Promoting improved transparency, accountability and economic policy for governments: The Australian experience

October 2012

CPA AUSTRALIA

ISBN 978-1-921742-32-3

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First published
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Executive summary

This report examines the important role that the information derived from an independently-set accrual accounting standards-based reporting framework can have in informing government policy to the challenges brought on by the banking and sovereign debt crises.

Currently, the Australian Government is one of only eight (of 135) central governments that enjoy a triple A rating and stable outlook from the three major rating agencies.

The major findings indicate that accrual accounting standards-based ex-post (actuals) and ex-ante (budget) information can benefit the policies of all governments as it provides them with important and useful information about the financial position of the sovereign state – a necessary precondition for good decision making.

While it is clear that our political leaders' attitude to taking informed advice is variable, to not have access to the information that comes from the operation of a transparent government reporting regime has a cost including the loss of public trust in government and their ability to manage their country's financial position. It is recommended that the experiences of the Australian Government in introducing accrual accounting standards-based ex-post and ex-ante reporting practices and making use of that information are worthy of consideration by the G20 and governments of the world and stand as an aspirational goal.

Introduction

> "We have the most crude accounting tools. It's tragic because our accounts and national arithmetic do not add up."
>
> *Susan George, Fellow Transnational Institute, Interview, ABC Radio National, 27 May 2005*

The sovereign debt crisis has highlighted some significant deficiencies in the economic policy making of many governments of the world. The primary purpose of this report is to explore the important role that the information derived from an independently-set accrual accounting standards-based reporting framework can have in informing government policy. Accrual reporting is necessary, but not sufficient, for the effective financial management of government and its entities. However, we suggest it is the most critical element.[1] The International Monetary Fund (IMF) has stressed the importance of strengthening sovereign balance sheets; in contrast, no recommendations on improving the quality of government accounting have been forthcoming from the Group of Twenty (G20) as it discusses the financial crises that currently confront the world.

Governments should be held to a level of integrity and transparency by their citizens at least as high as that demanded of business, as governments need to be directly accountable for their financial managements of public funds. If government leaders' self-interest will not allow them to demand greater government financial transparency and accountability reporting, then the accounting bodies and the citizens have the right to demand this from their government heads. CPA Australia suggests that accrual accounting standards-based information can benefit the policies of all governments as it provides them with important and useful information about the financial position of the sovereign state; a necessary precondition for good decision making.

We trace the development, adoption, and use of accrual accounting within the Australian public sector across more than four decades. In doing so, we examine Australia's harmonisation of Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS). Further, we look at how accrual accounting has helped to inform the policies of different Australian Governments.

The strong financial position of the Australian Government relative to other governments can be illustrated by the following percentages:

- total liabilities to Gross Domestic Product (GDP) is 31 per cent (UK 156 per cent)
- superannuation and other employee liabilities to GDP is 11 per cent (UK 73 per cent)
- superannuation and other employee liabilities to total interest bearing liabilities is 59 per cent (UK 148 per cent)[2,3]

While the reporting practices of the Australian Government could be further enhanced, CPA Australia recommends those practices are worthy of consideration by the G20 and governments of the world as an aspirational goal.

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1 See IFAC (2012) for a discussion of the different elements necessary for effective financial management.

2 The presented percentages are derived from the most recent published GDP data and publicly available financial statements of the Australian and UK Governments. The UK data is used as the comparison due to its availability.

3 Last year the UK published its first audited whole of government financial statements. In contrast, the first audited consolidated accrual IFRS accounting standards-based financial statements for Australia were published for the financial year ended 30 June 2006 (preceded, first by unaudited shadow financial statements that used independently set accrual Australian accounting standard from 30 June 1997, and two years later by audited financial statements). Australia has had more time than the UK to benefit from its access to information of this type. Currently, only about five of the 27 EU member countries central governments adopt accrual accounting. It is not clear whether this extends to both ex-post (actuals) and ex-ante (budget) reporting. The rest adopt cash accounting, which does not provide any information about assets, the future obligations and net worth of government.

Historical developments in accrual accounting: Public and private sectors

The final decades of the 20th century saw the governments of some countries, notably Australia, New Zealand and the United Kingdom, introduce micro-economic policies to reform the organisation and procedures of their public sectors to make them more competitive and efficient in resource use and service delivery and more accountable for performance to the public they serve (see for example, Connolly and Hyndman 2010). The adoption of accrual accounting principles for budget setting and financial reporting purposes was one part of that change; a change that focused attention on liabilities for superannuation, other deferred employee benefit obligations and asset depreciation. In Australia, the financial management acts of each jurisdiction were changed to reflect the new financial reporting requirements and required standards to be met, with the standards set by a body independent of government (Cameron 2006).

Today, of the 191 countries of the world, Blood (2012) asserts about 40 countries and reporting jurisdictions use accrual accounting to produce budgets and financial statements.[4] Some countries and reporting jurisdictions:

- adopt the cash-basis International Public Sector Accounting Standards (IPSAS) of the International Public Sector Accounting Standards Board (IPSASB) unmodified
- adopt the accrual-basis IPSAS unmodified
- use either the cash or the accrual-basis IPSAS as foundation standards with adaptation
- adopt the International Financial Reporting Standards (IFRS) of the private sector focused International Accounting Standards Board (IASB) as foundation standards with adaptation
- develop their own accounting standards without reference to an international framework

To date the approach of the IPSASB is to adapt the IFRS of the private sector focused IASB. In undertaking that process, the IPSASB attempts, wherever possible, to maintain the accounting treatment and original text of the IFRS unless there is a significant public sector issue which warrants a departure. Some topics of interest to the public sector are of no interest to the private sector. The presentation of budget information in the financial statements is one example. On these occasions the developed IPSAS has no equivalent IFRS.

Ball and Pflugrath (2012) note that the central governments of Australia, Canada, UK, the US and other jurisdictions require accrual accounting that uses standards that are not IPSAS or IPSAS based, with different approaches taken. The UK whole of government report uses IFRS, whereas the financial reports of the governments of Canada and the US use locally written public sector accounting standards. The Australian Government whole of government report uses the accounting standards of the Australian Accounting Standards Board (AASB) that are the adopted IFRS.

The AASB has adopted a policy of producing transaction neutral standards. The operation of this policy means the Australian Accounting Standards, which are the adopted IFRS issued by the IASB, apply to entities of all sectors. Additional text, suitably identified, is included in the accounting standard to deal with those limited cases where there is a need, due to the Australian context, to have different or additional requirements for public sector and other private not-for-profit sector entities. In addition, there are a small number of accounting standards that are specific to public sector and private not-for-profit sector entities. As required, the additional specific text and accounting standards for the Australian public and not-for-profit sectors are informed by IPSAS.

The reporting by Australian governments of macro-economic information was initially unaffected by these changes and the Australian Government continued to use a cash-based reporting framework which was first complemented by the publication of trial unaudited consolidated accrual based financial statements from year ended 30 June 1995 and was replaced in the 1999–2000 financial year which saw the reporting of ex-post and ex-ante statements on a full accrual basis (Australian Government 1997). It was not until 2001 that the IMF released its accrual-based international statistical reporting system IMF 2001 Government Finance Statistics (GFS) Manual to be used to gather and present information about the Budget Sector (General Government Sector [GGS]) on a basis that is consistent with the requirements of the UN System of National Accounts 1993. The IMF 2001 GFS Manual had its equivalent in regional or country specific manuals, such as the European System of Integrated Economic Accounts (Eurostat 2000, ESA 95) and the Australian Bureau of Statistics (ABS) Australian National Accounts: Concepts, Sources and Methods 2000 and

4 It is not clear what is meant by the expression “reporting jurisdiction”. Some countries can be described as a federation of states, whereby there are central and state governments. State governments are one possible example of a reporting jurisdiction that is not a country. There are more than 550 state governments around the world.

supplemented by the ABS Information Paper: Accruals-based Government Finance Statistics 2000. The European Commission Eurostat Public Consultation Paper 15 February 2012 notes “ESA based statistics are in practice a transformation of ‘primary’ accounts established on the basis of Member States’ national accounting standards. Members States’ national public sector accounting standards are, in the majority, not accrual based.” In contrast, it is clear from the ABS Information Paper that from 2000 the ABS was able to take the accounting standards accrual-based “whole of government” financial statements of each Australian jurisdiction and then extract from those the information relevant to presenting statistical information about the GGS of each government. This will be covered in more detail later in the report.

The last three decades of the last century also saw a threefold growth of world trade; the associated growth of cross-border investment and ended with nearly 1200 foreign registered companies subject to the reporting requirements of the US Securities Exchange Commission (Blanchet 2000). The advent of the new millennium saw the IASB, with the qualified support of a number of national and international bodies,[5] take responsibility for the development of global accounting standards that would enhance the financial statements to help participants in the world’s capital markets and other users make economic decisions.

The European Union and Australia adopted International Financial Reporting Standards (IFRS) in 2005. Today, about 90 countries and reporting jurisdictions have fully conformed their private sector accounting standards with IFRS as promulgated by the IASB. The auditors or entities in these jurisdictions are required to include a statement acknowledging such conformity in their audit report attached to the financial statements (AICPA 2012).

The drivers for changes that have informed and shaped developments in the reporting by governments and listed companies are very different. Some commentators argue for the retention of this approach. However, current world events suggest that approach is problematic and may not be appropriate as the crisis that continues to overwhelm many countries of the world, including much of Europe, is very much a function of two interconnected crises of the two sectors: a banking crisis and a sovereign debt crisis. Furthermore, clearly a majority of private and government transactions can be identified as similar and arguably should be accounted in the same manner. Like corporates, governments also have transactions that give rise to revenue and expenses, assets to manage and liabilities to be met.

5 For example, the Report of the Technical Committee on IASC standards, May 2000, International Organization of Securities Commissions; the Basel Committee on Banking Supervision, April 2000; the position paper, 8 October 1999, the Federation Des Experts Comptables Europeens; the Action Plan to improve the Single Market for Financial Services, 11 May 1999, the European Commission.

The crises: Banking and sovereign debt[6]

The beginnings of the current banking crisis (sometimes referred to as the Global Financial Crisis [GFC]) are traceable to the mid-1990s, a time of easy credit and subprime lending that fuelled a consumption and property boom in some countries. In July 2006, house prices across the US began to fall and investors lost confidence in the mortgage and asset-based securities in the US. The drying up of interbank lending and liquidity was followed by a dramatic increase in the interbank interest rate as banks lost trust in one another, nervous as to who would be left holding worthless subprime paper hidden in opaque derivatives. Banks stopped lending; households and business stopped borrowing. This occurrence and the fall in property values (often to well below the original loan amount), which was accompanied by a spike in loan default rates, resulted in banks being left with loans that they themselves were now struggling to pay back.

The current sovereign debt crisis is a function of the economic decisions of the governments of some countries to accumulate significant debt and operate large fiscal deficits and persistent current account deficits. In 2008, some of those governments already in a poor fiscal state issued more debt, either to inject huge amounts of capital into those banks that they had judged "too big to fail" to help restore confidence in the financial system, to provide guarantees to wholesale and retail investors and depositors, or to fund economic stimulus programs and ongoing fiscal programs. While these decisions have led some commentators to more recently claim certain countries are bankrupt, the absence of accrual-based sovereign balance sheets meant the catalyst for those claims surfacing was the actions of external players that became intolerable to markets (for example lenders significantly reducing their risks by requiring higher interest rates). With burgeoning government fiscal deficits, debt reaching excessive levels and worsening credit ratings, new and even rollover funding became difficult to access and much more expensive to governments as well as to the private banking institutions.

The interconnectedness of the two crises is vividly illustrated by the author Michael Lewis:

> A handful of Irish bankers incurred debts they could never repay, of something like 100 billion euros [$A129.26 billion]. They may have had no idea what they were doing, but they did it all the same. Their debts were private – owed by them to investors around the world – and still the Irish people have undertaken to repay them as if they were obligations of the state. (Lewis 2011)

6 This section makes particular use of material written by Blundell-Wignall (2012), Bollard and Hannah (2012), Blundell-Wignall and Slovik (2011) and Murphy (2011).

Calls for action

The bankruptcy of Lehmans on 15 September 2008, the credit downgrade of American International Group and the collapse of Washington Mutual and Icelandic banks required exceptional government measures through government recapitalisation, funding guarantees and central bank support. Yet two months later and again in early 2009 following summits in Washington DC and London, the G20 chose to concentrate its efforts solely on the banking crisis and ignore the financial problems of governments. The intensity of its calls on the IASB and the US Financial Accounting Standards Board "to work urgently with supervisors and regulators to improve standards on valuation [based on their liquidity and investors' holding horizons] and [strengthening accounting loan-loss] provisioning and achieve a single set of high-quality global accounting standards" are in stark contrast to their silence on the need to address the sovereign debt crisis and the inadequacies of the cash financial reporting that is practised by most of the governments of the world.[7,8] This decision appears not to pay due regard to the importance of the expenditure by the GGS of the governments of the world to the global economy, given the GGS comprises one-third or more of world GDP.

The most recent call of the International Federation of Accountants (IFAC) to the G20 to require improved government transparency and accountability reporting has again been ignored, for the third time.[9] Regarding this G20 refusal IFAC Chief Executive Officer Ian Ball states:

> The signal this sends is clear: even in the face of the most severe economic consequences, governments would prefer to budget, account, and manage their finances in ways that are non-transparent and are according to rules they themselves set. The Board of Enron should have been so lucky. (Ball 2011)

While it is not possible to identify the G20 leaders' motivations for this failure to act, there are possible explanations. At best, the G20 may have felt it has more pressing issues to deal with (for example unemployment, financial markets collapsing, level of debt, and even citizens' protests) than the inadequate financial reporting practised by most of the governments of the world; at worst, self-interest is causing it not to call on the governments of its membership to introduce and adopt financial reporting requirements based on independently set accounting standards that will result in a level of financial transparency and accountability by governments that is equal to that which they ask of listed companies. A view reflective of the middle ground would suggest that the G20 believes it is a task for governments and their leaders that is too hard, too costly and with minimum benefits when measured in terms of the election cycle.

CPA Australia thinks otherwise. Expenditure by the GGS of the state, territory and national governments of Australia is about 33 per cent of GDP, a number similar to the global average. However, on a number of other metrics, for example the percentage of total liabilities to GDP, Australia is quite different from most of its peers. In the remainder of this report CPA Australia shares with the G20 and the governments of other jurisdictions the benefits enjoyed by Australia from the Australian Government's approach to an accrual budgeting and actuals reporting framework that has been in place for almost two decades and how that approach might be improved. CPA Australia considers the approach of successive Australian Governments to ex-post (such as actuals) and ex-ante (such as budget) reporting is relevant to governments of all countries regardless of their political ideology and vision for the role of the state.

7 In contrast, investors, credit providers including banks, regulators of listed companies and other users of the financial statements of listed companies have long ago embraced accrual accounting based financial reporting in place of cash accounting as necessary for their purpose.

8 The IMF after experiencing significant demand for its resources called on governments to unburden their sovereign balance sheets, for example by targeting a long-term decline in their public debt-to-GDP ratio.

9 The initial IFAC recommendation to the G20 on this topic was made in 2009.

Australia's journey to accrual accounting

Some commentators trace the history of the implementation of accrual accounting back to the Royal Commission on Australian Government Administration in 1976, which called for more accountability, devolved management and better performance measurement in the Australian public sector. During the next five years, reports from the Senate Standing Committee on Finance and Government Operations and similar committees in the Australian state jurisdictions of New South Wales and Victoria recommended accrual accounting. Equally important was the election of governments federally and by some states and territories with shared policy visions that emphasised economic reform and the crucial part played by accrual accounting budget and financial reporting principles in the implementation of those policies. Christensen (2009) observes that most unusually, an election issue of the March 1988 New South Wales state election was accrual accounting in the public sector. At the federal level, in 1996, the newly elected Howard government had promised to apply private sector principles to the public sector as part of its commitment to continuing the process of microeconomic reform underway in Australia since the early 1980s with the leadership of governments from both sides of politics.

The *Charter of Budget Honesty Act* 1998 as amended is one important example of the reform steps taken by the Australian Government. The principles of sound fiscal management as articulated in the Act (paragraph 5) address:

- the management of financial risks
- achievement of adequate national saving and appropriate counter-cyclical demand management
- tax burden stability and predictability and tax system integrity
- having regard to intergenerational fiscal effects

Fiscal prudence and the target of "budget surpluses" on average, over the course of the economic cycle, remain the aspirations of the major political parties in government and opposition alike.

Some commentators note the priority governments give to GFS, a statistical reporting framework, compared to accrual based financial statement reporting, an accounting framework based on GAAP. One consequence of this approach is that the financial statements of the GGS of a government and the whole of government not prepared on the GFS basis are to a large extent ignored by policy makers. Parry (2011) suggests there exists a general acceptance that statistical reports and financial statements have different objectives and harmonisation will not occur.

Australia's approach is different to the approach of most countries – harmonisation of GAAP and GFS has been achieved to a great extent. The catalyst for all this work is, we believe, to be found in the 2000 Australian Government Budget figures which included the proceeds from the sale of mobile phone licences (with the licences having a life of 15 years) as opposed to spreading the revenue across 15 years. Media debate raged over whether or not the approach of the government to its budget was consistent with the requirements of GFS reporting by the GGS of the Australian Government and the financial reporting of the Australian Government's whole-of-government reporting as required by Australian accounting standards.[10] A couple of years later, the Australian Financial Reporting Council (FRC) set the broad strategic direction for the Australian accounting standard setter whereby "The [standard setter] should pursue as an urgent priority the harmonisation of … GFS and … GAAP reporting. The objective should be to achieve an Australian accounting standard for a single set of Government reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements" (FRC Bulletin 2002/5 18 December 2002, as modified by FRC Bulletin 2003/1 11 April 2003).

The Australian accounting standard setter implementation of the FRC's broad strategic direction is in two phases and the first phase is described here.[11] Phase one relates to financial reporting by the Australian Government and the State and Territory governments and the sectors therein, that is, the GGS, Public Non-Financial Corporations (PNFC) sector and Public Financial Corporations (PFC) sector. The Australian accounting standard setter, cognisant of the relationship between the GGS and the whole of government, recognised the potential confusion for users if it were to adopt an approach that would result in fundamentally different bases for GGS financial statements and whole of government financial statements.

Accordingly, the Australian standard setter required the GGS financial statements and the financial statements of the whole of government to be prepared in accordance with the requirements of its Australian Accounting Standard AASB 1049 *Whole of Government and General Government*

10 See for example the transcript of the interview with the then Treasurer of the Australian Government Peter Costello.

11 The second of the two-phase approach relates to financial reporting by entities within the GGS, comprising financial reporting by government departments, statutory bodies, and other entities within the GGS. Work on this phase continues.

Sector Financial Reporting, with the requirements in other applicable Australian Accounting Standards to be applied, unless otherwise specified. In particular, under AASB 1049, where Australian Accounting Standards allow for optional treatments, only those optional treatments aligned with the ABS GFS Manual option are applied. To align with GFS, the GAAP concept of control has been relaxed to allow the GGS financial statements to consolidate only the entities that are classified within the GGS as defined by the ABS Manual Australian System of Government Finance Statistics: Concepts, Sources and Methods (the ABS GFS Manual). The GGSs interests in the government's controlled entities in the PNFC sector or PFC sector are recognised as an asset and reported in the GGS statement of financial position as "investments in other sector entities". As the focus of the government's budget is restricted to the GGS, the approach of the Australian accounting standard setter enables a clear comparison between the budget and the relevant actual financial statements. Hence, Australians have a better tool for keeping government accountable.

In addition, AASB 1049 requires the whole of government financial statements and GGS financial statements to include, "on their face", information that is required by other Australian Accounting Standards, together with key fiscal aggregates. For example, the statements of comprehensive income will classify amounts used to determine a comprehensive result as transactions or other economic flows in a manner that is consistent with the principles in the ABS GFS Manual and present net operating balance, total changes in net worth and net lending/borrowing (such as the Australian fiscal balance). In addition to the usual private sector cash flow statements classification, a government's statements of cash flows is required to present separately cash flows relating to investing in financial assets for policy purposes and for liquidity management purposes.

AASB 1049 notes that in some cases these approaches facilitate the reduction of differences between GAAP and GFS. However, where specified key fiscal aggregates on the face of the financial statements differ from the corresponding key fiscal aggregates measured under the ABS GFS, the ABS GFS measure is to be disclosed in the notes together with a reconciliation of the two measures and an explanation of the differences.

Ex-ante statements of financial position, comprehensive income, changes in equity or cash flows of the GGS or whole of government for presentation to parliament must be prepared on the basis prescribed for ex-post statements in AASB 1049. This assists the direct comparison between the budget and the financial statements.

Further, what the government now issues is monthly and year-to-date unaudited ex-post GGS financial statements prepared in accordance with AASB 1049 alongside expected budget estimates. On an annual basis, the government is required to publish a Final Budget Outcome (FBO) within 90 days of the end of the financial year[12] and an annual audited Consolidated Financial Statements (CFS), including the Financial Statements of the Whole of Government and the General Government Sector with a year end of 30 June as soon as practicable after the end of the financial year.[13] Currently the government aims to release the FBO within 45 days and the CFS by the end of November after the end of the financial year. Ministers are required to table in parliament the annual reports of their agencies by 31 October of that year.[14]

In addition, the ex-ante reporting policy of the government is to report both accrual and cash estimates and outcomes in the Budget Papers. Every six months, the government issues its Mid-year Economic and Fiscal Outlook (MYEFO) to allow an assessment of the government's fiscal performance against the fiscal strategy set out in the current Budget Papers.

To summarise, the government's development and implementation of this regime has taken several years, first to move government accounting from cash to accrual and then to accrual budgeting.[15] It is not perfect and the framework is in continuous development as it evolves to respond to the ever changing environment. Nonetheless, for a government willing to commit to changing from cash to accrual accounting principles for budget setting, as well as financial reporting purposes, there may be benefit from implementing a regime that is informed by the experience of the Australian Government, its model for changes, and the implementation of ex-post and ex-ante reporting.

12 *Charter of Budget Honesty Act* 1998.

13 *Financial Management and Accountability Act* 1997, section 55.

14 Requirements for Annual Reports issued by the Australian Department of the Prime Minister and Cabinet in accordance with subsections 63(2) and 70(2) of the *Public Service Act* 1999 and approved each year by the Joint Committee of Public Accounts and Audit.

15 The IFAC Public Sector Committee (PSC) concluded "The transition to accrual accounting is a long-term project. National and international experience indicate that a time period of about eight to 10 years is needed to change the accounting system and fully implement the necessary reforms." (PSC 2003 p29).

Preparing for the journey

The lack of government employees' expertise in and exposure to accrual accounting has been raised by some commentators as an issue. As noted, a significant majority of government transactions under the accrual accounting framework are similar to the private sector transactions. Governments are like big businesses: they have revenue, expenses, assets to manage and liabilities to meet, some of which arise from their policy decisions about banks immediately following the onset of the GFC. Such expertise can be found among accountants and business consultants. In contrast, different accounting and reporting frameworks for the public and private sectors segregate expertise and reduce the pool of qualified candidates. Differences do exist but there again the Australian experience can help in developing expertise on the specific public sector issues and how these have been dealt with in the past two decades.

Competition in the marketplace for human resources may also increase employee interest in working within the public sector and an increase in the supply of qualified candidates may lead to a reduction in staffing costs. Unfortunately, the government's financial reporting reform occurred at the same time as Australia introduced a value added tax, the GST. This created a shortage in accountants and the private and public sectors had to compete in the same market, hence increasing somewhat the cost of implementation. This may not be the case in other countries.

New or enhanced IT platforms may need to be implemented in some countries, a consequence of the different reporting environment. Asset management systems are one example of the data base infrastructure developed in Australia to accompany the introduction of accrual accounting.

However, there may be economies of scale to be had from governments forming blocs to adopt accrual accounting, which may be a more cost effective solution.

Successive Australian Governments have been and continue to be at the forefront of developments in ex-post and ex-ante reporting. Much has been achieved and lessons learnt from the Australian experience could assist other governments in charting their own path.

Benefits

The publication of the audited Australian Government ex-post financial statements increases the level of credibility and reliability of the figures published. Some of the other benefits are obvious and evidenced by the preparedness of Australia's political leaders to accept advice informed by ex-post and ex-ante information and the retention of the Australian Government's AAA rating post GFC, "… one of only eight countries globally that enjoys a triple A rating and stable outlook from the three major rating agencies" (Hernandez 2012). On some metrics, Australia has weathered well the post GFC difficulties faced by the governments of some other OECD countries. For example, its level of debt remains low when compared to these countries and many governments would envy the debate in Australia about whether or not the Australian Government will achieve its objective to return its budget to surplus for 2012–13, when most are facing very high deficits. With the availability to the government of more reliable and comprehensive financial information, it is also better informed to consider and act to develop and implement policies that address inter-generational fiscal sustainability in the context of an ageing population than its counterparts in Europe and North America.

The Sovereign Fiscal Responsibility Index produced by Stanford University in the US and Comeback America Initiative post GFC (April 2011) is one independent assessment of benefits that flow to Australia as a result of the policies of successive Australian governments to improve fiscal responsibility and sustainability. Although the index is not a direct measure of the benefits that come from accrual accounting, with its focus on policies that emphasise micro-economic reform (and we have already seen the role of accrual accounting in the delivery of those reforms) it is a surrogate measure. The index is constructed making use of three factors – a government's current level of debt, the sustainability of government debt levels over time, and the degree to which governments act transparently and are accountable for their fiscal decisions. Applying this index, Australia is ranked first as the best performer. In contrast, on a league table of 34 countries, selected rankings are – UK ninth, Netherlands 14th, France 23rd, Spain 24th, Germany 25th, US 28th, Ireland 30th and Greece 34th.

Further, the assessment highlights that the benefits are not just temporary but are long term. The fiscal sustainability index indicates that the Australian Government's excellent position will provide for greater financial management flexibility in the future compared with debt-ridden governments.

Cash accounting ignores liabilities, for example government employee liabilities, as they are not required outlays to be made currently, which also results in the non-inclusion of the associated expense in the cost of delivering services. There is a general consensus in Australia that as accrual accounting requires the gathering and reporting of additional data compared to the cash approach, it provides more useful information for assessing a government's financial performance and relevant information necessary to measure the true economic consequence of public sector financial management. For example, the Australian Public Sector reporting regime requires the Australian Government to gather data to measure and report its liabilities including superannuation and other employee entitlements.

The initial reporting of superannuation and other employee entitlements data highlighted to government the need for it to develop economic policy to provide for its employees retirement costs and not leave it to the next generation to pay it through the tax system. Implementation of that policy decision saw the establishment in 2006 of the Australian Government Future Fund with initial seed money of $A18 billion. Independently managed, the Department of Finance and Deregulation (2008) reports the investment fund has since received further amounts credited to its account with a value at the time of transfer of $A42.537 billion (being the amounts of the budget surplus for the years 2005–2006 and 2006–2007, the proceeds from the sale of shares in Telstra and the government's shareholding in Telstra). The fund invests these amounts in financial assets for the sole focus of generating revenue to meet the obligations of the Australian Government to its employees.

One year before the establishment of the Future Fund, the Australian Government implemented a policy decision to close its defined benefits scheme to new members. Government employee defined benefit schemes were typically unfunded with retirement benefits met on an emerging cost basis and investment risk sitting with the government. Today, we have the relative triviality of the government's liability position when compared to that of many governments of the world – total liabilities to GDP is 32 per cent and superannuation and other employee liabilities to GDP is 11 per cent. In addition, superannuation and other employee liabilities to total interest bearing liabilities ratio of 3:5 is very favourable. CPA Australia suggests that the making of these policy decisions benefited from having access to accrual information reported in the financial statements of the Australian Government.

Accrual accounting and the related accounting standards have enabled the integration of financial reporting and asset management and thereby the optimisation of the service delivery potential of assets and the minimisation of related risks and costs. The accounting policies of the financial statements of the different governments in Australia all utilise the accounting policy of periodic revaluation of property, plant and equipment assets; an approach that is useful for users and management alike to understand the full life cycle costs to deliver services and to promote thinking about approaches to funding asset acquisition. Maintaining asset information has caused the Australian Government to take explicit notice of some expenses that were not apparent under cash accounting – depreciation (amortisation) expense and the loss (revenue) on disposal of assets.

Further improvements

The Organisation for Economic Co-operation and Development (OECD) (2002 p2) describes the budget as "… the single most important policy document of governments, where policy objectives are reconciled and implemented in concrete terms." The level of attention that journalists give to the budget indicates they think the same as the OECD. In contrast, when journalists turn their attention to listed companies, their usual focus is to the ex-post half-yearly and annual financial statements and little or no attention is paid to their budgets. The fact that a listed company operates within a transparent capital market might explain why there is little interest in their budgets. However, there is no easy explanation as to why so little attention is paid by journalists to the ex-post financial statements of government.

The budget developed, introduced and maintained by the Executive Government of the Australian Government is the subject of parliamentary scrutiny through the estimates process. This process is, and should continue to be, a fundamental accountability tool.[16] The recently established independent officer of the Australian Parliament, the Parliamentary Budget Office (PBO) has a number of purposes that include the provision to the Parliament of independent, non-partisan and policy neutral analysis on the full Budget cycle, fiscal policy and the financial implications of proposals and the costing of promises from all parties at election time. It is too early to evaluate the effectiveness of the PBO. CPA Australia believes the level of parliamentary scrutiny will be enhanced once the PBO is operating. Further improvement to the budget process (and ex-post financial reporting) could come from better training and continuing professional development for parliamentarians which would enable them to develop the appropriate skills to increase the likelihood of them asking the questions that matter. Given the importance of the budget, we suggest the credibility and reliability of the published ex-ante financial statements might be further enhanced by the use of an independent review. Currently, legislation in the Australian state jurisdiction of Victoria requires a review of the estimated financial statements by the Auditor General and the review is presented to Parliament as part of the annual budget papers. This review encompasses the assumptions underlying the budget, and the process of compiling the estimated accounts.

CPA Australia does not frame the involvement of the Auditor General in the budget process as a recommendation. One reason for this is we would prefer to wait and see what the benefits are to the budget process that flow from the involvement of the PBO. Rather, our intention is to open discussion around the key questions of independence and scrutiny in the budget process and the benefits that would have for the integrity of reporting by governments.

16 The Executive Government consists of the Cabinet (the most senior ministers) and the Ministry led by the Prime Minister.

Aspirational goals and concluding comments

The economic historian Professor Niall Ferguson (2012) recently noted that many governments are dishonest about their true level of debt and he calls on governments to adopt the GAAP by which corporations abide. As stated in the introduction to this report, CPA Australia believes governments should be held to a level of integrity and transparency by its citizens at least as high as that demanded of business, as governments need to be directly accountable for their financial management of public funds.

The current challenges of a banking crisis and a sovereign debt crisis faced by many countries will not be resolved by adopting the Australian Government's approach to budgeting and financial reporting. The attitude of political leaders to taking informed advice is paramount, a point well made by George Megalogenis in his book *The Australian moment – how we were made for these times:*

> [Australian Prime Minister Kevin] Rudd shone during the [initial phase of the] GFC because he took advice. It was out of character for him to allow someone else to tell him what he didn't know. In fact, no leader on either side since [former Prime Minister] Paul Keating paid as much attention to what the Reserve Bank and Treasury had to say as Rudd did in those first few weeks of the GFC. (Megalogenis 2012 p366)

The on-going financial decisions of governments to the challenges brought on by the crises should be informed by robust financial information that comes from an independently-set accrual accounting standards-based reporting framework. Otherwise, governments are likely to repeat those actions that caused the current crisis and the country's government, parliament and citizens will fail to understand fully the financial consequences of those actions. It is time to change now. A crisis highlights the need for change and presents opportunity to do so, otherwise, we will simply hope that the storm will pass.

The implementation of a transparent government reporting regime that utilises accrual accounting principles for budget setting, as well as financial reporting purposes, will take time and will have a cost. However, not changing also has its cost. Referring to the Australian experience will assist other governments to keep the implementation time to a minimum and reduce the cost. Currently the majority of governments develop and maintain their own accounting rules. This domestic approach to accounting and reporting setting has its cost as it is expensive to develop, to maintain and to update continuously a domestic accounting framework that exists independently of an international framework. A more cost effective alternative is to refer to an international accounting standards setter. Further, this option provides greater credibility to the financial reports prepared in accordance with such standards due to the acknowledged independence of the standard setters from government.

Finally, governments caught up in the financial and sovereign debt crises will need, among other things, to regain the trust of the public concerning their ability to manage their country's financial position. Ernst and Young (2011) notes "… an accounting method alone cannot guarantee that governments will always make the right decision …" CPA Australia agrees. Nonetheless, a willingness to increase transparency and accountability of its financial position is certainly a step in the right direction and the Australian Government experience provides a useful road map to assist governments of the world in making this journey easier and less costly.

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CPA261275_WL 09/2012