported by the accounting bodies.
- 2.4 Walker makes the point that:
- '... what one person may regard as an "improvement", another might regard as a costly or time consuming exercise of no particular value.' (para. 3.7, p. 9)
- 2.5 In regard to g.p.f.r's produced by public sector entities, it is true that "total agreement" does not exist on exactly what constitutes the correct basis and format for producing g.p.f.r's. However, the overwhelming weight and trend of professional opinion in regard to what constitutes "good" financial reporting is clear and is reflected in SAC 2. This document was developed by the accounting profession in accordance with its "due process". During this "due process", extensive comments and feedback were received from those interested in financial reporting by public sector entities. The overwhelming nature of that comment was support for the concepts espoused in SAC 2: that discharging accountability required the provision of information in g.p.f.r's that enabled users to make informed judgements about the performance, financial position, financing and investing and compliance of reporting entities.
- 2.6 This view is supported internationally by bodies such as the Governmental Accounting Standards Board in the United States, the Public Sector Committee of the Canadian Institute of Chartered Accountants in Canada, and the New Zealand Society of Accountants. Further, this view is reflected in governmental accounting reforms, both domestically and overseas; for example, Australian governmental jurisdictions such as New South Wales and Victoria, and the New Zealand Government, have been international leaders in requiring the production of more useful g.p.f.r's for accountability purposes.
- 2.7 The PSASB therefore believe that there is strong support for financial reporting measures which can be used to improve the accountability of government, and that the framework for such reporting is embodied in the Statements of Accounting Concepts and other professional accounting pronouncements and literature. The Auditor-General's recommendations to review the financial reporting practices of "government as a whole", "departments" and "(public sector) corporations" are clearly aimed at examining what measures can be implemented so as to improve financial reporting by public sector entities.

3 INFORMATION NEEDS OF USERS OF GOVERNMENT FINANCIAL REPORTS (p. 17, 1988-89 Auditor-General's Report; pp. 11-15, Report by R.G. Walker; and pp. 6 -9, Report by C. Hall).

3.1 Recommendation 2 of the N.T. Auditor-General in his 1988-89 Report (p.17) is, in respect of government as a whole:

'That a review be undertaken to determine the information needs of the users of government financial reports.'

3.2 Walker's report recommends that such a review not be undertaken

'... in light of the fact that a similar exercise has recently been undertaken by the Australian Accounting Research Foundation.' (para. 4.16, p. 15)

3.3 A number of points need to be made in relation to this matter.

3.3.1 The PSASB believe that a broad consensus has emerged about the information needs of users of the financial reports of public sector entities. Whilst different users are likely to require different information for their own particular needs, SAC 2 reflects the accounting profession's view that the common information needs of a wide variety of users can be satisfied with a set of g.p.f.r's that depict an organisation's performance, financial position, financing and investing and compliance. That this view is generally held by commentators and 'practitioners' alike is borne out by the fact that the trend has been, over the last decade or so, for governments to produce and report in g.p.f.r's more of this type of information.

3.3.2 This submission agrees with Walker about the technical and other difficulties associated with conducting research into user's needs. Unless empirical research was to be undertaken in such a way so as to lead to statistically valid results and conclusions, the study would be of little additional value to those studies already conducted. The conducting of such research would be costly, time consuming, and require considerable specialised expertise.

3.3.3 As mentioned by Walker, in 1989 the AARF undertook a survey of user's information needs viz whole of government and departmental g.p.f.r's. The response to the survey from certain important user groups, such as parliamentarians, the press, and members of the public, was disappointing. The results of the AARF survey were not able to be used to draw statistically valid conclusions about the information needs of the users of whole of government and departmental g.p.f.r's. However, bearing this in mind, the results of the study did indicate that the information needs of users were consistent with those espoused in SAC 2; that is, users desire information pertaining to the performance (including [accrual] cost and cost recovery information), financial position (including information about assets and liabilities), financing an investing activities and compliance of the governmental reporting entity. Much of this information is currently not produced in the g.p.f.r's of governmental entities in some jurisdictions, and hence it seems that users perceive a shortfall of information provided relative to that needed. However, the trend is that the regulations governing the production of financial reports by governments are increasingly requiring the satisfaction of these information needs by requiring more information relating to a governments performance, financial position and financing and investing activities, to be disclosed in g.p.f.r's.

4 ANNUAL REPORTING BY DEPARTMENTS

(p. 17, 1988-89 Auditor-General's Report; pp. 16-39, Report by R.G. Walker; and pp. 17-20 Report by C. Hall).

- 4.1 The Auditor-General's third recommendation in his report was:
- 'that a review be undertaken to determine the adequacy or otherwise of current annual reporting methods by departments in terms of their appropriateness.' (p. 17)
- 4.2 It is important to note at the outset that the PSASB strongly supports the Auditor-General's recommendation. The PSASB has in progress a very high priority project "Financial Reporting by Government Departments" and a Discussion Paper is to be published in April 1991. The Discussion Paper will be used by the PSASB in the development of a proposed standard (exposure draft) on financial reporting by departments. The Discussion Paper will recommend the preparation of g.p.f.r.'s by departments and the adoption of the accrual basis of accounting.
- 4.3 Walker made several points in relation to the general trend in the debate about public sector accounting. The first of these was that the advocacy of '... accrual accounting to the public sector is a comparatively recent phenomenon' (p. 17). This submission disagrees with such a view. Support for accrual accounting in the public sector is not a recent phenomenon, nor has it exclusively been focused on the whole of government level.
- 4.3.1 For example, an Arthur Anderson (U.S) report notes:
- 'Both Hoover Commissions recommended accrual accounting for the U.S. Government. In 1950, this led to passage of legislation - supplemented by related Treasury regulations - that requires U.S. Government agencies to prepare GAAP-basis financial reports ... Succeeding Administrations and Congresses have largely ignored these laws and regulations. However, recent actions by GAO [Government Accounting Office] and OMB [Office of Management and Budget] ... may result in greater compliance with the 1950 legislation.'¹
- 4.3.2 Tiller² noted that in 1967 the President's Commission on Budget Concepts endorsed the trend towards the use of accrual accounting systems.
- 4.3.3 In Australia, the concept of the adoption of accrual accounting in the public sector has also been debated for decades. For example, in 1957 Wright³ made the point that effective '... control over expenditure by government ... must be based upon the knowledge of the (accrued) cost of carrying out each operation or project.'

1 Arthur Anderson, 1986.

Sound Financial Reporting in the U.S. Government - A Prerequisite to Fiscal Responsibility, February, p. 2.

2 Tiller, C.W., 1970

"Accrual Accounting and Budgeting for Government", The Federal Accountant, March.

3 Wright, F.K., 1957.

"Government Accounting and Management Control", The Australian Accountant, March.

- 4.4 This submission agrees with Walker's assertion that '... it is recognised that accrual accounting and cash based accounting should operate in tandem, since the use of cash-based accounting is an essential component of current accountability arrangements whereby parliament allocates funds for particular purposes each year, and later is advised how those funds have been expended.' (p. 17)
- 4.5 This submission does not agree with Walker's assertion (p. 17) that the profession's stance about the desirability of having a common series of standards has changed. Since the inception of the PSASB, the profession has publicly expressed the view that a common series of standards (and concepts) should apply to both the public and private sectors, save that there may be "industry specific" issues in the public or private sector which may need to be addressed by standards. For example, the PSASB is currently finalising a standard on local government financial reporting. While this Standard applies to a particular "industry", it applies the same concepts and standards applicable to a wide range of reporting entities.
- 4.6 This submission does not agree with Walker's assertion that
- "... the view that all public sector entities should prepare financial statements on an accrual basis ... does not appear to have found favour in other countries' (p. 17).
- 4.6.1 Many standard setting-bodies have recognised that accrual accounting is essential if performance (including the cost of services) and financial position are to be faithfully depicted in g.p.f.r's. Further, as well as recognising the importance of the accrual accounting basis in concept, many overseas standard-setters and regulators have promulgated requirements for specified public sector entities to adopt accrual accounting. For example, many public sector entities in Canada, including (whole of) Government, are required by professional promulgations to prepare financial reports, or elements of their financial reports, on an accruals basis. Hall notes that 'In recent years there has been a trend in most states to move more to an accrual base.' (p. 17)
- 4.6.2 Walker states that N.S.W. implementation of accrual accounting is, in places, inconsistent with the form advocated by some elements of the accounting profession (he refers specifically to "community" and "heritage" assets). That there is debate on the accounting treatment of such items is accepted. However, the subject of accounting for infrastructure (community) and heritage assets is currently a high priority project of the PSASB. In the absence of accounting guidance on this matter, N.S.W. are to be applauded for taking the first steps towards resolution of these issues and towards full reporting and disclosure of all the resources under the control of public sector entities.
- 4.6.3 Walker also mentions that the PSASB
- '... has yet to produce accounting standards relating to the identification and valuation of "assets" and "liabilities" in the public sector context.'

This statement is misleading and requires clarification. Firstly, in respect of asset accounting, the PSASB has issued an Exposure Draft ED 42C "Definition and Recognition of Assets". This document sets out the definition criteria in respect of assets and the circumstances in which assets are to be brought to account (recognised) by reporting entities. The Board is currently reviewing submissions made in respect of this document and expects to issue a Statement of Accounting Concepts in 1991. Secondly, as mentioned above, the Board is progressing, as a high priority, the project "Accounting for Infrastructure and Heritage Assets". A discussion paper is expected to be published by mid 1991. Third, current accounting standards dealing with the recognition and valuation of assets, for example AAS 21 "Accounting for the Acquisition of Assets (including business entities)" and AAS 10 "Revaluation of Non-Current Assets", apply to public sector reporting entities to the extent that they adopt the accrual basis of accounting. The PSASB is also currently reviewing AAS 10 and it is expected that a revised Standard will be issued by mid 1991.

- 4.6.4 Secondly, in relation to liabilities, the PSASB has issued an Exposure Draft Proposed Statement of Accounting Concepts ED 42D "Definition and Recognition of Liabilities". This document sets out the criteria for defining liabilities and the circumstances under which liabilities should be brought to account (recognised). Again, the PSASB is currently reviewing the submissions made on this Exposure Draft and expect to release the finalised Concepts Statement in 1991. Further, current Standards and guidance relating to liabilities, such as AAS 23 "Set off and Extinguishment of Debt", and Accounting Guidance Release AGR 10 "Measurement of Monetary Assets and Liabilities" also apply to public sector entities where appropriate. Finally, the PSASB has as a high priority project "Accounting for Employee Entitlements", which will apply to public sector reporting entities. An exposure draft is expected to be released for comment in mid 1991.

- 4.7 Walker also states that:

'the suggestion that consolidated income and expenditure statements and consolidated balance sheets should be prepared to encompass "whole of government" has likewise not been widely accepted; moreover there are no settled views about how those accounts are to be prepared' (p. 17).

- 4.7.1 The overwhelming trend in this area is that governments have recognised the usefulness, and indeed the necessity, of such consolidated statements and have begun to implement reforms enabling the production of such statements. There are, it is recognised, some "transitional problems" in the production of such statements, such as those cited by Walker viz N.S.W. These problems are however largely the result of timing differences in the introduction of accrual accounting by "components" of the Government (departments) and will "disappear" when adoption of accrual accounting is completed. A recently issued Accounting Standard AAS 24 "Consolidated Financial Statements" which is applicable to public sector reporting entities, sets clear standards in relation to consolidation issues. In addition, the PSASB currently has in progress the preparation of a discussion paper on "Financial Reporting by Whole of Government" which will address the issues relating to consolidation that are peculiar to whole of government financial reporting.

- 4.7.2 Hall (p. 26) asserts that '... there is some philosophical question as to what the final result actually means in terms of accountability ...' when consolidated whole of government balance sheets are produced. He goes on to point out that the concept of "equity", and what this means in the context of government, is contentious. The inference is that uncertainty about the nature of "equity" reporting in whole of government financial statements seriously undermines the value of the statements as a whole. However, the relevance of a consolidated statement of financial position prepared at the whole of government level rests not so much in the knowledge of the "equity" position disclosed, but rather rests on the assets, liabilities, revenues and expenses that are reported. Knowledge about the resources under the control of government, the use of those resources, and the liabilities that the government has incurred is clearly vital from an accountability and decision making perspective.
- 4.8 Walker cites Mautz as suggesting that all private-sector accounting techniques are not readily transferable to the public sector (p. 18). However, it is relevant to note that the point Mautz is making is that whilst the accounting basis, and the recognition and measurement techniques relating to assets, liabilities, expenses and revenues should be the same for all entities whether they are private or public sector entities, the methods of presenting and disclosing information has a substantial influence on the "message" communicated to users of g.p.f.r's. For example, presenting a "profit or loss statement" with emphasis on a "bottom line" result would be inappropriate for a government or government department. The PSASB agree with this view. The Statements of Accounting Concepts, Proposed Statements of Accounting Concepts, and current accounting standards, such as AAS 1 "Profit or Loss or Other Operating Statement", recognise that the presentation and display of the elements within financial statements need to take into account the particular operating environment and characteristics of the reporting entity in question. In the quest for improving the financial reporting practices of public sector entities, and particularly non-business public sector entities, the PSASB is not proposing that the methods of presenting information which are employed by private sector entities be slavishly followed by public sector entities. For example, in the forthcoming AARF Discussion Paper "Financial Reporting by Government Departments", it is recommended that Departments adopt accrual accounting and prepare a balance sheet displaying the assets, liabilities and equity of the department, and an operating statement showing the cost of departmental operations for the reporting period and cost recoveries. However, the Discussion Paper recognises that the display of that information needs to be sensitive to the organisation's objectives and that, for example, an emphasis on a "bottom line" figure in the operating statement would not be appropriate.
- 4.9 The following comments are made in relation to Walker's report and its discussion about the type of financial reporting required by departments in terms of the revised Treasurer's Direction (pp. 23-24).
- 4.9.1 This submission agrees that the disclosure of cash-based information about appropriations and expenditure provides information useful for management and parliaments for decision making purposes and will demonstrate compliance (or otherwise) with spending mandates.

- 4.9.2 This submission is not of the opinion that reporting information about receivables and payables will substantially capture the benefits of accrual accounting. Only full accrual accounting can depict the resources under the control of a department, its obligations, and the cost of services provided by a department during the reporting period. Anything less than full accrual accounting by departments implies a narrow view of accountability and will inhibit the role that g.p.f.r's can play as vehicles to communicate information useful for decision making and accountability purposes.
- 4.9.3 In relation to information about employee entitlements, this submission disagrees with Walker's assertion (p. 23) that disclosure of information about a department's employee entitlement liabilities such as superannuation, would not produce information which is relevant to departmental managers (and other users of g.p.f.r's).
- 4.9.4 The following extract from a forthcoming AARF discussion paper on financial reporting by government departments⁴ is relevant to an analysis of the issue:

"The terms of employment of the work force of most departments include access to superannuation and other employee benefits. The costs of superannuation obligations and other benefits which accrue to their employees during a period are part of the costs of the services provided by individual departments. If the function of the financial report is to, *inter alia*, communicate information about the cost of services, costs related to employee entitlements should be reported as such.

The cost of superannuation is incurred because of the activities of the department, and the magnitude of the government's liability may be influenced by decisions of departmental management. However, while there is little question that the government has a liability in respect of settlement of those superannuation obligations and other employee entitlements, it is unlikely that individual departments have liabilities in respect of them. It is the Treasury, or other central agency, which is authorised to draw funds in respect of such liabilities and has the obligation to transfer assets to external parties in settlement of them.

Whether or not that portion of the government's liability which clearly arises because of the activities of individual departments should be recognised as a departmental liability and reported as such in the financial statements prepared by departments is dependent on the relationship that exists (or is perceived to exist) between the department and the government, Treasury or other central agency. For example, it may be argued that the department incurs the liability and should report it as such. However, the obligation to transfer funds to meet that liability is subsequently assumed by the government. On assumption of the obligation by the government, the department would recognise revenue equivalent to the liability offset. The consistency of this approach with the definition of a liability proposed by ED 42D is of course dependent on the existence, in the first place, of a departmental obligation which is subsequently assumed by governments. It would result in the department reporting a cost and liability in respect of the

4 Sutcliffe, P., Micallef, F., and Parker, L.D
 "Financial Reporting by Government Departments",
 Discussion Paper No. 16, Australian Accounting Research Foundation,
 (forthcoming, 1991).

incurrence of the obligation and an asset and revenue in respect of the government's assumption of the responsibility for settlement. Application of Australian Accounting Standard AAS 23 "Set-off and Extinguishment of Debt" would result in the liability for superannuation (or other obligation) being offset by an asset of equivalent amount on assumption of the obligation by the government. Such an approach has a number of attractions - it will ensure that the amount of the government's liability contributed by each department would be monitored by that department and that the costs of services provided by the department will include the costs of employee entitlements. The consequences of manpower planning, and other, decisions made by management on the liabilities of the State, Territory or Commonwealth will then be measured and included in the costs of operating the department. Not to acknowledge the costs and liabilities that arise as a result of the operations of departments can diminish some of the benefits that will flow from adoption of accrual accounting. For example, R. Ritchie, Secretary of the South Australian Public Accounts Committee, discussing alternative strategies available for the management of long-service leave by the South Australian Education Department, noted:

"The opportunity to reduce the Government's liability was missed. I suspect it was not seen inside the Education Department as an opportunity to reduce the Department's liability. Indeed, the liability is the Government's. Furthermore, the Department does not appear to be held accountable for management of this liability. This illustrates the lack of attention given to accounting for stewardship of assets and liabilities in government service ...

The lack of emphasis in public reporting appears to be matched by internal reporting. Therefore, it is not surprising that little attention is paid to managing the long-service leave liability." (Ritchie, 1989, p. 8)

- 4.10 These arguments about the need for accrual accounting would also be applicable to whole of government reporting. The arguments developed in this submission in relation to departmental reporting are also applicable to whole of government reporting; that is, that whilst cash-based information will be necessary for compliance and some decision making purposes, a broad view of accountability for public resources and the provision of adequate useful information for decision making purposes would require accrual based whole of government financial reports
- 4.11 In conclusion, this submission argues that the accrual accounting system is necessary (in tandem with disclosures of cash-based information relating to appropriations and expenditure) so that g.p.f.r.'s disclose sufficient information to allow users to assess the performance, financial position, and financing activities of a department. Accrual accounting will allow the reporting of the resources under the control of a department, the resources used by a department in providing services during a reporting period, and the financial obligations (liabilities) of a department, and thus provide information more useful for decision making and accountability purposes than cash-based information would alone. Therefore, this submission agrees with the Auditor-General's recommendation that the adequacy of annual reporting by departments be examined, and as part of that process, serious consideration be given to the adoption by departments of g.p.f.r.'s prepared under the full accrual basis of accounting. Further, this submission argues that whole of government accrual based reports will serve the same purposes, and the

requirement to produce such accrual based g.p.f.r's for the whole of government should also be carefully examined.

5 ACCOUNTABILITY OF NORTHERN TERRITORY CORPORATIONS

(p. 17, 1988-89 Auditor-General's Report and pp. 40-66, Report by R.G. Walker).

- 5.1 Walker's report discusses accountability considerations and reporting requirements (or lack thereof) for government created entities (whether created by departments or other "arms" of government). The report then recommends:
- 'That the Auditor-General be established as the auditor of all government-owned or government-controlled companies or trusts ...' (p. 49).
- 5.2 This submission agrees that steps should be taken to ensure that such entities are held accountable for the resources controlled and used which are, after all, public resources. That such entities are made subject to the scrutiny of the Auditor-General is certainly a step towards ensuring accountability. However, an essential part of ensuring the accountability of these entities is to ensure that these entities are required to produce g.p.f.r's, or that financial information relating to these entities is consolidated into the g.p.f.r's of controlling entities where appropriate. The g.p.f.r's could be incorporated in departmental annual reports where appropriate, or, for example, if departments were required to produce accrual based g.p.f.r's, the department should be required to produce consolidated financial statements.
- 5.3 Justification for the assertion that such entities should produce g.p.f.r's or that departments should consolidate the results of such entities into their financial statements is straight-forward and based on accountability requirements. SAC 1 "Definition of the Reporting Entity" states that entities shall produce g.p.f.r's when it is reasonable to expect that there are users dependent upon such information being provided. This is surely the case for entities such as government owned or controlled companies and trusts, as arguing that there are no users dependent upon financial information about these companies and trusts is tantamount to arguing that these entities are not accountable to government, and government should not be accountable for the activities of these entities to parliament and the public. The requirement to audit would be evidence in itself that an accountability relationship exists and that there are users (such as government, parliament and the public) reliant on information about these entities.
- 5.4 Walker's report addresses the issue of the application of accrual accounting and model financial statements to various public sector entities (para. 6.31, p. 52) and goes on to again repeat possible arguments against the introduction of accrual accounting (para. 6.33, p. 53).
- 5.4.1 A requirement for public sector entities to comply with Australian Accounting Standards would help ensure the full and proper discharge of accountability and satisfaction of report user's needs.
- 5.4.2 In relation to local government (para. 7.28, p. 74 Walker), in November 1989 the AARF issued Exposure Draft ED 50 "Financial Reporting by Local Governments". The vast majority of the proposals in ED 50 were strongly

supported by the 154 respondents to the exposure draft. The PSASB, having taken into account the comments provided by respondents, is finalising an Australian Accounting Standard which is expected to be issued in mid 1991. A Financial Reporting Systems Project has been established under the auspices of the Australian Local Government Ministers, to explore possibilities for Australia wide harmonisation of local government financial reporting regulations. It is relevant that most members of the project group have indicated their support for the proposals in ED 50. Project group members from N.S.W, Victoria and South Australia have indicated that their Ministers will be recommending that full compliance by local governments with the forthcoming Australian Accounting Standard be mandated.

5.4.3 In relation to superannuation funds (para. 7.21, p. 72 Walker) the PSASB has recently issued Australian Accounting Standard AAS 25 "Financial Reporting by Superannuation Plans". This Standard is applicable to the public sector and it would be appropriate that N.T. public sector superannuation plans were required to report in accordance with this Standard.

5.5 The report again questions the appropriateness of accrual accounting for public sector entities. As well as repeating arguments made several times earlier in the report, it goes on to state that:

'Indeed, the commonwealth does not yet employ full accrual accounting for its statutory authorities; nor does the commonwealth employ any form of accrual accounting for reporting by departments.' (p. 54)

5.5.1 Both these assertions are plainly incorrect. Commonwealth statutory authorities report under guidelines which require financial reports to be prepared on an accruals basis in accordance with relevant Australian Accounting Standards, and Commonwealth Departments are required by the Financial Statement Guidelines for Departmental Secretaries to report various accrual information, including a Statement of Supplementary Financial Information which requires the disclosure of assets and liabilities.

**OFFICE OF
LOCAL GOVERNMENT**
NORTHERN TERRITORY



Ref: LG89/431

12 October 1990

Ms Sue Lee
Secretary
Public Accounts Committee
Legislative Assembly of the
Northern Territory
GPO Box 3721
DARWIN NT 0801

Dear Ms Lee

RE: AUDITOR-GENERAL'S REPORT FOR THE YEAR ENDED 30 JUNE 1989

Thank you for your letters of 18 and 21 September 1990, in which you enclosed:

- . the Auditor-General's 1989 annual report;
- . the report by Dr Chris Hall, University of Technology, Kuring gai, on "The Adequacy of Financial Reporting in the Northern Territory: Accountability and Management Issues"; and
- . the report to the Public Accounts Committee, Legislative Assembly of the Northern Territory of Australia, by R G Walker.

The Office found all the reports interesting and informative. It supports much of the comment expressed in both the consultants' reports. The recommendations listed on page 75 of Mr Walker's report are supported although not for all the reasons given by him on page 74.

All community government councils, with the exception of Angurugu Community Government Council, have their annual financial statements prepared by professional accounting firms whom they employ as consultants. Compliance with accrual accounting therefore, is not an issue for them in this

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DEPARTMENT OF LABOUR AND ADMINISTRATIVE SERVICES

instance. Most of these councils operate a cash or modified accrual system of accounting. If these systems are properly maintained the transition from cash based records to accrual financial statements is generally not exhaustive. Cash records are generally kept to trial balance standard.

The Office supports the view that the Auditor-General's model financial statements are generally not suitable for local government. There may be parts of the model however, which are suitable simply because they conform with practices or standards. The main variance with the model lies in the format of the income and expenditure statement. If the model were adopted it would not provide sufficient detail on the revenues and costs associated with services carried out by councils; detail which is useful to a significant range of users, including ratepayers.

The Office is continuing with its work in revising accounting regulations for use by municipal and community government councils. It aims to have regulations in place by 1 July 1991, all being well. A significant impact upon the regulations has been exposure draft 50 published by the Australian Accounting Research Foundation. It is likely to become an accounting standard by January 1991, although it may not be mandatory for members of accounting professions to adopt until 1992.

Thank you for the opportunity to comment on these matters.

Yours sincerely



GRAEME MARSHALL
Director



Northern Territory of Australia
Office of the Auditor-General

Auditing for Parliament and People ... promoting improvement

Our reference

150-05-007
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Chairman
Public Accounts Committee
GPO Box 3721
DARWIN NT 0801

Dear Sir,

AUDITOR-GENERAL'S REPORT FOR THE YEAR ENDED 30 JUNE 1989

Your letter dated 29 August 1990 requested my comments in relation to the consultants' reports upon the above. Given the importance of the subject to me and the volume of material contained in the consultants' reports, it would have been possible for me to comment at length. However, I felt our common interests would be served best by a brief response that provides you with :

- (a) my overall opinion of each report (this appears below); and
- (b) my agreement or disagreement with each of the recommendations made by the consultants (this appears on the schedules attached).

REPORT BY NICHOLAS CLARK AND ASSOCIATES

Of the two reports I feel that this one provides the greater opportunity for improvement-orientated action in line with the spirit of my original recommendations. It deals appropriately with the broad strategic issues that need to be faced. I find it coherent and cohesive, it recognises the practical aspects of developing a co-ordinated long-term action plan and it provides a priority listing of potential improvements with which I generally agree.

REPORT BY R G WALKER

As indicated on the attached schedules I agree with each of the recommendations made (with some qualifications). The report is certainly detailed but I feel that the spirit of my original recommendations is sometimes lost in the detail. I also consider that the recommendations need to be given some sense of broader strategic direction and priority. Perhaps a practical approach would be to place these detailed recommendations within the broader context of Nicholas Clark's priority listing.

IMPLEMENTATION

I would see the momentum initiated by the Committee being maintained by a collaborative effort and I would agree with Nicholas Clark's observation that "co-ordinated improvements in financial reporting in the Territory will best be achieved by the development of a strategic plan which has the general support of the major parties responsible for financial reporting, management and accountability."

Should there be any further information you require please contact me.

Yours sincerely,

E M ISAACSON
Auditor-General

12 October 1990

Attach

| ITEM | PRIORITY | IMPROVEMENT | |
|-------------------------------|--------------|--|-------------|
| Whole of Government | | | |
| 1. | High | Introduce a general summary statement of economic and financial conditions | Agree |
| 2. | Medium | Development of Territory wide register of assets and asset valuations | Agree |
| 3. | Low | Consolidated Whole of Government accounts | Agree (1) * |
| Departmental Reporting | | | |
| 4. | High | Introduction of standard guidelines and checklists for Annual Reports | Agree |
| 5. | Medium | Compulsory asset management and reporting procedures | Agree |
| 6. | Medium | Compulsory risk management and reporting procedures | Agree |
| 7. | Medium | Compulsory reporting on future financial impact of decisions | Agree |
| 8. | Low - Medium | Full accrual accounting | Agree (1) * |
| 9. | Low - Medium | Move to forward estimates | Agree |
| Statutory Authorities | | | |
| 10. | Medium | Rate of return targets | Agree |
| Other Corporations | | | |
| 11. | High | Compulsory reporting | Agree |
| 12. | High | Auditing by Auditor General | Agree |

Review of information needs of users of government financial reports

- 4.16 That the Auditor-General's recommendation that a survey be conducted to determine the "information needs" of various users of government financial reports be **not** acted upon, in light of the fact that a similar exercise has recently been undertaken by the Australian Accounting Research Foundation. Agree (2)*

Current annual reporting methods of departments

- 5.15 That Treasury be asked to consider whether the Treasurer's Directions should be further expanded to require departmental financial reports to include:
(a) more detailed guidelines concerning disclosure of liabilities and other financial commitments arising from departmental activities;
(b) explanations as to the basis of attributing money values to properties "written off"; and
(c) narrative descriptions of the major resources held, controlled or maintained by departments. Agree (3)*
- 5.30 That the Public Accounts Committee suggest that the Treasurer's Directions should be further expanded to provide encouragement to departments to devise and publish indicators of the economy, efficiency and effectiveness with which they have conducted their major programmes during a financial year. Agree
- 5.38 That the Public Accounts Committee endorse suggestions that departmental financial statements be subject to audit by the Auditor-General. Agree
- That the Public Accounts Committee seek legal advice as to whether any statutory amendments are necessary to require departmental financial statements to be subject to audit - or whether it would be sufficient to make further amendments to the Treasurer's Directions. Agree (4)*

Form and content of the Treasurer's Annual Financial Statements

- 5.47 That Treasury give consideration to the inclusion within the **Annual Statements** of a five-year summary of payments for capital works, showing expenditure in terms of such categories as road works, housing, hospitals, education facilities, police fire & emergency services, etc. Agree (3)*
- 5.53 That Treasury give consideration to the inclusion within the Treasurer's **Annual Statements** of explanations of such matters as "appropriations (from) former years" the basis of inter-fund transfers, and "recovery of principal and interest". Agree (3)*
- That Treasury give consideration to the inclusion within the Treasurer's **Annual Statements** of cash-flow statements depicting operating, financing and investing activities undertaken by the NT public sector. Consideration should be given to the preparation of cash flow statements encompassing the Consolidated Fund, the Trust Fund and trust accounts external to the NT government account (after eliminating inter-fund transfers). Agree (3)*
- That Treasury give consideration to the inclusion of cash flow statements in its quarterly reports to Parliament. Agree (3)*

- Continued -

5.60 That Treasury give consideration to expanding the content of Statement 6 "Guarantees and contingent liabilities" to encompass "Liabilities, commitments for expenditure and contingent Liabilities". Agree (3)*

That consideration be given to the presentation in the Annual Statements of information concerning "liabilities" and "commitments for expenditure" in the form required by clause 21 of Schedule 7 of the Companies Code. Agree (3)*

Adequacy of accountability and reporting arrangements for government-owned companies, corporations, trusts, etc.

6.22 That the Auditor-General be established as the auditor of all government-owned or government-controlled companies or trusts - save that the Auditor-General may contract-out such audit work to private-sector audit firms. Agree (5)*

That Treasury be asked to consider revisions of the Treasurer's Directions so as to require Departments, and statutory authorities to include in their annual financial statements :

- (a) a list of subsidiary companies and trusts, and of other companies or trusts in which the Territory holds 20% or more of the shares or units;
- (b) a description of the principal activities of those companies or trusts.

6.62 That the Committee consider the merits of either : Agree (6)*

- (i) the expansion of the Treasurer's Directions relating to prescribed statutory corporations so as to incorporate additional guidance on financial reporting issues; or
- (ii) the introduction of legislation along the lines of the NSW State-Owned Corporations Act, adapted for the requirements of the Northern Territory, so as to establish accountability arrangements for all public sector corporations (both prescribed statutory corporations, and other government-owned or government-controlled companies (or trusts).

6.77 That the Auditor-General be encouraged to develop or adopt a set of auditing standards dealing with the conduct of "compliance" auditing, and with reporting the findings of that auditing work to management, boards of public sector corporations, Ministers and Parliament. Agree (7)*

That the Auditor-General consider the introduction of guidelines for the reporting to Parliament (perhaps through the Public Accounts Committee) of any matters raised in management letters which have not been rectified or attended to within six months from the date of those letters. Agree (8)*

Model financial statements

7.20 That the Auditor-General's recommendation that all corporations should comply with the proposed model financial statements should not apply to incorporated school councils. Agree (9)*

That the Public Accounts Committee consider reviewing how the accountability arrangements for school councils established by the Education Act and accompanying guidelines are operating in practice. Agree

| | | |
|--|--|------------|
| 7.27 | That the Auditor-General's recommendations not be accepted in their present form for application to superannuation funds. | Agree (9)* |
| | That Treasury be advised that in exercising discretions in terms of section 68 of the Financial Administration and Audit Act, it would be appropriate for NT superannuation funds to adopt only those Australian Accounting Standards which are relevant to the superannuation industry. | Agree (3)* |
| | That it be suggested to Treasury that consideration be given to requiring annual reports of superannuation funds to include a Statement of Cash Flows (rather than a Statement of Sources and Applications of Funds). | (10)* |
| 7.32 | That the Auditor-General's recommendations for the adoption of model financial statements not be accepted as appropriate for community government councils. | Agree (9)* |
| | That the Auditor-General's recommendations for the adoption of model financial statements (implying as they do the use of accrual accounting) not be supported as appropriate for local government councils at this stage. | Agree (9)* |
| Reviews of the efficiency and effectiveness of financial management | | |
| 8.9 | That the Public Accounts Committee support proposals that government departments and statutory authorities should review the efficiency and effectiveness of the financial management processes and systems they employ in managing the public sector - but that it not support suggestions that monitoring those activities should necessarily be the responsibility of Treasury. | Agree |
| 8.13 | That the Public Accounts Committee express the view that it encourages departmental reviews of financial management, but would not endorse the suggestion the formal reviews of financial management practices and systems be instituted across departments, pending further advice from the Auditor-General concerning substantive evidence of "problems". | Agree |
| 8.24 | That the Public Accounts Committee support the efforts of the Auditor-General to undertake occasional reviews of the economy, efficiency or effectiveness of selected public sector activities. | Agree |
| 8.38 | That the Auditor-General be encouraged to develop or adopt standards dealing with the conduct of "performance auditing" and with reporting the findings of that auditing work to public service managers, Ministers and Parliament. | Agree (7) |
| 8.39 | That the Auditor-General be encouraged to discuss draft standards on compliance auditing and performance auditing with the Public Accounts Committee. | Agree |
| 8.40 | That at a later date the Public Accounts Committee review the activities of the Auditor-General's office in performance auditing, with a view to considering whether the office is adequately funded for such activities. | Agree |

EXPLANATORY NOTES TO THE AUDITOR-GENERAL'S RESPONSES

- Note (1): I would tend to rank these of at least "medium" priority.
- Note (2): It would seem that the intention of my original recommendation was not made sufficiently clear. I did not envisage a survey of users which would duplicate that undertaken by the Australian Accounting Research Foundation. Rather, I envisaged an approach similar to that outlined by Nicholas Clark and Associates in section 5.2 of their report, whereby options for improving the Whole-of-Government financial report would be prepared and users would be invited to comment.
- Note (3): I would also suggest that other groups with an interest in these financial statements should be asked for their views so that the development process becomes participative and the outcome (in the words of Nicholas Clark and Associates) "has the general support of the major parties responsible for financial reporting, management and accountability".
- Note (4): I agree that departmental financial statements should be audited by the Auditor General pursuant to statutory provision. My view is that any requirement for the Auditor General to perform an audit and its scope and extent should be expressed in legislation rather than by ministerial direction. This preserves the independence of the Auditor General from executive government.
- Note (5): I would also suggest that the Auditor-General should be the auditor of all Northern Territory government agencies whatever their legal form.
- Note (6): I would suggest that the proposals not be considered as mutually exclusive and that, in fact, both could be implemented.
- Note (7): I have been discussing with other Australian-area Auditors-General the desirability of developing auditing standards dealing with the conduct of "compliance" and "performance" auditing. My view is that such standards are best developed at the professional body level rather than at the individual Auditor-General level because:
- (a) it avoids an ad-hoc approach;
 - (b) development costs can be shared;
 - (c) a wider range of expertise and experience can be brought to bear; and
 - (d) if the matter is of such wide-spread concern then the profession will ultimately have to deal with the matter in any case.
- Note (8): The present arrangement is that any major matters raised in a management letter will be followed up at the next audit visit (which could be up to 8 months later).
- Note (9): It would seem that the intended use of the model financial statements was not made sufficiently clear. They were prepared to assist prescribed statutory corporations only, not other types of corporations.
- Note (10): Since Professor Walker's report was produced, Australian Accounting Standard AAS 25 has been issued which would make the adoption of this recommendation inconsistent with the preceding one. However, the intended result can be achieved if both a Statement of Cash flows and a Statement of Sources and Applications of Funds are included in the financial statements of Superannuation Funds.



DEPARTMENT OF
INDUSTRIES & DEVELOPMENT

Our ref: 89/1378
PC109010

Ms Sue Lee
Secretary
Public Accounts Committee
Legislative Assembly of the
Northern Territory
GPO Box 3721
DARWIN NT 0801

Dear Ms Lee

REPORT TO THE PUBLIC ACCOUNTS COMMITTEE
BY NICHOLAS CLARK AND ASSOCIATES

The Chairman of the Public Accounts Committee asked for comments on this report in his letter 3/4/28/SL/MKD of 29 August 1990. The following comments focus mainly on issues of direct relevance to this Department, but necessarily some may also be relevant to other Departments/Authorities. As a general comment, the report is very general with little opportunity for specific comment.

With regard to item 4.1.3 page 15, major unforeseen expenditure can (and is) met in a number of different ways, not only use of the Treasurer's Advance. Other ways include re-allocation of appropriation both intra-Departments and inter-Departments, use of reserves, etc.

Item 4.2.4.2 consolidated whole of Government accounts do not require in my view that "all Departments must usually adopt full accrual accounting". I suggest rather cash accounting could be used for consolidated accounts supplemented by accrual accounting where appropriate. However, I note that the consultant sees limited merit in consolidated accounts for Government.

On page 29 item (b) the consultant suggests that investors or rating agencies "may be willing to contribute to the cost of providing information which would otherwise be too expensive to justify". This is a naive view - the Government seeks investors and seeks rating by rating agencies, and they do not need to contribute by paying for information they reasonably require.

On page 31, the consultant recommends (i) that interests be declared in annual reports (ii) that changes be reported within say 10 days to (a) a central register and (b) to the Assembly (iii) that Government agencies not be constituted as limited liability companies but possibly under separate Territory legislation and (iv) that any Government-controlled company limit its purpose to those of its parent Department/Authority.

Recommendation (i) seems acceptable. Recommendation (ii) is quite unrealistic - 10 days is not necessary at all, and out of session, there is no-one effectively to report to in the Assembly. Rather, I suggest that there be annual reporting to a Treasury-maintained register and that each Department or Authority's annual report (which is tabled in the Assembly) should give details of companies including any changes in interest.

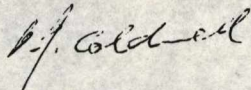
Recommendation (iii) is also unreasonable. There are legal and tax reasons for using various company structures, and it would hinder Government's legitimate commercial interests to prohibit using companies. I would expect that existing laws could be used to restrict the formation of companies for Government purposes or equity investment in companies if this can be shown to be needed eg amendment of the Treasurer's Directors. However, the consultant has not shown any need for this.

Recommendation (iv) seems fairly reasonable, although I am not aware of any case where an NT Government agency has set up a company just to get around limitations to its own powers - nor am I aware of any Government company abusing its powers. On this basis, is this really an issue of importance?

On page 33 the consultant provides guidance for a new publication, but with no justification for its content. I can see no evident reason why this publication (which seems merely to select, in an apparently random way, information generally available already) would add anything to the usefulness of existing Government financial publications (particularly Budget Paper No. 6). However, this is really a matter for Treasury in the first instance.

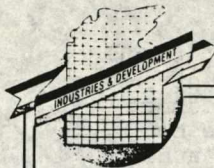
On page 34 under contingent liabilities, the consultant makes a number of suggestions to improve management and accountability. No justification is given, and little is apparent. I do not see why, just because Government owns a share in a company, then the company must report differently to any other company. I do, however, see some merit in a fuller introductory statement prefacing Numbers 5 and 6 of the Treasurer's Annual Statements indicating their coverage.

Yours sincerely



P J CALDWELL
Assistant Secretary
Industry and Economic Policy

22 October 1990



DEPARTMENT OF
INDUSTRIES & DEVELOPMENT

Our ref: PC109008
89/1378

Ms Sue Lee
Secretary
Public Accounts Committee
Legislative Assembly of the
Northern Territory
GPO Box 3721
DARWIN NT 0801

Dear Ms Lee

REPORT TO THE PUBLIC ACCOUNTS COMMITTEE BY R S WALKER

The Chairman asked for comments on this Report in his letter 3/4/28/SL/MKD of 29 August 1990. The following comments focus mainly on issues of direct relevance to this Department, but necessarily some may also be relevant to other Departments/Authorities.

Recommendations. These seem to be sensible and in line with what is already happening in the Territory and elsewhere in Australia. However, I am not entirely convinced that recommendation 5.38 is appropriate, since Departments are not separate legal entities but merely areas of Government and the overall accounts of the Crown (which is the legal entity) are in fact already audited. Given the fairly frequent changes in functions performed by Departments and changes in number of Departments, auditing of departmental financial statements might be quite difficult. For example, this Department operated under three different Administrative Arrangements Orders in 1989/90, gaining or losing functions each time.

Recommendation 5.60 suggests Statement 6 be expanded to cover commitments. I would think a separate statement on commitments could be more appropriate. However, this does not go to the heart of the issue, which is that at present the basic accounting system of central government is cash accounting, and a commitment statement would be more of an accrual concept.

Recommendation 6.22. As previously discussed, I think it proper that all government-owned and government-controlled companies or trusts be audited, but cannot see sufficient reason for the Auditor-General to be automatically the auditor. A qualified company auditor (perhaps one who is a member of the Auditor-General's panel of private auditors) should be sufficient. Such an auditor should be chosen in the usual way ie by vote of shareholders.

The proposed list of companies and their principal activities could sensibly be included in the Treasurer's Statements or in the accounts of statutory authorities. I suggest that further detail be shown in the annual reports of appropriate Departments, including listing shareholders, directors and principal officers. Consideration could also be given to tabling the statutory returns of such companies in Parliament, perhaps as an attachment to each Department's annual report. I would not support any requirement to table information of a commercially confidential nature which a non-government company would not be required to disclose.

I note that Section 5 points out the differing views within the profession about Government accounting. This section seems to lead to a view that the Territory should not be too quick to change its existing accounting.

The table at page 21 indicates that this Department in 1988/89 did not fully comply with Treasury guidelines for departmental reports. It should be noted that these guidelines were not issued until August 1989 ie after the end of that financial year. This Department's draft annual report for 1989/90 would score a yes in all of the nine categories covered in the table.

With regard to the comment at page 23 on accrued superannuation entitlements, I agree that there is little need for Departments to have this information. Rather, it should be seen as a service-wide function and Treasury should keep an overview on emerging costs.

The proposals at page 45 seem excessive in some areas, and I note that they have not been implemented. I see no objection to tabling reports of such companies in Parliament, but do not see good reason to restrict such companies in other ways eg a Government ought to be able to invest in any legal form of company and should not be handicapped in the commercial activities involving companies in ways in which the private sector is not.

Some of the issues raise legal questions eg as to the priority of state versus Commonwealth law and I think lawyers should be asked for their views, not just accountants and auditors.

On page 47 it is stated that "\$50 million is held in a long term investment in Investnorth Limited". I think the correct figure is \$10 million for Investnorth Limited; perhaps the \$50 million relates to PAWA.

On pages 48 and 49 it is said that the Auditor-General "is not in a position to maintain oversight over the whole spectrum of public sector financial activities ..." because of government-owned companies. To the extent that such companies are funded from appropriation, the Auditor-General does of course oversight all expenditures from appropriation.

The report (eg on page 49) does not say that the Auditor-General should use his own audit standards, but merely that he should be auditor as of right. The question of auditor standards is key, as to use public sector audit standards would tend to involve giving away commercially confidential information that no private sector company would accept.

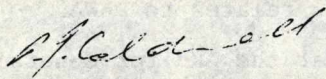
The paper goes on to say in pages 53 and 54 that there is no settled view that accrual accounting is more appropriate than cash accounting for Government functions.

The report also canvasses the differences between financial disclosure requirements of exempt proprietary companies, public companies and listed public companies. There are, of course, reasons for the different levels of disclosure, and one factor in influencing what status a company might have is the level of disclosure which shareholders and directors are willing to permit. To an extent, the desire for restricted reporting is commercially based.

On this basis, there is an argument that the relevant Minister carries the responsibility of shareholders' representative, and that the often drawn analogy between voters and shareholders is misleading. On that basis, as long as the Minister is fully informed, there is no need for a government-owned company to disclose to the public information which a non-government-owned company would not. Indeed, disclosure beyond the level of a non-government owned company would tend to commercially disadvantage any Government company.

The related question is that there may often be private shareholders in a Government company. These shareholders' interests could be compromised by too high a level of public disclosure.

Yours sincerely



P J CALDWELL
Assistant Secretary
Industry and Economic Policy

19 October 1990



PUBLIC SERVICE COMMISSIONER FOR THE NORTHERN TERRITORY

DEVELOPMENT HOUSE,
76 ESPLANADE,
DARWIN

G.P.O. BOX 4371,
DARWIN, N.T. 0801
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11 December 1990

Mr Mick Palmer MLA
Chairman
Public Accounts Committee
GPO Box 3721
DARWIN NT 0801

Dear Mick

AUDITOR GENERAL'S REPORT FOR THE YEAR ENDED 30 JUNE 1989

On 29 August 1990 you referred to me two consultants reports in relation to this matter. I apologise for not replying at an earlier date, but the delay is not an indication of my lack of interest in the matter.

The reports deal with some very important issues, including some which I have discussed with the Public Accounts Committee on a previous occasion. They relate, in particular, to the role of the Public Service Commissioner and my capacity or that of some other authority, to carry out effectiveness reviews.

It has not been possible for me, during my first two years of appointment, to take this issue further than the discussion stage but there are indications that 1991 will present some opportunities to do so. Among other things, the Government has indicated its desire to replace the Public Service Act with more modern legislation and I think that provides a unique opportunity for there to be some discussion on the respective roles and responsibilities of central agencies.

As to the consultants' reports, I found that the report prepared by Nicholas Clark and Associates to be succinct and to the point. I found the report by R G Walker to be overlong and somewhat remote.

I trust my comments prove helpful to the Committee.

Yours sincerely

D J HAWKES



NORTHERN TERRITORY TREASURY

Our Ref: 4-2-32:GY:gf:11
Your Ref:

Mr M Palmer
Chairman
Public Accounts Committee
GPO Box 3721
DARWIN NT 0801

Dear Mr Palmer

**RE: CONSULTANTS REVIEW OF THE 1988/89
AUDITOR-GENERAL'S REPORT**

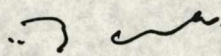
I refer to the Public Accounts Committee commissioned reports prepared by Nicholas Clark and Associates and Professor Bob Walker.

Treasury has now completed its comments on the consultants reports which appear as Attachment A (Nicholas Clark) and Attachment B (Bob Walker), both should be read in conjunction with the following Treasury rating key:-

1. Accepted and in hand for implementation.
2. Accepted and introduction in planning stage.
3. Questioned and on hold pending provision of greater evidence of "problems".
4. Rejected because of incompatibility with Government policy and/or excessive cost.

Please do not hesitate to contact Mick Martin (897911) for clarification of any of the issues involved.

Yours sincerely


K B CLARKE
A/G Under Treasurer
3/January 1991

Telephone: (089) 89 5511
Facsimile: (089) 89 6150
Location: AMP Building
Cnr Cavenagh and Knuckey Streets
DARWIN NT

Address all correspondence to:
The Under Treasurer
NT Treasury
GPO Box 1974
DARWIN NT 0801

NICHOLAS CLARK'S REPORT

| CONSULTANT'S RECOMMENDATION | PRIORITY GIVEN BY CONSULTANT | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|---|------------------------------------|---|--|--------------------|
| <u>WHOLE OF GOVERNMENT</u> | | | | |
| 1. Introduce a general summary statement of economic and financial conditions | HIGH | - it is noted that all relevant information is in fact published, however, at present no summary statement exists | Whilst the concept is sound, it would appear impractical to merge parts of the TAFS and Budget Papers because of the timing of the two documents. However, it is envisaged that a cross-referenced index will improve useability. | 3 |
| 2. Development of Territory wide register of assets and asset valuations | MEDIUM | - the asset management working party is currently investigating this issue - the major problem is in the valuation of assets, however, there is a general public sector move to recognise the importance of asset management rather than just asset recording - NSW has recently released guidelines for reporting and valuing assets | Introduction is dependent on departments and agencies, however, it is envisaged that Treasury would take a proactive role. Implementation could only proceed after implementation of recommendation 5 and may involve the incorporation of this requirement into the Treasurer's Directions. | 3 |

NICHOLAS CLARK'S REPORT

| CONSULTANT'S RECOMMENDATION | PRIORITY GIVEN BY CONSULTANT | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|--|------------------------------------|--|---|--------------------|
| 3. Consolidated whole of Government Accounts | LOW | <ul style="list-style-type: none"> - the PSASB arm of AARF has on its agenda a project to consider this issue - a form of consolidated whole of government accounts is already available from ABS presentation of ETF data - it is noted that to consolidate whole of government accounts, a consistent basis of accounting across all government organisations is required - the exercise may be costly | The low priority offered by the consultant is noted and we should await AARF'S findings | 3 |
| 4. Introduction of Standard Guidelines and Checklists for departmental Annual Reports | HIGH | <ul style="list-style-type: none"> - guidelines would help to present comparable annual reports - comparability in all aspects may be inappropriate given the diversity of NT government departments - such proposals may inhibit creative or practical experimentation with information reported in annual reports | It is noted that the recent changes to section 24 of the Treasurer's Directions refer to financial reporting only. Under the Public Service Act, the Public Service Commissioner is responsible for introducing the qualitative and other necessary quantitative requirements however, consideration could be given to incorporating/cross referencing some of these requirements into/with the FA&A Act. | 2 |
| 5. Compulsory Asset Management and Reporting Procedures for departments | MEDIUM | <ul style="list-style-type: none"> - valuation of assets problem may make it difficult to report this information - it may eventuate that asset management and maintenance is very costly, and that the government of the day may not | This concept has been accepted and recent revisions to the Treasurer's Directions reflect this. At present assets are recorded but not reported, however, it is envisaged that further revisions will be | 1 |

NICHOLAS CLARK'S REPORT

| CONSULTANT'S RECOMMENDATION | PRIORITY GIVEN BY CONSULTANT | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|--|------------------------------------|--|---|--------------------|
| 6. Compulsory Risk Management and Reporting Procedures for departments | MEDIUM | <ul style="list-style-type: none"> - there are very different interpretations of practices and what actually constitutes risk management - general trend is to implement programs to evaluate levels of risk exposure and steps to assess risk | More information and a clarification of the definition of this concept is required. | 3 |
| 7. Compulsory Reporting on future Financial Impact of Decisions | MEDIUM | <ul style="list-style-type: none"> - at present there seems to be no standardised procedures for the prior appraisal and review of "major" decisions except for capital works projects | Requires more information and a substantiation of the benefits before this recommendation can be implemented. | 3 |
| 8. Full Accrual Accounting in departments | LOW MEDIUM | <ul style="list-style-type: none"> - many of the advantages of accrual accounting can be enjoyed without the introduction of "full accrual accounting" eg, accounts payable and receivable, and employee provisions - adoption of "full accrual accounting" would involve considerable cost for quite uncertain benefits | Requires more information and a substantiation of the benefits before this recommendation can be implemented. | 3 |
| 9. Move to Forward Estimates | LOW MEDIUM | <ul style="list-style-type: none"> - this may be difficult due to the Territory's reliance on Commonwealth funding and the uncertain nature of the future flow of funding - uncertainty may make forward estimates all the more important | This recommendation is accepted and is a priority for implementation. | 1 |

NICHOLAS CLARK'S REPORT

| CONSULTANT'S RECOMMENDATION | PRIORITY GIVEN BY CONSULTANT | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|--|------------------------------------|--|---|--------------------|
| <u>STATUTORY AUTHORITIES</u> | | | | |
| 10. Rate of Return Targets for statutory authorities | MEDIUM | <ul style="list-style-type: none"> - will these be used to gauge a rate for payment of dividend by the authorities to the government? - should only apply to commercial operations - the provision of social goods and services may distort the figures calculated and render them meaningless | The concept is accepted, however, because all statutory authorities in the NT require government funding, alternative measures may be more relevant such as absolute profit targets, or subsidy targets as a percentage of revenue. | 3 |
| 11. Compulsory Reporting for "other corporations" | HIGH | <ul style="list-style-type: none"> - it is acknowledged that such corporations have a right to confidentiality, however, this must be weighed against the need for government to know what its commitments are - Nicholas Clark provides no evidence for their conclusions other than that a "trend" has been identified | The trend in other states is not to report this information. Treasury recommends a similar approach. | 3 |
| 12. Auditing the reports of "other corporations" by the Auditor-General. | HIGH | <ul style="list-style-type: none"> - Nicholas Clark suggests that there is a balance of opinion favouring compulsory auditing by the Auditor-General in situations where there is government "control", but fails to identify the source of opinion or reasoning for the "balance of opinion". | Treasury rejects this recommendation as the companies may be placed in a position of disadvantage. | 4 |

BOB WALKER'S REPORT

| CONSULTANT'S RECOMMENDATION AND REFERENCE | PRIORITY GIVEN BY CONSULTANTS | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|---|-------------------------------------|--|--|--------------------|
| <u>REVIEW OF INFORMATION NEEDS OF USERS OF GOVERNMENT FINANCIAL REPORTS</u> | | | | |
| 4.16 That the Auditor-General's recommendation that a survey be conducted to determine the "information needs" of various users of government financial reports be <u>not</u> acted upon in light of the fact that a similar exercise has recently been undertaken by the Australian Accounting Research Foundation | MINOR PRIORITY | <ul style="list-style-type: none"> - the findings of AARF have not yet been published - The consultant doubts whether any conclusive evidence as to the precise nature of the information needs will be discovered from this research anyway, and that debate will continue | Treasury agrees with this recommendation because the survey is unlikely to shed new light on the issue and would be costly and time consuming. | 1 |
| <u>CURRENT ANNUAL REPORTING METHODS OF DEPARTMENTS</u> | | | | |
| 5.15 That Treasury be asked to consider whether the Treasurer's Directions should be further expanded to require departmental financial reports to include: a) more detailed guidelines concerning disclosures of liabilities and other financial commitments arising from departmental activities; | MINOR PRIORITY | <ul style="list-style-type: none"> - Disclosure of contractual liabilities and information about assets would provide an indication of the scale of administrative responsibilities undertaken by some departments - The disclosures proposed would help to clarify the information currently reported | Treasury will implement the recommendation via revisions to the Treasurer's Directions by 30/06/92. | 2 |

BOB WALKER'S REPORT

| CONSULTANT'S RECOMMENDATION AND REFERENCE | PRIORITY GIVEN BY CONSULTANTS | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|---|-------------------------------------|---|---|--------------------|
| <p>b) explanations as to the basis of attributing money values to properties "written off";</p> <p>c) narrative descriptions of the major resources held, controlled or maintained by departments</p> | | | | |
| <p>5.30 That the Public Accounts Committee suggest that the Treasurer's Directions should be further expanded to provide encouragement to departments to devise and publish indicators of the economy, efficiency and effectiveness with which they have conducted their major programmes during the financial year</p> | <p>MINOR PRIORITY</p> | <p>- Bob Walker advises against the mandatory publication of performance indicators within the auditable section of an annual report, citing difficulties experienced both locally and overseas</p> | <p>Implementation will depend upon the establishment of performance indicators and measurements. This may require a longer term outlook of say 3-5 years.</p> | <p>2</p> |
| <p>5.38 (i) That the Public Accounts Committee endorse suggestions that departmental financial statements be subject to audit by the Auditor-General</p> | <p>MAJOR PRIORITY</p> | <p>- The consultant suggests that such an audit would not be unduly time consuming nor costly if the audit is conducted progressively throughout the accounting period</p> | <p>Audit of departmental financial statements may be an appropriate task for the internal audit bureau, with the Auditor-General performing only selective random audits in satisfaction of his own requirements.</p> | <p>3</p> |

BOB WALKER'S REPORT

| CONSULTANT'S RECOMMENDATION AND REFERENCE | PRIORITY GIVEN BY CONSULTANTS | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|---|-------------------------------------|---|---|--------------------|
| 5.38 (ii) That the Public Accounts Committee seek legal advice as to whether any statutory amendments are necessary to require departmental financial statements to be subject to audit - or whether it would be sufficient to make further amendments to the Treasurer's Directions | MINOR PRIORITY | N/A | N/A | N/A |
| 5.47 That Treasury give consideration to the inclusion within the <u>Annual Statements</u> of a five year summary of payments for capital works, showing expenditure in terms of such categories as roadworks, housing, hospitals, educational facilities, police fire & emergency services etc | MAJOR PRIORITY | - such an approach would reflect a broader view of the government's activities and the manner in which expenditures have been allocated | Information is being provided now in Budget Papers which may satisfy this recommendation. The utility of the information will be enhanced by cross referencing both the TAFS and Budget Papers. | 1 |
| 5.53 (i) That Treasury give consideration to the inclusion within the Treasurer's <u>Annual Statements</u> of explanation of such matters as "appropriations (from former years", the basis of inter-fund transfers and "recovery of principal and interest" | MAJOR PRIORITY | - the information provided will enable a clearer interpretation of the TAFS, with little additional cost | The 1990/91 TAFS will include these details. | 2 |

BOB WALKER'S REPORT

| CONSULTANT'S RECOMMENDATION AND REFERENCE | PRIORITY GIVEN BY CONSULTANTS | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|---|-------------------------------------|---|---|--------------------|
| <p>5.53 (ii) That Treasury give consideration to the inclusion within the Treasurer's <u>Annual Statements</u> of cash-flow statements depicting operating, financing and investing activities undertaken by the NT public sector. Consideration should be given to the Consolidated Fund, the Trust Fund and trust accounts external to the NT government account (after eliminating inter-fund transfers)</p> | <p>MAJOR PRIORITY</p> | <p>- the concept of cash-flow statements is relatively new in Australia with a possible standard not even at draft stage. As such, inclusion of this information may be inappropriate at this stage</p> | <p>Some cashflow information is already presented in the budget papers since the Consolidated Fund and most trust accounts use a "cash" accounting methodology.</p> | <p>3</p> |
| <p>5.53 (iii) That Treasury give consideration to the inclusion of cash flow statements in its quarterly reports to Parliament.</p> | <p>MAJOR PRIORITY</p> | | <p>The spirit of the recommendation is currently being followed as noted above.</p> | <p>3</p> |
| <p>5.60 (i) That Treasury give consideration to the content of Statement 6 "Guarantees and Contingent Liabilities" to encompass "Liabilities, commitments for expenditure and contingent liabilities"</p> | <p>MINOR PRIORITY</p> | <p>- It is noted that the NTGPASS is unfunded and is an example of the type of information which would be reported under this recommendation</p> | <p>Requires additional information and a substantiation of the benefits before this recommendation can be implemented.</p> | <p>3</p> |

BOB WALKER'S REPORT

| CONSULTANT'S RECOMMENDATION AND REFERENCE | PRIORITY GIVEN BY CONSULTANTS | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|--|-------------------------------------|---|---|--------------------|
| 5.60 (ii) That consideration be given to the presentation in the <u>Annual Statements</u> of information concerning "liabilities" and "commitments for expenditure" in the form required by clause 21 of Schedule 7 of the Companies Code. | MINOR PRIORITY | - Reporting of liabilities such as the emerging cost of superannuation entitlements is considered unnecessary and inappropriate in the first instance | Requires additional information and a substantiation of the benefits before this recommendation can be implemented. | 3 |
| <u>ADEQUACY OF ACCOUNTABILITY AND REPORTING ARRANGEMENTS FOR GOVERNMENT OWNED COMPANIES, CORPORATIONS, TRUSTS, ETC</u> | | | | |
| 6.22 (i) That the Auditor-General be established as the auditor of all government owned or government controlled companies or trusts - save that the Auditor-General may contract-out such audit work to private sector audit firms | MAJOR PRIORITY | - the entities in question should be allowed to operate in a completely confidential environment just like other commercial enterprises | Treasury rejects this recommendation as the companies may be placed in a position of disadvantage. | 4 |

BOB WALKER'S REPORT

| CONSULTANT'S RECOMMENDATION AND REFERENCE | PRIORITY GIVEN BY CONSULTANTS | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|--|-------------------------------------|--|---|--------------------|
| <p>6.22 (ii) That Treasury be asked to consider revisions of the <u>Treasurer's Directions</u> so as to require Departments, and statutory authorities to include in their annual financial statements:</p> <p>a) a list of subsidiary companies and trusts and of other companies or trusts in which the Territory holds 20% or more of the shares or units;</p> <p>b) a description of the principal activities of those companies or trusts</p> | <p>MAJOR PRIORITY</p> | <p>- the Treasurer's Directions do not apply to statutory authorities</p> <p>- legal advice should be sought.</p> <p>- the Treasurer may be able to issue a determination to the statutory authorities</p> | <p>Treasury agrees in principle with the recommendation.</p> | <p>3</p> |
| <p>6.62 That the Committee consider the merits of either:</p> <p>i) the expansion of the Treasurer's Directions relating to prescribed statutory corporations so as to incorporate additional guidance on financial reporting issues; or</p> | <p>MAJOR PRIORITY</p> | <p>- given the stage of development of government owned enterprises in the Territory it may be inappropriate to subject such entities to additional controls and requirements</p> | <p>No action is necessary because appropriate companies legislation and accounting standards already exist.</p> | <p>4</p> |

BOB WALKER'S REPORT

| CONSULTANT'S RECOMMENDATION AND REFERENCE | PRIORITY GIVEN BY CONSULTANTS | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|--|-------------------------------------|---|---|--------------------|
| ii) the introduction of legislation along the lines of the NSW State-owned Corporations Act, so as to establish accountability arrangements for all public sector corporations, (both prescribed statutory corporations and other government-controlled companies or trusts) | | | | |
| 6.77 (i) That the Auditor-General be encouraged to develop or adopt a set of auditing standards dealing with the conduct of "compliance" auditing, and with reporting the findings of that auditing work to management, boards of public sector corporations, Ministers and Parliament | MAJOR PRIORITY | - currently the Auditor-General is to inform the Minister of "any significant irregularity", however, the term "significant" is not defined | Treasury accepts this recommendation and suggests that the Auditor-General adopt standards to be approved by government (parliament). | 1 |
| 6.77 (ii) That the Auditor-General consider the introduction of guidelines for the reporting of Parliament (perhaps through the Public Accounts Committee) of any matters raised in management letters which have not been rectified or attended to within six months from the date of those letters | MAJOR PRIORITY | - it is noted that non-response may fail to bring pertinent matters to the attention of the parliament | Treasury accepts this recommendation. | 1 |

BOB WALKER'S REPORT

| CONSULTANT'S RECOMMENDATION AND REFERENCE | PRIORITY GIVEN BY CONSULTANTS | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|--|-------------------------------------|--|---|--------------------|
| 7.20 That the Auditor-General's (i) recommendation that all corporations should comply with the proposed model financial statements should <u>not</u> apply to incorporated school councils | MINOR PRIORITY | - the benefits of such reporting are at this stage unidentified and the costs may be high | Treasury accepts this recommendation. | 1 |
| 7.20 That the Public Accounts (ii) Committee consider reviewing how the accountability arrangements for school councils established by the Education Act and accompanying guidelines are operating in practice. | MINOR PRIORITY | - some school councils receive large grants, and consequently, it is appropriate to ensure that the funds are in fact being used for the purposes intended | Treasury accepts this recommendation. | 1 |
| 7.27 That the Auditor-General's (i) recommendation not be accepted in their present form for application to superannuation funds. | MAJOR PRIORITY | | Treasury assessing in line with AAS25. | 3 |

BOB WALKER'S REPORT

| CONSULTANT'S RECOMMENDATION AND REFERENCE | PRIORITY GIVEN BY CONSULTANTS | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|---|-------------------------------------|---|--|--------------------|
| 7.27 (ii) That Treasury be advised that in exercising discretion in terms of section 68 of the Financial Administration and Audit Act, it would be appropriate for NT superannuation funds to adopt only those Australian Accounting Standards which are relevant to the superannuation industry. | MINOR PRIORITY | | Recommendation supported. | 2 |
| 7.27 (iii) That it be suggested to Treasury that consideration be given to requiring annual reports of superannuation funds to include a statement of Cash Flows (rather than a Statement of Sources and Application of Funds). | MINOR PRIORITY | | Recommendation deferred, while Treasury assessing impact of AAS25. | 3 |
| 7.32 (i) That the Auditor-General's recommendation for the adoption of model financial statements not be accepted as appropriate for community government councils. | MAJOR PRIORITY | <ul style="list-style-type: none"> - the accounting exposure draft dealing with reporting for community government councils has generated considerable debate - at this stage, the Auditor-General's recommendation is considered inappropriate | Treasury accepts this recommendation. | 1 |

BOB WALKER'S REPORT

| CONSULTANT'S RECOMMENDATION AND REFERENCE | PRIORITY GIVEN BY CONSULTANTS | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|--|-------------------------------------|--|--|--------------------|
| 7.32 (ii) That the Auditor-General's recommendation for the adoption of model financial statements (implying as they do the use of accrual accounting) not be supported as appropriate for local government councils at this stage. | MINOR PRIORITY | - same comment as above | Treasury accepts this recommendation. | 1 |
| 8.9 That the Public Accounts Committee support proposals that government departments and statutory authorities should review the efficiency and effectiveness of the financial management processes and systems they employ in managing the public sector - but that it not support suggestions that monitoring those activities should necessarily be the responsibility of Treasury. | MINOR PRIORITY | - previously, Treasury has undertaken an active role in co-ordinating such reviews, however, it does support devolution of responsibility in this instance | Treasury accepts this recommendation but is willing to review the situation following the provision of more concrete evidence of the "problems". | 2 |

BOB WALKER'S REPORT

| CONSULTANT'S RECOMMENDATION AND REFERENCE | PRIORITY GIVEN BY CONSULTANTS | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|---|-------------------------------------|--|---|--------------------|
| 8.13 That the Public Accounts Committee express the view that it encourages departmental reviews of financial management, but would not endorse the suggestion that formal reviews of financial management practices and systems be instituted across departments, pending further advice from the Auditor-General concerning substantive evidence of "problems". | MINOR PRIORITY | - it is quite clear that the "problems" have not been specifically identified | Treasury supports the view that the Auditor General should research performance auditing to assist the Estimates Review Committee, with the ultimate aim of enabling parliament to make informed decisions. | 1 |
| 8.24 That the Public Accounts Committee support the efforts of the Auditor-General to undertake occasional reviews of the economy, efficiency or effectiveness of selected public sector activities. | MINOR PRIORITY | - following substantiation of the "problems" by the Auditor-General it must be determined whether the Auditor-General has the skill and resources to undertake this exercise | Treasury recommends that further evidence is required before resources are allocated, but notes that the Estimates Review Committee is embarking on this task. | 3 |

BOB WALKER'S REPORT

| CONSULTANT'S RECOMMENDATION AND REFERENCE | PRIORITY GIVEN BY CONSULTANTS | COMMENTS | TREASURY RECOMMENDATION | TREASURY RATING |
|--|-------------------------------------|---|---|--------------------|
| 8.38 That the Auditor-General be encouraged to develop or adopt standards dealing with the conduct of "performance auditing" and with reporting the findings of that auditing work to public service managers, Ministers and Parliament. | MINOR | - the cost must be considered | see recommendation under 8.24 | 4 |
| 8.39 That the Auditor-General be encouraged to discuss draft standards on compliance auditing and performance auditing with the Public Accounts Committee. | MINOR PRIORITY | - it is appropriate that the Auditor-General liaise with the PAC because both bodies are responsible for reporting to parliament. | Treasury accepts this recommendation in respect to compliance auditing but performance auditing will be undertaken by Estimates Review Committee. | 4 |
| 8.40 That at a later date the Public Accounts Committee review the activities of the Auditor-General's office in performance auditing, with a view to considering whether the office is adequately funded for such activities. | MINOR PRIORITY | N/A | N/A | N/A |



NORTHERN TERRITORY OF AUSTRALIA

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SECRETARY
DEPARTMENT OF THE CHIEF MINISTER

11 MAR 1991

Mr M Palmer
Chairman
Public Accounts Committee
Legislative Assembly of the
Northern Territory
GPO Box 3721
DARWIN NT 0801

Dear Mr Palmer

AUDITOR-GENERAL'S REPORT FOR THE YEAR ENDED 30TH JUNE 1989

I refer to previous correspondence in relation to the Auditor-General's Report for the year ended 30th June, 1989. Specifically you forwarded copies of the reports of two consultants, employed by the Public Accounts Committee to comment upon the Report, and you have sought this Department's comments on the matters raised by the Report and the consultants' findings.

Given the nature of the matters raised in the Auditor-General's Report, reports from two independent consultants would have to be viewed as beneficial.

As a general comment, it can be stated that Professor Walker's report provides a very detailed, analytical view of the matters raised in the Report. The review of Nicholas Clark and Associates, on the other hand, is very much premised on the rhetoric of sources interviewed in Government and non-Government agencies throughout Australia. That is not meant as a comment to diminish the report in any way, but rather to indicate that the two consultants' reports have considered the terms of reference from somewhat different perspectives. Of itself, that should prove beneficial to the Public Accounts Committee, as it may be able to extract the best from both reviews.

The Nicholas Clark review provides a very broad, strategic future planning approach to the topics alluded to in the Auditor-General's Report. It is clear that, in considering the terms of reference from the Public Accounts Committee, the statements made by the Auditor-General were determined to be, prima facie, statements of undisputed fact. Whether such an assumption should have been made by the consultant is a moot point, particularly having regard to Professor Walker's dissertation.

It is clear that in relation to a number of the matters raised in the Auditor-General's Report there is no definitive answer. For example, the matter of accrual-based versus cash-based accounting and the detail of the financial reporting required to satisfy all users of the information. These subjects raise vexed questions for which there seems to be no easy solution.

While acknowledging that the Northern Territory Treasury has, in recent years, made enormous inroads into providing Departments with Directions that assist greatly in efficiency, and effectiveness, as well as ensuring that Accountable Officers report accurately and in detail on revenue raising and expenditure of public monies, the starting point in this exercise should be that there is room for improvement. The Northern Territory Government does not stand alone in this regard - Governments the world over are considering more meaningful, more efficient and more effective ways of providing information on financial status, while at the same time ensuring that Accountable Officers are managing the public purse efficiently and effectively. It is heartening to note, as both Professor Walker's and Nicholas Clark and Associates' reports indicate, no one Government seems to have the ideal solution.

That is, of course, not to say that there should not be persistence in achieving what may be seen to be well nigh impossible. Professor Walker's report, and to some extent, Nicholas Clark and Associates' report may be used as a basis. It is abundantly clear though that the Northern Territory Government, and in particular the Treasury have already implemented, and will continue to implement, innovations in financial management. The recommendations in Professor Walker's report should be seen as complementary to those innovations.

I enclose for your use some detailed comments on the two reports.

Thank you for the opportunity to comment on the consultants' reports on the Auditor-General's Report for the year ended 30th June, 1989.

Yours sincerely

Margaret P. Kyens

for HUGH BOWERS

Specific Comments

1. Financial Statements

Recommendation 6.22

This recommendation suggests that the Treasurer's Directions be revised to require departments and statutory authorities to include specified information in their annual financial statements.

Such action is appropriate and proper for amending departmental financial statement requirements (covered by Section 24 of the Treasurer's Directions). However, changes to requirements for financial statements of statutory authorities would not usually be accomplished by revising the Treasurer's Directions.

The Treasurer's Directions generally only apply to departments, the exception being Section 20 on purchasing procedures.

Section 68 (1) of Financial Administration and Audit Act provides that the financial statements of prescribed statutory corporations (statutory authorities) shall be in a form approved by the Treasurer.

The most appropriate, and easiest, means of achieving the intended outcome of Professor Walker's recommendation, if its adoption is considered warranted, is as follows:

- (a) for departments - amend Section 24 of the Treasurer's Directions; and
- (b) for statutory authorities - have the Treasurer include the recommended requirements in his approved form of financial statements.

This solution would simply require the Treasurer to issue an amended instrument under Section 68 (1) of the Act. It would require no legislative change.

Extension of the Treasurer's Directions to statutory authorities can be achieved either through legislative amendment or a complex administrative process involving Ministerial instructions.

2. Financial Reporting by Public Sector Corporations

Recommendation 6.62

The options presented in paragraphs 6.59 and 6.62 appear to ignore other solutions to the perceived financial reporting inadequacies.

With regard to Option (i), as explained above, a preferred method for modifying the financial reporting requirements of prescribed statutory corporations is for the Treasurer to approve a revised form of financial statements.

Further, Treasury could prepare and publish guidelines to assist statutory authorities with financial statement presentation. The Treasurer's approval, under Section 68 (1) of the Act, could then require the authorities to follow these guidelines.

Of the two (2) options presented in Walker's report, Option (i) would seem to be the preferred option. It represents a less costly and more flexible alternative.

It allows for changes to be incorporated into financial reporting guidelines without the need for legislative amendment. In addition such changes could be initiated and processed on a more timely basis.

As financial reporting standards have evolved over time and will continue to evolve, it is important to have in place a flexible mechanism which is readily and easily able to evaluate and adopt these changes.

The Corporations Law, Schedule 5 (dealing with financial reporting requirements) is included in the regulations rather than the body of the legislation to facilitate timely amendment. A similar approach to public sector financial reporting guidelines would seem to precipitate flexibility.

It is acknowledged that Option (i) only covers prescribed statutory corporations. Alternative mechanisms may need to be considered to cover the other types of public sector corporations (principally government controlled companies) should this be deemed necessary. It should be noted that these companies would already be subject to a significant degree of control over their financial reporting through the application of the Corporations Law, and Schedule 5, in particular.

3. Treasurer's Annual Financial Statements - Explanation of Terms

Recommendation 5.53

The financial statement items specified as needing explanation appear to be the requirements of an individual reader. Other readers of the statements may understand some of the terms mentioned but not other terms used in the statements. An alternative approach suggested would be to use a standard set of terms, with definitions included in a glossary.

4. Departmental Financial Management Philosophy

Paragraphs 8.14 to 8.17

The Treasurer's Directions are instructions by the Treasurer to all accountable and accounting officers. There must be compliance with the Treasurer's Directions by these officers pursuant to Section 35 of the Financial Administration and Audit Act.

Philosophical concepts do not seem appropriate in this context. Perhaps Treasury could consider including an overall statement of the objectives of the Treasurer's Directions, particularly relating to departmental financial management. This could be incorporated into either the existing Foreword or Section 1 (Introduction) of the Directions.

REPORT BY NICHOLAS CLARK AND ASSOCIATES

1. Terms of Reference

The Public Accounts Committee's terms of reference for the report required an assessment of the Treasurer's Annual Financial Statements and an evaluation of the relevance of the Auditor-General's recommendations in his 88/89 Annual Report (Foreword).

On page i, the report's main focus is described as:

- . "to identify areas where further improvement is warranted in Territory financial reporting...; and
- . to establish some tentative priorities for (these) improvements..."

This focus is mentioned again on page 1 where it is further stated:

"...the purpose of this report is not to carry out an in-depth and comprehensive review of the issues raised by the Auditor-General."

It may be argued that the contents and conclusions of the report seem inconsistent with the stated terms of reference.

2. Potential Problems

The report states that:

"... although there is no evidence that either accountability or the quality of resource management is presently jeopardised by inadequate financial reporting, it is possible that problems may arise in the future."

This statement would appear to be meaningless in the context of the report. It is possible that problems may arise in any given area or system should an appropriate set of circumstances prevail. It is important to note that the report acknowledges that there is no deficiency evident in the present system.

3. Company Reporting

The report provides that corporations are normally subject to the reporting requirements of the relevant "corporate legal jurisdiction". It then goes on to say that the reports produced "are not particularly informative".

Where these corporations are companies, in Australia they would have to comply with the Corporations Law, including the reporting requirements of Schedule 5. It should be noted that these requirements are uniform throughout Australia.

Much of the Auditor-General's advocated model financial statements appear based on the reporting conditions prescribed in Schedule 5. It seems that this report is implying that financial reports based on Corporations Law requirements and using commercial (accrual) accounting principles would not be "particularly informative". It would seem that this implication may be at odds with other aspects of the report which appear to favour accrual accounting techniques.

4. Accrual Accounting

The report indicates that most governments in Australia are moving towards accrual accounting. Further, it appears to favour the adoption of full accrual accounting throughout the Northern Territory public sector. This seems to be reinforced in the priority listing at end of the report.

Professor Walker also makes a number of references to accrual accounting in his report. He addresses both its adoption by other governments and its application in the Northern Territory.

Walker's observations and conclusions on the appropriateness of full accrual accounting to the total public sector differ markedly from those indicated in this report.

While the question is a vexed one, Professor Walker's arguments leading to his conclusion, seem more soundly based in theory and in practice.

5. Asset Valuation

The report cites New South Wales as "probably the most advanced" in the area of public sector asset valuation.

New South Wales classifies many so-called heritage assets under the term "community" assets and records them at a nominal value of \$1 each.

This valuation technique does not seem particularly advanced. It is certainly not attributing values representative of the future economic benefits to be derived from these assets, or even of the significant expenditures which have been outlaid in creating the assets.

6. Superannuation

The comments on superannuation entitlements are correct but no reasons for the Northern Territory Government's position in this regard are provided.

It would seem to be inappropriate to require departments to report superannuation "liabilities". Departments do not pay employer contributions or directly fund liabilities. Employee transfers between departments and the subsequent cost and liability apportionments would lead to a costly and inefficient approach.

7. Rate of Return Reporting

Rate of return reporting and the "dividend" concept would not be appropriate for Northern Territory statutory authorities at this time. The authorities are still budget dependent and receive appropriation. Thus, "dividend" returns to the Government are not possible.

8. Whole of Government Reporting

The issue of whole of government financial reports does not mean that departments must adopt full accrual accounting as is stated in the report.

Statutory authorities would be equally able to provide cash accounting based information for centralised reporting purposes. In fact, this information would be more readily available as statutory authorities already maintain some cash accounting information.

9. Monitoring Financial Information

The report advises that procedures are needed to continue to monitor the usefulness of financial reporting information. The report does not describe what monitoring procedures are currently in place.

10. Review of Accountability and Reporting Arrangements

The report agrees that a review would be "useful". However, it provides no guidance as to how and by whom this review should be conducted, or what would be its objectives.

The basis for recommending this review is the "potential problems ... which could arise". No explanation of these potential problems is given and no analysis of the probability of their occurrence is provided. Alternatively, there is no recognition given here to the need to assess these, or other factors prior to initiating such a review.

11. Summary of Financial Information

The report accepts the Auditor-General's observation of a demand for a summary of key financial information about the Territory.

There is no evidence of any independent assessment or verification of the Auditor-General's observation. No explanation is provided as to the sources of this "demand", or why some information should be regarded as "key" data and the purposes for which it is required.

12. Priorities for Improving Financial Reporting

The specified assessment criteria of minimal disruption and/or low implementation costs should not, of themselves, cause a desired change to be high priority. These criteria relate to the ease with which any change can be introduced rather than its need for introduction.

The third criteria of significant, potential benefits would seem to be the most important assessment criteria when contemplating changes to financial reporting processes.

The benefits and costs expected to arise from any given decision should always be considered together and not in isolation.



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FROM THE OFFICE OF THE SECRETARY

Ms Susanne Lee
Secretary
Public Accounts Committee
Legislative Assembly of the Northern Territory
GPO Box 3721
DARWIN NT 0801

Dear Ms Lee

**RE: REPORTS TO THE LEGISLATIVE ASSEMBLY OF THE NORTHERN
 TERRITORY REGARDING THE AUDITOR GENERAL'S REPORT FOR
 THE YEAR ENDED 30 JUNE 1989**

I refer to your letter of 14 February 1991 concerning the reports by Professor Walker and Dr Hall which were commissioned by the Public Accounts Committee.

There are two areas in the reports on which I would like to comment.

1. Accrual Accounting

Most departments are engaged in few commercial activities and the determination of profit is not central to Departmental accounting systems. The costs of introducing accrual accounting would far outweigh any benefits gained through implementation.

If Departments were to adopt accrual accounting, accounting systems would need to be substantially changed as the current system focuses on cash based accounting.

Other significant costs involved in the implementation of accrual accounting include the valuation of fixed assets, the calculation of depreciation, amortization and appreciation, and the compilation of contingent liabilities data such as superannuation, airfare entitlements and long service provisions.

It is important to recognise that this range of information is not readily available in the current system.

2. Program Indicators

The importance, and difficulty, of developing useful indicators for effectiveness cannot be overstated. Effectiveness indicators focus on the quality of the service provided by the program and assist to decide if programs are achieving their objectives and are having their desired impact.

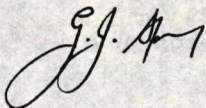
As indicated in the reports, apart from simple numerical data there are few satisfactory performance indicators to date despite considerable effort devoted to the development of appropriate measures in the Northern Territory and other States.

In assessing performance of programs, efficiency and effectiveness should not be considered in isolation. Efficiency is concerned with performing the work as inexpensively as possible, whereas effectiveness is related to the quality of service. A program may be efficient but not effective because it may be cheap to run but it is not achieving the stated objective. Similarly, a program may be effective but not efficient because it is too costly to maintain. Focus on both aspects of performance will give a better guide to the cost-effectiveness of programs.

Improvement is desirable but information is expensive.

Given the current economic situation and the need for Government to critically examine all areas of expenditure, it is contingent on the Government to fully cost out any changes to Departmental accounting arrangements before deciding on their implementation.

Yours sincerely



G J SPRING
Secretary

14 March 1991

SAC 2:
'OBJECTIVES
of
GENERAL PURPOSE FINANCIAL REPORTING'

Objective of General Purpose Financial Reporting

Prepared by the **Public Sector Accounting Standards Board** of
the **Australian Accounting Research Foundation** and the
Accounting Standards Review Board



Issued by the **Australian Accounting Research Foundation** on
behalf of the **Australian Society of Certified Practising
Accountants** and **The Institute of Chartered Accountants in
Australia** and by the **Accounting Standards Review Board**

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STATEMENT OF ACCOUNTING CONCEPTS
SAC 2 "OBJECTIVE OF GENERAL PURPOSE
FINANCIAL REPORTING"

Citation

- 1 This Statement may be cited as Statement of Accounting Concepts SAC 2 "Objective of General Purpose Financial Reporting".

Application and Operative Date

- 2 This Statement applies to each reporting entity in relation to its first reporting period that ends on or after 31 August 1990, and in relation to subsequent reporting periods.

INTRODUCTION

- 3 The purpose of this Statement is to establish the objective of general purpose financial reporting by reporting entities in the private and public sectors. The Statement identifies the users of general purpose financial reports, the common information needs of such users and the broad types of information, consistent with those needs, that general purpose financial reports should provide.
- 4 Although the specification of an objective will have implications for the type of information to be included in general purpose financial reports and for the manner in which such information is to be communicated to users, this Statement contains no conclusions regarding the particular qualities that information should possess to meet this objective, the number, nature and form of the financial statements to be prepared, and the nature and measurement of the elements of such statements. These matters are the subject of other Statements of Accounting Concepts.

DEFINITIONS

- 5 For the purposes of this Statement:

"accountability" means the responsibility to provide information to enable users to make informed judgements about the performance, financial position, financing and investing, and compliance of the reporting entity;

"compliance" means adherence to those statutory requirements, regulations, rules, ordinances, directives or other externally-imposed requirements in respect of which non-compliance may have, or may have had, a financial effect on the reporting entity;

"financial position" means the economic condition of a reporting entity, having regard to its control over resources, financial structure, capacity for adaptation and solvency;

"financing and investing" means those activities of a reporting entity that relate to the financing of its operations and the investment of its resources;

"general purpose financial report" means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs;

"performance" means the proficiency of a reporting entity in acquiring resources economically and using those resources efficiently and effectively in achieving specified objectives; and

"reporting entity" means an entity (including an economic entity) in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources.

DISCUSSION

Scope and Applicability

- 6 The objective specified in this Statement applies to general purpose financial reporting by all reporting entities.
- 7 General purpose financial reporting focuses on providing information to meet the common information needs of users who are unable to command the preparation of reports tailored to their particular information needs. These users must rely on the information communicated to them by the reporting entity.
- 8 Some users have specialised needs and will possess the authority to obtain the information to meet those needs. Examples of such users are taxation authorities, central banks and grants commissions. Although such users may make use of the information contained in general purpose financial reports, because they have the authority to command the information they require they do not need to rely on

information provided to other groups. Special purpose financial reports directed at the needs of such users are beyond the scope of this Statement.

- 9 This Statement encompasses general purpose financial reporting by business and non-business reporting entities in the public and private sectors. It covers general purpose financial reporting by all types of reporting entities, whether legal, administrative or economic entities, and therefore encompasses all types of government entities, including government departments, statutory authorities, and, as a whole, Federal, State, Territorial and local governments; investor-owned entities, including companies and unit trusts; mutual co-operative entities, including building societies and credit unions; human service entities, including churches, foundations, professional associations and charities; superannuation plans; partnerships; and sole proprietorships.
- 10 Financial reporting encompasses the provision of financial statements and related financial and other information. Financial reports, comprising financial statements, notes, supplementary schedules and explanatory material intended to be read with the financial statements, are the principal means of communicating financial information about a reporting entity to users. However, other information can best be provided, or can only be provided, outside financial reports. Financial reports are not the only source of relevant information about a reporting entity, and users of financial reports may need to consult other sources to satisfy their information needs. This Statement does not attempt to draw a clear distinction between financial reports and financial reporting, nor does it attempt to define the boundaries of general purpose financial reporting. Distinctions will be made and boundaries drawn, as required, in other Statements of Accounting Concepts and in Accounting Standards.

Purpose of General Purpose Financial Reporting

- 11 General purpose financial reporting is not an end in itself, but is a means of communicating relevant and reliable information about a reporting entity to users. The objective specified in this Statement derives from the information needs of those identified as the users of general purpose financial reports. Those needs depend, in turn, on the activities of reporting entities and the decisions users make about them.
- 12 Reporting entities control resources and influence members of the community through providing goods and services, levying prices, charges, rates and taxes, and acquiring and investing resources.

The community interest is best served if scarce resources controlled by reporting entities are allocated to those entities which will use them in the most efficient and effective manner in providing goods and services. Efficient use of resources raises output, has desirable macroeconomic effects by enhancing employment and the standard of living, and enables social policy objectives to be achieved at the lowest cost. Members of the community make resource allocation decisions in respect of reporting entities - that is, they make reasoned choices among alternative uses of scarce resources. For example, investors decide whether to invest in an entity; creditors decide whether to lend resources to an entity; governments and parliaments decide, on behalf of constituents, whether to fund particular programmes for delivery by an entity; taxpayers decide who should represent them in government; donors decide whether to donate resources to an entity; individuals decide whether to contribute to a superannuation plan; employees decide whether to sell their services to a particular entity; owners/members of reporting entities decide whether they should contribute resources to the entity and who should manage the entity on their behalf; and ratepayers decide whether they should support the particular programmes of their local government and who should represent them on the local government council.

- 13 Efficient allocation of scarce resources will be enhanced if those who make resource allocation decisions, such as those groups identified above, have the appropriate financial information on which to base their decisions. General purpose financial reporting aims to provide this information.
- 14 General purpose financial reporting also provides a mechanism to enable managements and governing bodies to discharge their accountability. Managements and governing bodies are accountable to those who provide resources to the entity for planning and controlling the operations of the entity. In a broader sense, because of the influence reporting entities exert on members of the community at both the microeconomic and macroeconomic levels, they are accountable to the public at large. General purpose financial reporting provides a means by which this responsibility can be discharged.
- 15 Although the subsequent discussion of users and their information needs at times distinguishes between business and non-business entities, the common objective specified in this Statement reflects the inherent similarities between the two types of entities. While business entities seek to earn profits or desired rates of return and non-business entities pursue primarily non-financial objectives, both types of entities provide goods and services to the community and use scarce resources in the process; both obtain these resources

from external sources and are accountable to the providers of the resources or their representatives; both control stocks of resources; both incur obligations; and both must be financially viable to meet their operating objectives.

Users of General Purpose Financial Reports

- 16 Many individuals and organisations base resource allocation decisions on their relationship with and knowledge about reporting entities and are therefore potentially interested in the information provided in general purpose financial reports. The following three categories of user groups are identified as the primary users of general purpose financial reports, and those whose common information needs should dictate the type of information to be disclosed by such reports: resource providers, recipients of goods and services, and parties performing a review or oversight function.

Resource providers

- 17 Providers of resources include those who may be compensated either directly or indirectly for the resources they provide. The former category includes employees, lenders, creditors, suppliers and, in the case of business entities, investors and contributors. The latter category includes donors, members of non-business entities such as clubs, societies and professional bodies, and, in the case of public sector bodies, parliament, taxpayers and ratepayers.

Recipients of goods and services

- 18 Recipients of goods and services are those who consume or otherwise benefit from the goods and services provided by the reporting entity. This category comprises customers and beneficiaries. In many non-business entities recipients of goods and services include resource providers, for example, ratepayers, taxpayers and members of professional associations.

Parties performing a review or oversight function

- 19 Certain parties, including parliaments, governments, regulatory agencies, analysts, labour unions, employer groups, media and special interest community groups, perform oversight or review services on behalf of the community. Members of this group tend to have indirect or derived interests in general purpose financial reports since they advise or represent those who have direct interests.

Managements and governing bodies

- 20 Managements and governing bodies are another category of user interested in the information provided in general purpose financial reports. However, managements and governing bodies need, in addition to the information contained in general purpose financial reports, management accounting and other information to carry out their planning and control responsibilities. Since this type of reporting has to be tailored to meet the specialised needs of these users, and since they will have the ability to determine the form and content of any such reports, this reporting is in the nature of special purpose financial reporting and is therefore beyond the scope of this Statement.

Purposes for which User Groups Require Financial Information

Resource providers

- 21 Providers of resources want to know whether the reporting entity is achieving the objectives which formed the reason for the provision of resources in the past and is operating economically and efficiently and using resources as prescribed. In the case of investor-owned business entities, investors and other resource providers will want to know whether the entity is operating profitably and generating favourable cash flows in the process, since their decisions relate to amounts, timing and uncertainties of expected cash flows. In the case of public sector entities and non-business entities in the private sector, taxpayers (and ratepayers) and contributors, respectively, want to know whether the entity is delivering the services expected of it, that is, whether it is achieving its objectives, and is doing so economically and efficiently. Other providers of resources to public sector entities and non-business entities in the private sector, for example, employees, suppliers, creditors and lenders, will principally be interested in the entity's ability to generate cash flows for timely payment of the entity's obligations to them. However, they will be indirectly concerned about the extent to which the entity is achieving its objectives since the ability of the entity to generate future cash flows will depend on its performance in this regard. Information provided in general purpose financial reports to enable resource providers to make these assessments will assist them in determining whether continued support of the entity's activities is warranted and in predicting the level of resources necessary to support those activities.

Recipients of goods and services

- 22 Recipients of goods and services may want to assess the ability of the reporting entity to continue to provide goods and services in the future, the likely level at which the goods and services will be provided and the likely cost of the goods and services. In this regard, as with resource providers, they want to know whether the entity is achieving its objectives and is operating economically and efficiently in the provision of the goods and services.
- 23 In the case of business entities, the focus of this user group is on the ability of the entity to generate favourable cash flows, since only by obtaining sufficient cash to pay for the resources it uses and to meet its other obligations will the entity be able to continue to provide the goods and services in the future. Assessments by these users will affect their decisions to seek alternative suppliers of the goods and services.
- 24 In the case of non-business entities, and to an extent public sector business entities, the focus of this user group is on the extent to which the entity is using resources in their interests. Assessments made by this category of users in relation to public sector entities may influence their voting preferences and representations made to parliamentary and other representatives, and may lead to the continuation, expansion, contraction or even cessation of the entity's activities. Assessments made by this category of users in relation to private sector non-business entities may influence their voting preferences concerning the existing management or governing body of the entity and their decisions as to whether to continue to obtain the goods and services provided by the entity.

Parties performing a review or oversight function

- 25 Parties performing review or oversight services of interest to members of the community want to know whether the reporting entity has been operating in the interests of such members. Like resource providers and recipients of goods and services, they want to know whether the entity is achieving its objectives and is operating economically and efficiently in carrying out its operations. Assessments by these users of the extent to which the entity is operating satisfactorily in these respects will influence the decisions they make about the activities of the entities and, in respect of the advice they give to their constituents, will affect the decisions of those constituents. These users may have specific guidelines against which to assess the operations of the entity, and some may be able to demand special purpose financial reports to enable them to carry out this function.

Objective of General Purpose Financial Reporting

- 26 In view of the information needs of the users of general purpose financial reports identified in the preceding paragraphs, the position adopted in this Statement is that the objective of general purpose financial reporting is to provide information to users that is useful for making and evaluating decisions about the allocation of scarce resources.
- 27 When general purpose financial reports meet this objective they will also be the means by which managements and governing bodies discharge their accountability to the users of the reports. The provision of information for accountability purposes is an important function of the process of general purpose financial reporting, particularly in relation to public sector entities and non-business entities in the private sector. However, the rendering of accountability by reporting entities through general purpose financial reporting is encompassed by the broader objective of providing information useful for making and evaluating decisions about the allocation of scarce resources, since users will ultimately require the information for resource allocation decisions.

Types of Information Relevant to Users' Needs

- 28 The particular information users require for making and evaluating resource allocation decisions will overlap since all users will be interested, to varying degrees, in assessing whether the reporting entity is achieving its objectives and is operating economically and efficiently in the process, in assessing the ability of the entity to continue to provide goods and services in the future, and in confirming that resources have been used for the purposes intended. General purpose financial reports can provide information useful for these purposes by disclosing information about the performance, financial position, and financing and investing of the reporting entity, including information about compliance. The information useful for these purposes may be both historical and prospective in nature. Paragraphs 29 to 40 provide examples of information that users may require for making and evaluating decisions about the allocation of scarce resources.

Performance

- 29 Aspects of the performance of a reporting entity can be measured in financial and non-financial terms. Disclosure of the revenues generated by the entity during the reporting period and the expenses incurred in generating this revenue, together with the assets, liabilities and equity of the entity at the end of the reporting period,

will provide users with information to assist them to assess the financial performance of the entity over the reporting period. The information will be useful in determining the cost of providing goods and services and the change in the entity's control over resources during the reporting period. In relation to business entities, users will be able to evaluate the change in the entity's control over resources by reference to the resources or funds employed by the entity in achieving the change. In terms of the purposes for which users require information, as identified in paragraphs 21 to 25, this information is relevant to the users of general purpose financial reports of business entities in predicting both the capacity of the entity to generate cash from its existing resource base and the effectiveness with which it would employ additional resources. In relation to non-business entities, the information is useful in assessing the resources necessary to enable the entity to continue to provide services in the future and the likely cost of those services.

- 30 Non-financial measures of performance may also be relevant to users for the purposes identified, particularly in relation to non-business entities. The absence of a profit or rate of return objective for these entities means that financial measures of performance are unlikely to be sufficient to assess fully the extent to which those entities have achieved their objectives, which typically include social as well as financial dimensions. The extent to which non-financial performance measures can be considered to fall within the scope of general purpose financial reporting will be the subject of a separate Statement of Accounting Concepts.
- 31 In the public sector, information about government policies that affect a reporting entity's operations may be relevant to assessments of performance. For example, it may be relevant that an entity is subject to a government policy of break-even pricing or a stipulated target rate of return on assets.

Financial position

- 32 Disclosure of information about the financial position of the reporting entity involves disclosure of information about its control over resources, financial structure, capacity for adaptation and solvency.
- 33 The disclosure of information about the resources over which the entity has control, that is, disclosure of its assets, is relevant to users for making and evaluating decisions about the allocation of scarce resources. In terms of the purposes for which users require information, as identified in paragraphs 21 to 25, the information is useful in predicting the ability of the entity to continue to meet its

objectives, whether these relate to the generation of positive cash flows in the future or the continued provision of goods and services.

- 34 The disclosure of information about the financial structure of the entity, that is, the sources, types and time patterns of finance, whether debt or equity, and the types of assets used by the entity, is relevant to users for making and evaluating decisions about the allocation of scarce resources. In particular, it is useful in predicting the future distribution of cash flows among providers of resources and the ability of the entity to attract resources in the future, and in assessing the extent to which restrictions and limitations on the uses to which the entity's resources can be put will affect the ability of the entity to meet its objectives.
- 35 The disclosure of information about the capacity of the reporting entity to modify the composition of the resources under its control is relevant to making and evaluating decisions about the allocation of scarce resources. Such modification may be required by changes in the environment within which the entity operates or in response to directives from controlling bodies. In this respect, disclosure of information on the location, realisable value and current state of repair of the entity's assets would be relevant to users, as would disclosure of any restrictions that may have been imposed on the entity regarding its use of the assets.
- 36 Information about the solvency of the entity, that is, information about the availability of assets to meet financial commitments as they fall due, is relevant for making and evaluating decisions about the allocation of scarce resources. This information, such as disclosure of the liquidity of the entity's assets and the availability of cash from sources external to the entity, is useful in predicting the ability of the entity to meet its financial commitments as they fall due and, therefore, in predicting the ability of the entity to continue to provide goods and services in the future.
- 37 In the public sector, the ability of an entity to continue to provide goods and services in the future will, in addition to the dimensions of financial position outlined in paragraph 32, be influenced by government policy objectives.

Financing and investing

- 38 Information about financing and investing, for example, disclosure of the sources and applications of funds during the reporting period, is relevant for making and evaluating decisions about the allocation of scarce resources. This information indicates the way in which the reporting entity has financed its operations and invested its resources during the reporting period. It is useful to users in

confirming that resources have been used for the purposes intended and, as an input to assessing the solvency of the entity and analysing the change in the entity's financial position, it is useful in assessing the ability of the reporting entity to continue to provide goods and services in the future and in assessing whether the reporting entity is achieving its objectives.

Compliance

- 39 Information about compliance is relevant to making and evaluating decisions about the allocation of scarce resources because knowledge of non-compliance with externally-imposed requirements governing the reporting entity's operations may affect users' assessments of the reporting entity's performance, financial position, or financing and investing. For example, information about compliance with the following types of externally-imposed requirements may be relevant to users: conditions imposed by borrowing agreements, licencing agreements and grant arrangements; memorandum and articles of association and/or enabling legislation; spending mandates and borrowing limits; equal employment opportunity legislation; occupational health and safety legislation; environmental protection legislation; requirements to provide particular types or levels of service under a government grant programme or specific government directive; and requirements to observe specified tendering procedures for significant expenditures. Users should be able to presume that, in the absence of disclosures to the contrary, the reporting entity has complied with all externally-imposed requirements in respect of which non-compliance is relevant to assessments of the reporting entity's performance, financial position, or financing and investing. Information about compliance is relevant to users irrespective of the sector in which the reporting entity operates or whether the reporting entity is of a business or non-business nature.
- 40 The concept of compliance appropriate for general purpose financial reporting depends substantially on the types of information which are identified as being encompassed by general purpose financial reporting. If general purpose financial reports include non-financial information about an entity's performance, information about non-financial dimensions of compliance would be relevant to users. Because the boundaries of general purpose financial reporting will continue to evolve, the concept of compliance currently adopted in this Statement is consistent with the boundaries of general purpose financial reporting reflected in the current reporting practices of most reporting entities. Accordingly, the definition of compliance included in this Statement refers to adherence to externally-imposed requirements in respect of which non-compliance may have, or may have had, a

financial effect on the reporting entity. As such, reporting about compliance as defined in paragraph 5 would entail disclosure of the nature and probable financial effect of any non-compliance by the reporting entity with externally-imposed requirements which has occurred and which is relevant to assessments of the reporting entity's performance, financial position, or financing and investing.

ACCOUNTING CONCEPTS

Discussion and Definitions

- 41 **The following concepts shall be interpreted in the context of paragraphs 1 to 40 of this Statement.**
- 42 **Paragraph 5 (definitions) shall be read as forming part of the accounting concepts set out in this Statement.**

Objective of General Purpose Financial Reporting

- 43 **General purpose financial reports shall provide information useful to users for making and evaluating decisions about the allocation of scarce resources.**

Accountability

- 44 **Managements and governing bodies shall present general purpose financial reports in a manner which assists in discharging their accountability.**

Information disclosures

- 45 **General purpose financial reports shall disclose information relevant to the assessment of performance, financial position, and financing and investing, including information about compliance.**

**GUIDELINES FOR COMPANIES,
JOINT VENTURES
AND TRUSTS IN THE PUBLIC SECTOR**

GUIDELINES FOR COMPANIES, JOINT VENTURES AND TRUSTS IN THE PUBLIC SECTOR

A. INTRODUCTION

Within the Public Sector in Victoria, there are a considerable number of organisations, other than departments and public authorities, in which the Government of Victoria has a significant investment interest. These organisations fall into one of the following categories:-

- i) Companies incorporated in accordance with the Companies (Victoria) Code or equivalent interstate legislation;
- ii) Trusts (unincorporated); or
- iii) Joint ventures (unincorporated).

As at 30 June, 1986 by far the most common of these was the incorporated company.

The guidelines which follow have been developed to ensure that such organisations are subject to suitable accountability and auditing requirements consistent with similar requirements for other public sector bodies and in accordance with Government policy.

B. SCOPE OF THESE GUIDELINES

1. These guidelines apply to any company, trust, or joint venture over which a Minister* has control. The test for whether control exists is as follows:-

a) If a Minister*

- i) controls the composition of the board of directors or other governing body of the organisation;
- ii) is in a position to cast, or control the casting of, more than one-half of the maximum number of votes that might be cast at a general meeting of the organisation;
- iii) holds more than one-half of the issued share capital or other equity in the organisation (excluding any part of that issued share capital that carries no right to participate beyond a specified amount in a distribution of either profits or capital); or
- iv) controls the organisation by virtue of statute;

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then, for the purposes of these guidelines, Ministerial control exists.

* defined as one or more Victorian Government Ministers.

- b) Control also exists where an organisation is controlled by an organisation which in turn is controlled by a Minister.

In relation to a trust these guidelines shall not apply if the trust is one which operates within the Public Account.

2. The Government also has minority equity interests in companies and similar organisations, i.e. where control does not exist. These investments represent a form of financial assistance (somewhat similar to Government grants and other contributions including those which are part of the Government's industry policy), and are a mechanism whereby the Government is able to assist and encourage the establishment of various community projects deemed to be critical to the State's future industrial and community development. The nature of these interests is different from those where the Government has a controlling interest and is the main sponsor of the organisation.

For these reasons, only those organisations where there is a controlling interest are subject to these guidelines. However, it should be noted that where minority equity interests are established, this should be provisional upon the investee entity providing audited financial statements to the investor.

C. GUIDELINES

Each guideline below applies equally to companies, trusts and joint ventures under Ministerial control unless specifically stated otherwise.

1. Scope of powers and duties of the organisation

- i) Each organisation should create a document to be known as the "Statement of Objects" which should set out the purposes for which the organisation is formed.
- ii) The Statement of Objects should be approved by -
 - i) the controlling Minister; or
 - ii) at the discretion of the controlling Minister, Cabinet
- iii) The Statement of Objects, once approved, should be altered only with the approval of the responsible Minister or Cabinet in accordance with guideline 2(ii).

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- iv) The Statement of Objects should contain a limitations clause, the effect of which is to restrict the powers of the company, trust or joint venture so that these do not exceed the powers of the controlling Minister.
- v) The Statement of Objects with respect to a company should be included in the company's Memorandum of Association.

2. Approval process for creation or acquisition of an interest in an organisation

Before the creation or acquisition of a controlling interest in an organisation occurs, approval should be obtained from -

- i) the Treasurer; or
- ii) at the discretion of the Treasurer, Cabinet

3. Reporting of Operations and Financial Position

- (i) Each company (including corporate trustees) shall produce financial statements in accordance with the requirements of S.269 of the Companies (Victoria) Code. However, these reports should be produced within three months of the end of its financial year
- (ii) Each public sector party to a joint venture should comply with Statement of Accounting Standards AAS 19, "Accounting for Interests in Joint Ventures" issued by the joint Australian accounting bodies.
- (iii) Each unincorporated trustee (ie. where the trustee is not a company) or board of trustees of a trust should comply with the reporting requirements of the Annual Reporting Act 1983 and appropriate Regulations as determined by the Treasurer.
- (iv) Audited financial statements of an organisation subject to these Guidelines shall be included in an Annual Report of that organisation which will contain any financial or related information (in addition to that required under 3(i), (ii) or (iii) above) deemed by the Minister to be necessary for reporting to Parliament.

Subject to compliance with (i) to (iii) the Minister shall not be required to report to Parliament matters which he considers to be commercially confidential.

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- (v) All annual reports produced under this guideline should be tabled in Parliament either as part of the annual report of the "parent" body or as a separate report. All annual reports produced under this guideline should be tabled in Parliament at the same time as the annual report of the "parent" body. Where the "parent" body is not required to produce an Annual Report then the report of the company, joint venture or trust should be tabled by the responsible Minister before the expiration of the seventh sitting day after three months after the end of its financial year.

4. Audit

All bodies covered by these Guidelines must appoint an auditor. For companies the appointment will be pursuant to S. 280 of the Companies (Victoria) Code. In addition to auditors appointed under the Companies legislation the Treasurer has the power under S. 3 of the Audit Act 1958 to appoint the Auditor-General.

5. Relationship of the Organisation to the "Parent" Body

Whilst there is a Minister responsible for the organisation subject to these guidelines, the entity which for practical purposes exercises control of the organisation may be:

- i) a department
 - ii) a statutory authority
 - iii) an officer or officers who hold shares or units in the organisation in trust for the department, authority or Minister.
- i) The names of those members or beneficiaries (persons or entities) holding shares or units in the organisation should be properly recorded in the books of the organisation in accordance with section 256 of the Companies (Victoria) Code or to the like effect. A "branch register" of members or beneficiaries should be maintained in the books of the ultimate "parent" department.
 - ii) Where shares or units are held by a public sector officer, those interests shall be held in trust for the responsible Minister, i.e. non-beneficially.
 - iii) Where shares or units are held by public sector officers, at least one of those officers should be an officer of the "parent" department or authority.
 - iv) Appointments to the board of directors or other governing body of the organisation should be made by the responsible Minister whenever he has the power to do so.

6. Transitional provisions

Existing companies, trusts and joint ventures shall comply with these guidelines within six months of the date of issue of the guidelines.

7. Registers

Following approval by the Treasurer, or Cabinet in accordance with guideline 2, any investment within the scope of these guidelines shall be noted in a register of such investments, to be maintained by the Department of Management and Budget and containing such information as determined by Treasurer.

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