

8 December 2008

Public Finance Bill Project Team
Department of Treasury and Finance
Level 9, 1 Macarthur St
MELBOURNE VIC 3002

Discussion Paper - Public Finance in Victoria

Dear Secretary

We are pleased to submit our comments on the Department of Treasury and Finance Discussion Paper - *Public Finance in Victoria, Practices & Legislation*.

Overall objective

Whilst the Discussion Paper implies that the new legislation will consider the needs of the public (citizens) we believe it is important that this is more explicitly considered.

The public should expect new legislation to improve government transparency and accountability and to assist in making government services more accessible. In addition, a key objective of the legislation should be to improve governance practices so that the public has increased confidence that the government is being held accountable for the delivery of cost effective and efficient services.

Legislative development

In developing the new legislation, DTF needs to consider whether it should be developed on a "Principles based" or "Rules based" hierarchy. The current FMA has led to the development of a significant number of frameworks to support it. These include the Financial Management Compliance Framework, the Risk Management Framework, the Asset Management Framework, the Output Management Framework, and the Tax Compliance Framework. The government can use the development of the new legislation to re-balance the requirement to maintain sound and strong financial accountability with the onerous burden imposed on smaller entities by the number of frameworks which have been developed to support the current (outdated) legislation.

Cultural aspects of compliance

Following the financial scandals which occurred in the US in the early 2000s, legislation has been developed internationally in order to improve the cultural aspects of compliance. Strong governance is predicated on an organisation's adherence to a sound set of values and principles. This is even more important in the public sector where public interest considerations must be addressed.

In light of this it is important that principles relating to sound public sector governance are built into the legislation.

Modern government

One of the key dilemmas for all governments is the need to balance short term gains with long term planning and development. Any changes to the financial management legislation must be cognisant of this and the benefits that can be derived from multi year grants and their reporting.

Departmental sub-consolidations

Whilst we acknowledge that there is an increasing number of services which are provided by government via a multi-departmental approach, we believe the public is still interested in how each Department administers its portfolio responsibilities. Accordingly, there is an argument to suggest that in order to meet the needs of the public, government departments should prepare sub-consolidations. The introduction of the new public financial legislation could enable the requirement to prepare sub-consolidations.

Resource constraints

It is important that any new legislation is not so onerous that it places an unreasonable burden on government organisations which are already facing resource constraints. Whilst modern information technology and systems enable the capture of vast quantities of data it is important that the reporting obligations built into the new legislation focus on key measures and financial information. A number of suggestions in the Discussion Paper imply that there may be significant increases in reporting requirements such as outcome reporting, strategic planning, financial statements, multi-year funding reporting, etc. Any legislative amendments must simplify reporting whilst at the same time maintaining sound corporate governance.

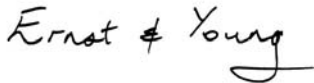
Outcomes reporting

We are fully supportive of the government's desire to move to outcome reporting, however, we acknowledge that this is an extremely ambitious objective. Specification of outcomes, their objective measurement and subsequent reporting are extremely difficult. Consideration should therefore be given to a phased approach that commences with more defined output reporting, moving over a three-five year period to outcome reporting

In addition to the above, our comments on the specific questions outlined in the Discussion Paper are addressed in Appendix A.

We would be pleased to discuss our comments further with you. Please contact Stuart Painter on 03 9288 8622 or Russell Twomey on 03 9288 8753 if you wish to discuss any of the matters raised in this response.

Yours faithfully



Ernst & Young

Appendix A

SPECIFIC QUESTIONS FOR COMMENT

3.1.1 Planning

Should a requirement to develop strategic plans be embedded in legislation? If so, should strategic plans be at the level of:

- ▶ whole-of-government
- ▶ departments
- ▶ entities?

What form should these strategic plans take?

We concur with the view that all government sector entities should prepare strategic plans that set the long and short term strategic directions of the organization. However, we have reservations that this should be legislated as there are concerns including:

- ▶ What penalties would be applied for breach of a legal obligation if a plan was not prepared.
- ▶ How would the legislation be phased to differentiate between large and small government sector organisations.
- ▶ The Government's objective to simplify legislation may not be achieved if strategic planning was to be legislated.
- ▶ How would the "policing" of such a legislative requirement be undertaken and by whom.
- ▶ What form and content would a legislated strategic plan take.

Despite our contention that strategic plans should not be legislated we believe they are a key platform in sound corporate governance, and could be better mandated through funding agreements which would enable them to be tailored for the size and complexity of the relevant organization. In this context we believe that strategic plans should be prepared at both departmental level and for individual public sector entities. The strategic plans developed should specify the key priorities of the department/entity, the strategic outcomes it is planning to achieve, major projects and how it has been structured to achieve its objectives.

3.1.2 Providing and allocating resources

Does the current Victorian parliamentary appropriation system serve any continuing purpose?

Should appropriations authorise:

- ▶ payments from the consolidated fund at the departmental / output level
- ▶ payments from the consolidated fund against each outcome
- ▶ drawing down of the consolidated fund to the level deemed necessary to achieve the government's desired outcomes?

Should appropriations be annual or multi-year, or a mix of both?

Whilst we acknowledge the points raised in the Discussion Paper regarding the current appropriation position, in light of our view expressed in Question 3.1.1 above (regarding a gradually or phased move to outcomes focused planning) we do not believe that it is practical to implement an outcome focused appropriation process in the short term.

Another interesting consideration that would need to be clarified prior to the implementation of a purely outcomes focused appropriation process would be how to cater for cross departmental outcomes where "joined up" government services are provided. In addition, care would need to be taken in respect to multi-year programs and how the public could be appropriately informed and government entities held accountable if an outcome based appropriation process was implemented.

In respect to the level at which appropriations should occur it is first important to consider government entities' ability to (a) determine realistic and measurable outcomes (b) measure these outcomes and (c) report on these outcomes in a meaningful and transparent manner. Our experience would provide anecdotal evidence that at present a large number of government entities would not have the systems and processes to capture, measure and report on many outcomes.

In addition, if appropriations authorized drawing down of the consolidated fund to the level deemed necessary to achieve the government's desired outcomes, there is a real risk that such outcomes would be at too high a level for the public to have confidence that the outcomes were being achieved. There is also a concern that the public may see such appropriations as politically motivated.

3.1.3 Accountability

(a) Should a requirement to report progress against strategic plans be legislated? If so, should reporting of progress against strategic plans be at the level of:

- ▶ whole-of-government
- ▶ departments
- ▶ entities?

(b) What accountability arrangements should be established for performance at input, output and outcome levels?

(c) In terms of reporting, what do you consider to be the appropriate balance between:

- ▶ financial and non-financial information
- ▶ prospective and retrospective information?

Based on our view that there are significant difficulties associated with the legislation of Strategic Plans we believe that the requirement to report progress against strategic plans should not be legislated.

Notwithstanding the above view we believe that the accountable officers/Board members should be charged with the responsibility of monitoring progress against strategic plans and the outcomes contained in such plans. Accordingly, reporting and monitoring of plans should be at both a departmental and entity level.

In relation to the question of what is the appropriate balance between financial and non-financial information, given that in principle we agree with outcomes based funding, there should be a greater weighting towards measures which support the outcomes. This would likely be more weighted to the non-financial measures. The public expects that government entities are appropriately managing both financial and non-financial measures and ensuring both the overall financial stability of the entity and the achievement of non-financial outcomes. Accordingly, there should be appropriate weighting towards the "measures that matter".

There should also be consideration given to both prospective and retrospective information, and its reporting, including forecast information both from a financial and non-financial nature. This will especially be important for multi-year appropriations to ensure that appropriate progress is monitored and assessed for achievement of longer-term objectives.

3.2.1 Entities

To which entities should the Public Finance Bill apply?

Currently there is a lack of clarity as to what are defined as "public sector entities" across different legislation. We agree that consistency of definitions for entities across Victorian legislation is a key issue that needs to be addressed by the proposed reform.

Notwithstanding this we believe that all entities should be covered by the new Public Finance Bill. It would not be appropriate to have separate legislation, however, we believe there should be some form of differential reporting.

Should all elements of the Bill apply equally to all entities (for example, financial management, governance, reporting, procurement, compliance frameworks)?

While all the principles of the Bill relating to financial management, governance, reporting, procurement, compliance frameworks should apply to all entities, they should not necessarily apply equally. Differential application should be available taking into consideration the nature of the entity.

If a differential framework were to be adopted, what form would it take and what criteria would it take into account (for example, financial position, materiality, public interest)?

At present the level of reporting is the same regardless of the size, risk or importance of the entity. While we acknowledge the need to establish a consistent reporting and governance framework for all entities, we also acknowledge that there needs to be a balance between accountability and reporting burden for such entities.

We therefore support the approach proposed in the Discussion Paper to adopt a differential reporting regime for entities within the Victorian Government, with departments and all other entities which are deemed material or of significant public importance reporting to Parliament and all other entities reporting to their Portfolio Minister only.

It is noted that the Australian Accounting Standards Board currently has a project on Differential Reporting on its agenda and any principles applied by Treasury in the revised FMA will need to take into account the deliberations and ultimate decisions of the Board.

The Board has tentatively decided that not-for-profit public sector entities would follow a two-tier reporting system as follows:

- ▶ Tier 1: financial reporting at federal, state and territory levels would apply the recognition, measurement and disclosure requirements of all accounting standards.
- ▶ Tier 2: all other public sector entities would have the choice of applying one of the following:
 - (i) full IFRS; or
 - (ii) the IFRS for Private Entities (as adopted in Australia); or
 - (iii) a regime of full IFRS recognition and measurement requirements with limited specified disclosures to be determined by the Board.

Hence while at the whole of government level, there would be a need to prepare full general purpose financial reports, to the extent that the Board adopts its tentative decisions above, there would be flexibility for Treasury to prescribe the level of reporting at the departmental level and for all other not-for-profit public sector entities within the Victorian Government. In our view, it would be appropriate to continue to require the preparation of full general purpose financial reports for all departments as well as those entities which, as per above are required to report to Parliament while all other entities which are only required to report to their Portfolio Minister are only required to prepare financial reports based on IFRS for Private Entities or a regime of full IFRS recognition and measurement requirements with limited specified disclosures as determined by the AASB.

We note however that the measures applied in determining whether an entity is required to prepare full AIFRS financial statements or not need to be able to be applied with limited subjectivity to be useful and consistent across their application. While materiality is an objective measure which can be applied without judgement, the concept of “significant public importance or interest” is a more subjective notion which may be difficult to implement.

In addition, problems may arise at the whole of government level if public sector entities were to apply different reporting requirements, possibly resulting in different accounting outcomes that would need to be adjusted on consolidation

3.2.2 Accrual-based appropriations and flexibility

What features of the cash-based system need to be retained? What other technical provisions are no longer required?

Given the highly prescriptive and detailed legislative provisions which would need to be reviewed and amended we believe it is more appropriate that the interested legal professionals should opine on this question.

3.2.3 Reporting

What options for modernising and simplifying reporting should be considered?

We support Treasury's proposal to evaluate the current level and type of financial reporting in Victoria. While financial reporting is an important accountability tool, there is a need to ensure there is an appropriate balance between transparency and reporting burden.

The current FMA requires the preparation of annual, half-year and quarterly financial statements together with estimated financial statements as part of the Annual Budget and Budget Update. These requirements are much more onerous than those required by listed entities under the ASIC and ASX rules.

We therefore support Treasury's proposal to remove the requirement to prepare quarterly financial reports and rather focus only the annual and half year reports together with the Budgets.

The disclosure of information on a timely basis is an important feature. We therefore support the tightening of the timeframe for tabling reports in Parliament to 3 months after the reporting period end in line with listed company requirements. This will ensure that information which is provided to Parliament and the public is more up-to-date and relevant.

The volume and complexity of financial information provided in current annual financial reports has increased significantly over the past decade. We therefore support Treasury in its consideration of issuing concise or "citizen" annual financial reports which provide highlights of the information provided in the annual report together with non-financial information which is considered of relevance and interest to the public. We believe that the issuance of such reports will enhance the communication with and engagement of citizens and provide greater transparency. Care however needs to be applied in determining the type of information which would be considered relevant by citizens.

3.2.4 Other public finance legislation

Are the proposals for related legislation appropriate?

We endorse the objective of simplifying legislation and legislative requirements and concur with the proposals to review, amend and repeal the related legislation (such as the Public Authorities (Dividend) Act 1993).

3.2.5 Procurement

Should procurement principles be incorporated into the new Public Finance Bill?

The principles of value for money, open and fair competition, risk management, probity and transparency are currently embodied in most government policies, processes and practices. While these principles are common across many government entities the interpretation and application may vary.

The new Public Finance Bill could help to formalise these procurement principles, providing greater guidance about their definition and application.

What functions associated with procurement need to remain entrusted to a statutory body or be independent of government?

The Victorian Government Purchasing Board (VGPB) currently performs a variety of roles, ranging from policy development and compliance monitoring to analysis of spending patterns by government departments.

Transitioning to principles-based legislation may require a change to the responsibilities of the VGPB and departments. Outcome based legislation will require flexibility for individual departments to make procurement policy decisions specific to their departments however some minimum policy and probity requirements may need to be managed by a statutory body.

Functions that should remain with a statutory body:

- ▶ Policy development pertaining to minimum standards in areas such as transparency and probity
- ▶ Contribution to activities benefiting all departments including fostering of new procurement technology, analysis of spending patterns across government sectors and leading spend aggregation activities.
- ▶ Auditing and limited monitoring

Independent of statutory body:

- ▶ Development of department or entity specific procurement policies and practices consistent with outcomes identified in principles-based legislation
- ▶ Compliance monitoring within department

Is the scope and nature of procurement controls sufficient?

The nature of the procurement controls managed by the VGPB may need to change in response to Principles Based Legislation. VGPB's role as developer and implementer of policies may no longer be as important in the future, nor will there be a need for detailed monitoring of compliance with policies by departments.

The procurement principles of value for money, open and fair competition, risk management, probity and transparency will still be relevant and must be supported by high level controls. As discussed earlier, procurement controls mandating minimum standards in support of these principles should be managed by a statutory body.

These procurement principles are relevant for purchasing for capital projects and by other public entities. In many cases the categories of expenditure and suppliers are common with VGPB administered entities. Accordingly similar minimum policy requirements or controls to those governing goods and services purchases should be in place to manage capital projects and other public entities.

3.2.6 Principles-based legislation

Should the Public Finance Bill be drafted as principles-based legislation?

Public sector governance (in fact all governance) is based on a necessity that appropriate values and corporate culture is established at all levels across government sector entities.

Despite the highly prescriptive rules based legislation established in the private sector (for example the Sarbanes Oxley Act in the US) there still continues to be high profile private sector corporate failure. In light of this we support the view that the new Public Finance Bill should be principles based.