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**TITLE OF MANUSCRIPT:  
WHERE MATERIALITY ISN'T ALWAYS CONSIDERED TO BE  
MATERIAL: PUBLIC SECTOR PERFORMANCE REPORTING**

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### **ABSTRACT:**

The principle of materiality extends beyond financial accounting and its assurance. It is indeed an underlying concept that unavoidably influences the usefulness of any information summary being presented to a user who is removed from the preparer of that summary. However, virtually no literature exists on issues of materiality applied to public sector performance reporting outside a financial reporting context. Notwithstanding that deficiency, this paper makes an international comparison of two performance reporting instances and examines how concepts of materiality were treated in each case. By using a communicative analysis within the frameworks offered by Goffman and Callon, our work shows how the absence of materiality became an overflow in bureaucratic communicative exercises between reporting agencies and the central agencies directing the reporting project. In the cases drawn from Australia and Denmark, preparers' decisions to include some pieces information and exclude other pieces were not guided by considerations of materiality.

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# WHERE MATERIALITY ISN'T ALWAYS CONSIDERED TO BE MATERIAL: PUBLIC SECTOR PERFORMANCE REPORTING

## 1. Introduction

Materiality is a concept derived from financial accounting and frequently operationalised in auditing of financial statements. As noted by Chambers decades ago, materiality is a simple concept involving “nothing more than an informed sense of proportion” (1966, p. 415). However, that ‘informed sense of proportion’ is dependent upon the information users’ decision environments which are not universal. Thus the field of materiality is rich in terms of research opportunities. However, regarding academic research of materiality concepts, it is not an understatement to note that materiality has become the hostage of audit processes at the expense of more broad understandings and analyses of materiality as a fundamental issue in accounting in general. Yet the principle of materiality extends beyond these traditionally limiting factors and is indeed an underlying concept that unavoidably influences both the accountability characteristics and the usefulness of any information summary being presented to a user who is removed from the preparer. The preparers’ decisions to include some pieces of information and exclude other pieces should be dictated by clear understandings and considerations of materiality regardless of whether the information relates to financial accounting transactions or non-financial information.

Public sector performance reporting is dominated by non-financial information notwithstanding arguments that it be based on explicit, formal and measurable standards of performance (Hood, 1995). However significant controversy revolves around difficulties of ensuring performance measurement that extends beyond mere rhetoric (Christensen and Yoshimi, 2001). A large literature exists to validate the argument that public sector performance reporting has been a disappointment to potential users of those reports (refer Schwartz et al, 2005; Radin, 2006). Thus, this paper dwells in the field of governmental performance reporting and analyses how concepts of materiality have been considered in past attempts to report on public sector non-financial matters. To do this it reveals detailed and processual views of what happens when performance reports are being prepared – at least in their innovative stages. These views are presented with the aid of a theoretical framework derived from Actor-Network Theory (ANT) and micro-sociological communications theory in which notions of framing and overflowing are used. We attempt to analyse how materiality becomes part of framing and whether overflowing of the frame can be explained in terms of materiality.

The overall conclusion arising from this comparative analysis is that presently the absence of a robust and workable concept of materiality applied to performance reporting is contributing to an absence of user utility in the performance reports. Meaningful reporting of outcomes is the main casualty resulting from an unimpeded ability to exclude material information and/or simultaneously include immaterial information. Whilst performance reports often provide copious amounts of data on inputs and outputs, it is notable that outcome information is under-reported and is not reported on a consistent basis over time (Carlin, 2004). Thus performance reports can be clouded with inconsequential data whilst omitting information that is essential to an informed view of the performance report’s subject. This unsatisfactory situation is likely to continue until greater importance is placed upon defining and implementing concepts of materiality in public sector performance reporting.

The remainder of this paper is structured as follows: Section 2 reviews the literature regarding materiality in public sector performance reporting although the paucity of same forces us to look beyond a tight focus limited only to the public sector; Section 3 describes our theoretical and methodological choices made so as to provide a comparative analysis of the absence of materiality in two instances of public sector performance reporting; then follows Section 4 in which we describe the two cases; and, finally in Section 5 we discuss the implications of these two cases for our research interest in order to reach some conclusions that may assist to advance the important field of improving public sector performance reporting.

## **2. Literature review**

Materiality is frequently referred to in the context of assurance of financial statements. It is generally understood to relate to “misstatements, including omissions, (that are) considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements” (INTOSAI, 2007a, p. 4). Although this definition is struck within an assurance context, it is nevertheless useful to report preparers in that it points them towards considering the impact of information on the users of reports as they decide what to include and exclude from those reports. It may be argued that the issue of inclusion and exclusion is heightened in importance and professional judgment where standards of practice are less prescriptive and defined – such as in the case of performance reporting as compared to financial accounting.

Literature searches focusing on materiality in public sector performance reporting result in very few contributions. Some marginal relevance can be found in the growing literature on materiality in non-financial reporting – especially environmental reporting (for example, Deegan and Rankin, 1997; 1999). Some of that literature shows that annual report users do require non-financial information and that the issue of reporting material information is considered by those users to be important. If that user requirement extends from the private sector financial reporting to public sector performance reporting there would be an expectation that materiality levels of the performance reports’ data could be related to the uses of those reports. Although not relating to the public sector, Faux (2001) considers environmental reporting (as opposed to financial reporting) and notes a need for qualitative differences to be recognized, perhaps with a separate materiality threshold as low as 6% compared to 10% for financial reporting. However, our efforts to use the literatures regarding materiality in non-financial and environmental reporting outside the public sector are constrained and so this research is only able to point to the fact that these literatures have considered materiality beyond a financial accounting or auditing contexts. Instead, what is needed is a literature that focuses specifically on materiality within a public sector performance reporting context.

The limited literature that is available regarding materiality in the public sector is dominated by matters of audit and a tendency to revert to financial statements. Price and Wallace (2001, 2002) analyse in excess of 3,000 documents (in seven English-speaking countries) that provide some guidance on materiality in public sector auditing and accounting. They primarily attempt to describe the confusion that has arisen from multiple terms being used in various pronouncements and conclude that materiality as a concept is subject to “diverse, contradictory and redundant terms” (2002, p. 306) in public sector usage. Whilst being a useful contribution to our research interest, Price and Wallace’s work is overly limited to

audit pronouncements that have at their core a focus on financial reporting, albeit for the public sector. However, there are some other contributions of relevance here: Pallot (1999) for example, surveys performance reporting audits in New Zealand and briefly conjectures that the idea of significance may be a preferable concept to materiality but does not further explore issues of materiality in performance reporting. Similarly, Taylor and Rossair (2000) investigate extent of disclosure in public sector annual reports. Whilst their analysis avoids issues of what is material, they conclude that accountability-related disclosure is influenced by efforts to meet what the report preparers perceive to be the requirements of 'within-government groups of users' (p.94).

Thus the limited literature that can be found to relate materiality to public sector performance reporting indicates confusing prescription that leads to great flexibility in which wide variation of what is material can be sustained. The question arises then as to what are the factors that shape the unavoidable decisions on information inclusion/exclusion as made by preparers of public sector performance reports? It is tantalizing also to consider if those factors – if successfully revealed – may be significant in explaining why performance reporting has persistently disappointed. In the following section, the theoretical framework and our methods of analysis are described in order that we may be able to fulfil our purpose of addressing materiality in public sector performance reporting.

### **3. Theory and methods to highlight materiality in performance reporting**

A focus on materiality in performance reporting is provided by comparing two cases drawn from disparate countries. This is done using theories shown to have utility in understanding communications and explicating means by which change is spread through organisations and society. These elements are described next.

#### ***3.1 Goffman's dramaturgical perspective on communications and Callon's notion of framing and overflowing***

Goffman's (1959) work on communications applies a dramaturgical perspective to everyday life in which an audience is the recipient of a presentation by actors within a context well understood by both audience and performers. It allows focus on the 'audience' (readers of performance measurement reports), the 'performers' (preparers of the reports) and the 'producers' (directing the reports' preparation). Thus, we may learn how the performers identify the audience in preparation for the performance and how they use various techniques to influence their audience. For example, Goffman shows how 'regions' such as front-stage (in view of the audience) and back-stage (unseen by the audience) are used by the performers and producers to shape the images presented to the audience. Back-stage is the place where the producers and performers will talk openly amongst themselves, decide what to show and rehearse, or draft the presentation. In these back-stage decisions, the producers will decide to use strategies such as 'secrets'. 'Free secrets' contain pertinent information which will be revealed strategically at planned points during the performance to secure confidence of the audience. Alternatively, 'dark secrets' will be intentionally hidden from the audience to avoid any disruption to the performance. But an additional feature of Goffman's work is important to this research: the use of frames to set up both performer and audience understandings of 'what is going on here'.

Goffman's (1974) concept of a frame surrounding all human communication is that it is the tacit stock of knowledge from which actors draw on in their everyday interaction. Although not explicitly in his exposition of his ideas, materiality is important here since it strikes at the centre of how the audience receives meaningful information from the performance. To Goffman, the audience and performers both arrive at an interactional 'theatre' with expectations. They understand where to sit, how to observe the performance and how to decode the actions of the performers. Equally, the performers know what they will do in the performance and how they will craft the message to be received by the audience. Thus, this research will focus on the communications between the producers, performers and audience involved in performance measurement reports so as to examine what decisions are made by the producers and performers as to what constitutes materially important performance information to be reported. It also shows how these communications are influenced by the frame and the ideas of materiality surrounding these reports and the processes by which they emerge.

Although Goffman's work was derived specifically from face-to-face communications, other scholars have made successful use of his micro sociology in relation to the study of accountability reports (Neu et al., 1998; White and Hanson, 2002; Skærbæk, 2005; Christensen and Skærbæk, 2007). Some have done so within a broad context of accounting and auditing (Pentland, 1993; Ahrens and Chapman, 2000). Also in a broader sense, Power (2003) suggests that Goffman's dramaturgical perspective is of help in the study of 'paperwork' such as accountability reports, because these 'mediate the front and back stage of a practice as an active process of erasing mess and of scripting a rational, defensible and legitimate 'face'' (Power, 2003, p. 386). However, Goffman's work can be extended by recognising that 'almost all of our interactions with other people are mediated through objects of one kind or another' (Law, 1992, pp. 381-82). Actor Network Theory attempts an explanation of how objects frame and mediate communications and we utilise Callon's (1998) notions of 'framing' and 'overflowing' to help explain why communications and relationships between actors in a related network translate certain outcomes.

Framing is a complex notion (see also Christensen and Skærbæk, 2007) but emphasises the case that communications and interactions are organized by a (unending) set of physical (framing) devices (similar to Law's objects) that help establish the cognitive boundaries within which interactions in an organized way can meaningfully take place. The physical devices tend to define what is inside and outside the strategic frame, i.e. what is appropriate action in the strip of interaction under study. 'Overflow' is Callon's sociological revision of the economists' concept of externality, where overflows comprise both the positive or negative externalities that are produced during framing attempts. Whilst being unpredictable in its precise form, it is important to recognise that some form of overflow is inevitable. As an example of an overflow, consider a government's act of taxation. Typically, taxation will cause a change of behaviour on the part of payers and non-payers of the tax: the changed behaviours may aim to minimise or avoid the tax and they instance overflows. In this example, they arise because the frames of the government and the taxpayers differ. According to Callon (1998) overflows are the norm but typically it might be hard to predict the form they will take. They also represent imperfections in the framing attempts that accompanied the change. The word 'imperfection' here might indicate an avoidable flaw in the frame but it is more accurate to view overflows as inevitabilities, rather than being the result of a weakness. Thus the success or failure of public sector performance reports to provide material information can be viewed with the aid of a theoretical lens that incorporates the concepts of

framing and overflowing. That is the aim of our comparison of two cases drawn each from NSW and Denmark.

### **3.2 Data methods**

The empirical corps of this paper derives from two cases of performance reporting. In both cases our purpose is to compare and contrast the processes by which the performance reports were prepared and in doing so we focus on how issues of materiality were considered – or ignored – by various actors.

The first case examines an annual report published in Denmark by an anonymous Danish business university according to the requirements of the Ministry of Finance (MOF) and the National Audit Office (NAOD). The second case is on a reporting innovation introduced by an Australian State government: New South Wales (NSW). That was system-wide across the whole jurisdiction but this paper confined its research to one area of performance: environmental programs. For both cases, data was gathered from two primary sources (unstructured interviews and various documents) with respect to a single performance reporting change. Interviews were conducted with the central agency responsible for introducing performance reporting, as well as with the main affected agencies<sup>1</sup>. The interviews ranged from 1 to 2 hours and were conducted under assurances of confidentiality<sup>2</sup>. Interviews were either audio recorded or notes were taken and these representations of the interviews were then coded and analysed by each researcher. Data was also sourced from documentary sources being the performance reports themselves; central agency reports; reporting agency performance reports using other methodologies (either publicly available or otherwise); Acts and Regulations establishing the central agency; and, Treasury documents. Following those analyses of the interview and documentary data, both researchers reviewed the other's technique in order to ensure comparability of analytical method. Subsequent to the individual cases' analyses, the two cases were compared so as to determine patterns of similarity and difference; those case expositions are presented next in Section 4 and then discussed in Section 5.

## **4. The cases of materiality in performance reporting – is materiality inside or outside the strategic reporting frames?**

### **4.1 Materiality in the Danish reporting case**

Due to NPM (Hood, 1995) the public sector has come under attack as being inefficient, bureaucratic and not providing public accounts to the taxpayers. This is also the case in Denmark. In 1995 the Danish parliament embarked with great enthusiasm on a new reform involving performance reporting as a strategy to cope with this criticism. To frame the government agencies for producing annual reports with performance information, a whole range of framing devices were invested in and subsequently broadly circulated in the political

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<sup>1</sup> By the term 'reporting agency' we include the Danish University and the various governmental organisations in NSW that were required to produce data for the respective performance reports.

<sup>2</sup> Direct quotes from interviews are provided with codes that denote the sources of the data but hide the identity of both the individuals and their relevant agency. In the NSW case, the codes 'CA' and 'RA' are used to respectively denote a Central Agency and a Reporting Agency without revealing the identity of any specific agency.

and administrative apparatus of the state. In 1995 the MoF published its White Paper on annual reports. Subsequently, this report developed into Statute No. 63 which, approved in 1995, made it mandatory for most government agencies to produce and publish an annual report with an extensive range of performance indicators - of which a number were non-financial. The report also provided space for qualitative descriptions of achieved results but quantitative performance information – especially financial information - was prioritized. Statute 63's mandatorily required inclusion of unit cost information thus became very important (see also Skærbæk and Thisted, 2004). To help this framework succeed, further framing devices in terms of guidelines for the reporting agencies were developed. Also, conferences were set up to mark the embarkation of the reform and to attract the consultancy market and IT-providers to assist with the reform. Several agencies contracted consultancy companies to develop necessary accounting systems and to help produce the reports. Furthermore, controllers and employees were trained and communication experts were employed to help produce reports with a professional appearance. All of such investments can be seen to help set up the frame of the annual performance report. Without these physical devices the framing of the performances would not have been feasible.

It is challenging to identify how materiality was developed in the framing devices. At first it seems that the materiality issue was ignored by the White Paper. The only place where one might be able to observe reference to the term “materiality” is at p. 35:

It must be aimed for that the description of the activities provides an adequate picture of the activities of the company. Therefore, it must comprise ‘all activities that fill a spot in the landscape’ (Finansministeriet, 1995, p. 35).

Primarily, this is a general statement about inclusion of information and it bears connotations with the “true and fair view” phrase. When it comes to defining users and their decision roles, the White Paper is silent. The careful instruction of what information the report should contain seems to be serving purposes of the administrative apparatus that is also defined as a primary user. In the White Paper (p. 23) the public is figuratively shown to be amongst stakeholders, and the text notes that: “some of their information needs can be satisfied” (Finansministeriet, 1995, p. 24). No more is being said about the public, and their decision-maker role is not described.

Subsequent to the initial foray into annual reporting, Statute 82 was approved in November 1996 expanding the number of agencies required to publish annual reports and requiring annotations regarding non-financial aspects and without restricting these annotations. However, although it gave no guidance or specification of internal audit of the reports, Statute 82 observed (p. 15) that the non-financial annotations signify that the report is “reliable, adequate and substantiated”. In contrast to this absence of direction, Statute 82 specifically notes that the conventional materiality regulations are applicable to financial (Budget-related) parts of the report. In a subsequent 1998 MoF guideline, this issue is not commented on at all except that Statute 82 is enclosed as an appendix to the more than 75 page long report. In the following section we analyse how a Danish university handled the issue of materiality in their report of 1998.

#### **4.1.1 Materiality of a university annual report**

The case used in this study concerns a large Danish university, which over the last decade has experienced huge growth in activities involving both research and teaching programmes. The University is an agency under the Ministry of Science, which has a secretary of state (MP)

who is chosen by the Prime Minister, and a permanent secretary of state who advises the minister regarding the management of ministerial responsibilities. The University published its first annual report in 1997 in accordance with MoF Statute 82. In this section, the 1998 report is analysed in order to uncover whether, and in what ways, materiality has framed, i.e. guided the University in its annual report performance.

The cover page on the annual report introduces the reader to the term ‘annual report’ which creates and confirms the expectation that accounting and the sort of metaphors attached to it will be used. The annual report itself spans 65 pages, including 24 pages of appendices. The first 41 pages are divided into five sections providing data on separate parts of the university. However, immediately before these main sections, the reader is introduced on page 5 to three certified signatures which are included to fulfil the expectation of the strategic frame that this *is* an accounting report.

In the first main section, multiple tables of numbers are quickly introduced which present data on University productivity with respect to, for example, the number of master’s students enrolled, research publications, foreign exchange students, etc. The tables facilitate a four-year comparative view and encourage the interpretation that increased output is good while decreased output is bad. Thus, the numbers show a somewhat positive development for the University. The output indicators show what is produced for the money consumed and the report shows 20 different sources of revenue such as, for example, various types of degrees funded by the state, EU grants, research grants and other sources.

The expectation that an accounting report includes numbers that illustrate the financial structure (or at least aspects of it) for a specific period of time for the University is once again confirmed. Furthermore, following accounting conventions, the numbers are analysed regarding the variety of problems that arise when comparing revenues to various expenses as well as reasons for change in the 20 sources of revenue. The use of accountability in the analysis given for revenue analysis is a reminder that an accounting situation is at hand. The report’s tables are accompanied by long, complex and apparently uninteresting explanations. Accounting metaphors are present which conform to the expectation of receiving a dispassionate, neutral product, but they also communicate a low level of enthusiasm, and are thus even more likely to be tedious reading for (consequentially uninterested) parties.

In sections two, three, four and five, which provide accounting information for two faculties, a research centre and the library, the notion of disaggregation seems to be the guiding idea. In sections two to five, student enrolment statistics are compared to other universities, and the quantity of teaching evaluations, the number of research publications, peer-reviewed departments, etc. are presented for the years 1996 to 1998. The sections conform to the idea within accountability that the sub parts of a whole must also come under scrutiny. In this case University faculties and the library, where, for example, information on lending is provided, are looked at. Thus the accounting notion of transparency acts as a guiding principle in reading and interpreting the report.

There are 38 appendices with 48 tables made up of various accounting numbers without accompanying explanations disclosed on pages 42-65 in the last section of the report. In an appendix 20 (p. 56 in the report) provides an example of numbers appearing as ‘unit costs’ as well as other measures of ‘productivity’, furnishes a tie to accounting. The type of meaning that can be interpreted from reading such numbers is that in general it is good to demonstrate decreasing ‘unit costs’ and increased ‘productivity’ as a signal of taxpayer money being used

more efficiently. The fact that a lower unit cost might be a sign of waste since objectives cannot be met where educational activities are concerned is not considered. Thus how the users and the public in general can use this information is absent in the report.

In summary, this analysis demonstrates that the social situation involved in reading the University's annual report provides many specific accounting metaphors such as the appearance of accounting numbers, sequences of numbers, 'true and fair view' references, certified signatures, transparency, accounting explanations, accountability, dispassion, unit costs, productivity, comparability, disaggregation, etc. These metaphors demonstrate that the frame guides the situation.

While the report generates the impression that the University complied with the framework, one must be aware that, as noted by Goffman, any framework can be keyed into different meanings. Thus it is important to uncover transformations of the frame and this is done next by using interviews with the actors involved in the construction of the annual report and the report itself.

#### ***4.1.2 The authors of the report and the transformations that emerged***

The problem with our annual report is that we have to demonstrate that we are in full control of how and for what purposes we use the taxpayers' money. Especially in our capacity as a University, we could live with a situation in which we are not in control of what we do. Therefore, we assign the whole administration the task of making the annual report. (University Director).

By referencing the need to show control over resources, the University Director confirms that the team should mobilise the annual reporting framework. However, the administrative team expressed astonishment over cautious advice to them:

Every year we ask the Deans and a top manager what they want us to write about. This year, we asked whether we should structure our report as we had structured our business plan. They merely answered, "Oh no, you really don't need to do that. The level of ambition should not run too high." Consequently, we applied the external rules. (Controller at faculty Y)

Although the administrative group tried to involve the senior managers in the report's production, it appears that the group who wrote the report was limited to the University Director, the Vice Director, the CFO, the controllers and the administrative managers from the various faculty administrations. That this group should not be too ambitious in their efforts caused the team to be careful in applying the external rules defined by the MoF. As a result, they embarked on a passive process rather than one designed to fulfil expectations of significant users and their decision needs:

We have not defined a target audience or said that we wanted to make a report intended for a specific party. It is a question of who we believe the target audience to be. We have not discussed that. However, as someone said to me, the report isn't read by anybody but some official in the Ministry of Science. (Controller at Faculty X)

Based on their understanding of what the report should be about, the team searched for a relevant target audience. In the process, it emerged that a bureaucratic audience within the government would be best targeted. As a result, the original meaning of producing ‘true and fair views’ of the University is translated into the situation of the usefulness of getting a high rank in the MoF and the NAOD’s evaluation of the report. The Vice Director explains:

Somebody in the MoF may read it, but how thoroughly and how interested they are, I don’t know. The MoF evaluated the annual reports and ranked them. They read the reports because they have to evaluate them, not because they can use them for anything. But we considered it important to get a high rank, because the MoF has some influence on our funding (Vice Director).

This situation is formed by the interpretation that the MoF is an influential authoritative body that can influence government funding. The manner in which it is interpreted, as indicated in the quote below, however, was to avoid being pinpointed as a producer of ‘bad’ reports.

In 1997 we got 84 points out of 100 in the report evaluation by the MoF. In 1998 we got 89 points without changing our layout, content, etc. Only the numbers showed something different. It is funny that our ratings changed so much for delivering almost the same product (Vice University Director).

Quite an ironic attitude towards the report is revealed in this quote, which shows that the potential users of the report also have certain role expectations for the University. The following quote indicates the University’s commitment to the expectation that they should just produce the numbers to satisfy government expectations.

In order to meet the requirements of the ministry we have to calculate numbers in ways that make no sense to us. We do not feel confident that these numbers give any meaning at all. How anybody else can get any meaning out of it is very unclear (Chief Financial Controller).

That the report could be used to impress the MoF in order to obtain more funding does not seem to be the case. The apparent meaning that develops out of this situation is that the team ends up developing a report that fulfils the role expectations of the authoritative bodies, thus translating the meanings of the framing into a ceremony with its comprehensive sets of rituals such as rankings, compulsory annual tasks, etc. The following quote also illustrates how the report producers play with the frame by considering what and how much should be included in relation to the tone of the audiences’ expectations:

I’m writing a lot about the failure rate within our master’s degrees because the failure rate is very high. Perhaps it is not wise to write so much about it. However, it does support the conversations we have with the Ministry of Science anyway. And it may help us get better conditions (Controller of Faculty X).

In these illustrative examples, the reporting team takes on the task of representing themselves in their social role as the caring and responsible users of the taxpayer money, while at the same time remaining distanced. Further evidence of this being a ceremonial writing process is:

We feel we’re writing it without anybody reading it or even using it. We had some intentions of bringing ourselves out of this situation by linking it to our internal reporting, but it failed. I feel it is just an exercise and we have not yet gotten anything out of it. (Head of Department in Faculty X)

This quotation shows that there is a very scant conception of who the users and what their decision-making situations are, hence materiality is absent from the minds of the producers. Also it shows how the producers may nourish the hope that the reporting process can result in internal benefits such as better management control.

Recalling the fact that the report is not circulated at the University and its circulation is mainly limited to the government, the ceremonial aspects of the 'strip of activity' seem quite significant. Materiality in terms of the users' decision-making requirements is entirely undetermined. However, in examining the report writing team's strategic conduct, further implications of this translation may be seen.

#### **4.1.3 Including 'free secrets' as a part of the transformations**

Through internal meetings and conferences, the team set about to include stories of management problems as an important aspect of the social role of being a caring and responsible government institution:

It is clear that we try to write as much as we can about what we have done in our business and to show that we are not trying to hide anything. However, we all know that the MoF and the NAOD both want us to discuss some of our problems and what we intend to do about them. When I write about what we will do about the problems, I simply try to remember past debates. (Chief Financial Controller at the University)

As is apparent in the statement above, the University *consciously* and *deliberately* includes some of the problems they actually face in their annual report. The problem related to PhD completions, for example, finds its way into the annual report in the following form:

The number of PhD-students has increased significantly. Unfortunately, the number of people who have finished their PhDs remains unchanged. However, in 1999 an increase in the number of students who have finished their studies is expected. (Annual Report, 1998, p. 11)

As the University Director states, however, they do not provide such disclosures in order to damage the credibility of the University. Rather than acknowledging the number of unfinished PhDs as a major problem, the disclosure serves to imply - 'as any sensible reader will know' - that dissertation completion is unpredictable and often does not go as planned. The University has also chosen to disclose information on some management control problems that are related to the increase in failure rates in some study programmes:

In 1998 more attention will be given to the above-mentioned problems concerning the decrease in the number of students who have finished their studies and the activity level of teaching activities ... (Annual Report, 1998, p. 29)

The problem of increased failure rates could perhaps become serious for the University. In the writing process, however, the University turns the issue into a very complex relation of cause and effect. The problem is described with such long complex sentences that it is arguable most potential readers would be unable to assess whether or not the explanation provided is a 'good' one. Thus the problem, which appears to be taken seriously, is described as being 'hard to understand' and not easily solved. Some of the team may not be conscious of this

mechanism, but the University Director certainly was and he even explained why such strategies are necessary:

In our annual report we include some of the problems facing us. We are indeed expected to include them, but it is also in our own interest to do so and to tell about some of our problems as honestly as possible, because nobody would believe in us otherwise. (University Director)

Disclosing problems such as low PhD completions, a lack of applicants for various programmes and high failure rates, may be seen as ‘free secrets’ that are disclosed following the rituals implied by playing its expected role. But the interviewees also noted that the issues written about were related to various managerial or operational debates that they continuously have with MoF officials. Such debates are very likely to refer to opinions of officials and politicians and thus influence the reporting behaviour. The University’s performance may help the government play their role of being the ones who make sure that the agencies appear careful and responsible. As a result, the University uses the annual report both to keep the state happy and to avoid attracting too much attention. In this regard, materiality does not at all seem to penetrate the considerations of the designers and the final report. Thus, even though the Danish case clearly exhibits strategic choices regarding what to report and what to exclude, these decisions were not made with a consideration of the materiality of specific pieces of information for report users. Given this description, the next section describes a performance reporting episode in a different jurisdiction and considers how materiality concepts were also strategically avoided.

#### **4.2 Materiality in the NSW SE&A reporting case**

In 1996, the NSW Government<sup>3</sup> embarked with great enthusiasm on a significant excursion into a new and publicly available form of performance reporting for its public sector (COCOG, 1996). However, that project ended in 2005 with much less fanfare than it commenced and so signalled another failed performance reporting regime. One explanation for the failure was that usage of the reports was limited (NSW CA, Interview 6). Principal in that absence of use is the high probability that the reports lacked materiality in the eyes of their intended external audience<sup>4</sup>. To understand how this failure evolved (and how decisions were made as to what information was to be reported), it is important to understand the emerging network of actants and their views on the power of performance reporting to acquit accountability obligations.

The reporting project was as an outcome of prior bureaucratic, political and administrative happenings. In particular, the creation of a new central agency, the Council on the Cost of Government (COCOG, 1996), was the most important factor because the COCOG embarked on a strong advocacy for performance reporting as an enhancement to NSW’s prior performance reporting practices. The COCOG was a central agency created by a newly elected government to identify the cost of delivering government. It reported to the Premier and was headed by a past vocal critic of the public sector, accountancy Professor Bob Walker, as its Chairman. Professor Walker had a highly respected reputation as a fearless and technically competent critic of government accounting and was charged by the Premier with

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<sup>3</sup> In terms of population and economy, NSW is the largest Australian State; its democratically elected Parliament forms a government under the leadership of a Premier with the support of a majority of Parliamentarians. Being the oldest Australian State, NSW has a relatively well established public administration.

<sup>4</sup> This research has not tested for the reasons that the intended users of the SE&A reports did not use these reports.

“looking for radical change in the way government and its agencies are managed ... (requiring) that agencies get control of costs (and) an understanding of the source of present levels of expenditure, and planning to achieve long term reductions in those costs’ (COCOG, 1996, p.5).

The COCOG was aware of work by the USA Governmental Accounting Standards Board advocating adoption of Service Efforts and Accomplishments (SE&A) reporting and was attracted to the presentation of data on inputs, outputs, outcomes, context and future directions (Walker, 2001). In recognition that some outcomes are beyond the control of government, the SE&A report outcomes were either program outcomes (directly attributable to a NSW Government agency) or community impacts (high level outcomes for which agencies cannot be held accountable). However, in the discourse surrounding SE&A reporting at its conception in NSW, there was not explicit discussion of materiality as an issue.

The COCOG embarked on efforts to first enrol the NSW Government in a network focused on SE&A reporting by offering the likelihood of savings in expenditure programs. It argued that the SE&A project was needed because agencies could not fully explain a 20% increase in real spending over the eight years to 1996 (McDonald, 1996, p. 2). Thus the clear implication of the effort to document and report accomplishments (in terms of outputs and particularly outcomes), was the strong possibility of subsequently reducing inputs to government services. As a result, an early coalition formed between the COCOG and the Government based on the problematization that a SE&A report would present useful budgetary data whilst also attesting to Government accomplishments in serving the NSW public. However, that coalition did not convince the NSW Treasury to enrol. Instead, it worked around Professor Walker and directed its resources to a new performance reporting technology that potentially threatened the SE&A innovation. That Treasury-COCOG tension frustrated reporting agencies but interviewees indicated that they did not feel powerful enough to resist the COCOG innovation.

Whilst Treasury did not join the network, sufficient other actants did. This allowed the SE&A reporting project to proceed in the absence of Treasury cooperation. The reporting agencies were enrolled by a combination of direction from the Premier and self-interest given that the SE&A project had become a high government priority. The reporting agencies’ participation in the network meant that they became committed to providing SE&A data to the COCOG and some even seconded staff to COCOG for this task. Although additional funding was not provided, the agencies recognised that it could be dangerous to deny either the COCOG or Treasury in their accountability projects.

In addition to the COCOG, Government and Reporting Agencies, a significant network member was the image of the general public and specialist stakeholders with an expected interest in performance matters. Other actors spoke of these images and it was assumed that they wanted data on costs, services and impacts (COCOG, 1997, pp71-73). By speaking for the general public and specialist stakeholders, the COCOG argued that the SE&A project would meet their information needs and thus what information was material to those needs. In addition to the sub-text of looking for opportunities to identify efficiencies, the COCOG’s ability to speak on behalf of the general public gave it great power. That power was increased additionally by the reporting agencies’ general ignorance about what a SE&A report would include and would achieve.

Once agreement as to the SE&A Reports was reached, work commenced on gathering the data necessary for this ‘accountability’ project. By 1999 when the first round of SE&A Reports had been published, significant resources in agencies and in the COCOG had been expended to achieve ‘the most comprehensive, systematic and focused presentation of performance indicators ever produced by an Australian government’ (Walker, 2001, p. 15). Indicative of the outputs from this project, the 1999 Environment SE&A Report consisted of 171 pages detailing 505 indicators and accounting for 97.8% of total expenses of the 28 agencies covered (Walker, 2001, p. 10).

A significant aspect of the SE&A project was reporting of performance data for a specific program rather than an agency. For the environmental bureaucracy this was problematic since 28 agencies were involved and many had been in conflict over responsibilities and relative importance of the conflicting aims of economic growth and environmental preservation. Thus, of the three agencies researched for this paper, the Environment Protection Agency often argued in favour of environmental policy whilst the Department of Urban Affairs and Planning, and the Department of Mineral Resources frequently promoted economic development. Nevertheless, all contributors to the Environment SE&A Report guarded their responsibilities and mitigated the appearance of duplication (NSW CA, Interview 5). It was apparent that duplication would signal potential cost savings and the reporting agencies were wary of that risk.

The first SE&A report for the environment was characterised by limited data on outcomes (only 11% of measures and many without 5 year data sets) and a heavy bias towards output data (80% of reported measures). This result was in sharp contrast to the rhetoric justifying the SE&A project as a useful information source to the general public - and it does not appear to be a simple result of a lack of available data. Data was initially provided by the reporting agencies and COCOG staff would indicate if that data was acceptable. Thus the COCOG was in direct control of what was considered to be materially important enough to be reported and what was not. Although agencies felt frustrated about the purpose of the SE&A project and were not convinced that they served any purpose at all (NSW RA, Interview 3), they sensed risk and did not challenge any of COCOG’s materiality decisions. As a result it seems that reports were produced to provide a ‘pleasing feeling’ where textual content regarding context and background mitigated against any risks to reporting agencies and apparently compensated for the absence of outcome data. Additionally, the reporting of banal data – that is, data that did not possess materiality to the expected end user – became a strategy that reduced the risk of being accused of not cooperating with the SE&A initiative.

The case evidence suggests that the reporting agencies’ frustration with SE&A reporting arose from three sources. First, the reporting agencies did not believe that the reports were for the public since they felt the ‘razor gang’ origin of this reform told them more about its purpose. Second, similar but slightly different requests for performance data by the COCOG and Treasury created additional workloads. Third, efforts to satisfy the COCOG’s requests for outcome data presented dangers that the data would be interpreted in a manner that would harm the reporting agencies’ interests. Each of these sources of frustration is a key to understanding why the communicative view of this instance of performance reporting explains its consequent failure. Equally, the avoidance of clarification as to what was material to end users of the SE&A reports also became a strategy in which these frustrations were dealt with by the reporting agencies. These matters and issues of how considerations of materiality were also absent from the Danish annual reporting case are discussed next

## **5. Discussion and conclusions: is the absence of materiality an inevitable source of overflowing of the public sector reporting process?**

In both the Danish and NSW cases, a network emerged around the reporting effort yet the result from that network was less than satisfying to the stated objectives of either project. In this section we argue that this was substantially because materiality as a concept was chosen by powerful members of the network to be either irrelevant to their purpose or capable of being ignored. Such an observation is useful but a more useful outcome of this research would be to offer an explanation for why considerations of materiality are not characteristic of the cases. In addition, in this section we consider if an absence of materiality is an inevitable overflow of the public sector performance reporting process.

Within the NSW case it was apparent that the actors' differing interests and the weak enrolment of the reporting agencies held the seeds for future difficulties. In particular, the differing expectations of the reporting agencies and the COCOG meant that the accountability objectives were unlikely to be achieved. This, coupled with the presence of the general public in image only and without active participation, meant that the reporting agencies crafted their response to the SE&A reform as a communication with the central agency about resource usage. The Danish case also demonstrates a nuanced response from the reporting agency towards the central agency: 'free secrets' were strategically revealed in order that the communication between the reporting and coordinating agencies could be smooth. These secrets were strategically included in the reports so as to create trustworthiness in the accounts in the minds of possible report readers. In both cases, these third parties were spoken of and, although some actors were unconvinced of external interest in the reports, the same actors realised that it would be beneficial to reduce possible criticism of the reports. The fact that neither case exhibits formation of reflexive agencies opposed to the reports or their reporting processes, is indicative that the strategies aimed at smooth communication between the coordinating agencies and the reporting agencies were successful. However, within these strategies, considerations of the general public and what information would be material to its decisions were not matters of concern. However, the cases studied here show instances where the communication between central and reporting agencies were careful to avoid information that may have been considered material.

At times, materiality was deliberately countered by other considerations of greater importance to the smooth communication between the central and reporting agencies. For example, in the NSW case there is evidence that some 'dark secrets' (Goffman, 1959) were revealed to the COCOG out of sight of the public (in a guarded passageway, in Goffman's terms). This information was kept out of the SE&A reports by advice to the COCOG that the information was commercial-in-confidence. Similarly, materiality was over-ridden in discussions where the reporting agencies would persuade the COCOG why its preferred data should not be disclosed:

we didn't want to report it because it was politically dangerous and also a lot of the information there is subjective and it served no good purpose to report that ... we had to convince them that what they were suggesting was not the right way to go (NSW RA, Interview 3).

These debates took place backstage away from the public and even away from senior managers in both central and reporting agencies. Within these debates however certain issues remained unspoken because both the reporting agencies and the central agency saw no point

in challenging the basic assumption that the public would derive benefit from the reports<sup>5</sup>. Thus, the picture emerges of the reports being the output of an administrative communication between the central agencies and the reporting agencies. This communication took place in hidden locations away from the citizens who were the stated but not the real audience. Whilst the central and reporting agencies maintained words about the citizens' information needs, in the absence of an imperative to provide material information, they converted the purpose of the performance reports to an unrelated resource-based purpose. In Callon's (1998) terms this exclusion of citizens' information needs can be seen as an 'overflow' that whilst being unpredictable in its precise form, was inevitable.

As explained by Goffman and Callon, to understand any communication, it is necessary to understand the frames adopted by both audience and performer/producer. In the NSW SE&A case, the reporting agencies (the performers) soon adopted the frame that this was a cost-cutting exercise to "whack agencies over the head" (NSW RA, Interview 2), rather than being an accountability exercise. Thus, the NSW agencies were cautious and equally so the Danish case demonstrates great care on the part of the reporting agency to ensure they were presenting information of a pleasing nature to the central agency. This degree of wariness was perhaps heightened deliberately by the central agencies since they would threaten recalcitrant agencies with loss of funding data was lacking for particular expenditure programs (NSW CA, Interview 5). The strength with which resource issues underpinned the SE&A project was not found in an equally blatant form in the Danish case but in both cases the reporting agencies were acutely aware of risks in not cooperating with the reform. This does not mean that their cooperation was entirely subservient and so it is observed in both cases that the reporting agencies identified available strategic responses. In these strategic responses, malleable concepts of materiality (and the absence of standards requiring materiality), became allies to the reporting agencies in dealing with the central agencies' requirements. Both cases' central agencies were pleased with the resultant performance reports and so the reporting agencies' strategies can be said to have succeeded. In the NSW case, the SE&A reports experienced significant volumes of internet downloads but there is no evidence whether that simply reflected intense bureaucratic interest. Even if the general public were downloading the SE&A reports, there is no evidence of their usage of them. Indeed, the COCOG itself was to acknowledge, after the network had broken down and SE&A reporting was abandoned in 2005, that "others didn't find the documents useful" (NSW CA, Interview 6). Although the Danish annual reporting continues, it is also the case that evidence of their public use is similarly unproven.

For both cases studied here, the most significant feature is that neither performance reporting project produced information with a clear relationship to what would be decision-useful to the public. Even though both networks had images of the public as a user, and actors spoke on behalf of the public, materiality expressed in terms of the public's decision-making was absent. So in the SE&A reports, a preoccupation with input and output measures and accompanying contextual and explanatory comments precluded firm conclusions being drawn from the indicators. Insignificant annotations, capable of multiple and harmless interpretations, mean that the input and output indicators cannot be used by an interested party for accountability purposes. Equally, those indicators could not be used to identify overlap between program providers; and so the reporting agencies had achieved their primary goal in

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<sup>5</sup> Decisions to avoid reporting 'politically dangerous' data and to dispute the utility of performance data to the general citizenry can be considered to be instances of 'public secrets' as theorized by Radcliffe (2008). A 'public secret' is something which is generally known but cannot be articulated or spoken for risk of an unwanted consequence eventuating from the articulation of the 'secret'.

the SE&A project: to survive without significant funding cuts or ‘turf wars’ in which responsibilities between agencies would be re-allocated. Similarly, the Danish annual reporting project’s performance reporting is characterised by annotations capable of multiple interpretations and a withered attention to outcomes.

An absence – or inadequate emphasis on – outcome data indicates a lack of concern with materiality in performance reporting. From the public’s performance reporting perspective, input and output data are important only to the extent that they are able to throw light on what outcomes were achieved (for example, if inputs were lower than previously consumed it is understandable that outcomes would be commensurately lower). Ultimately, it is outcome data that is decision-relevant to the public and so any materiality test of performance data being reported must assess whether the public’s decision making or judgement would be influenced by reporting or not reporting particular data. A fundamental difficulty in this regard is that the accounting profession has relied upon auditors to reach an opinion on materiality but that in turn has relied upon accounting standards that have been grounded in financial accounting. In contrast, the emerging discipline of performance measurement and reporting has been neither subject to rigorous audit nor developed within a set of standards that prescribe acceptable practice. With the absence of audit (both internal and external) and a flexibility based on an absence of prescription, an increased range of strategic options emerge for both reporting and central agencies in performance reporting projects. So, in the Danish and NSW cases compared here, the reporting agencies have been seen to be active in providing data that was not material and in avoiding reporting of material information.

Whilst the absences of rigorous audit or standards for the conduct of performance reporting are significant, it is important to sound caution regarding an expectation that improved materiality would result if those absences were to be remedied. To date the Supreme Audit Institutions have had little success in addressing assurance of performance reporting quality (Divorski, 2005) even though some jurisdictions have attempted to address the assurance of performance reporting. For example, the Office of the Auditor-General of Canada has produced audit criteria for the assessment of the fairness and reliability of performance information (OAGC, 2001) and in five criteria, materiality is noted only within one sub-criteria<sup>6</sup>. When it is recognised that materiality is not even defined with respect to performance reporting, it can be concluded that such pronouncements are unlikely to address the absence of concern regarding materiality. Similarly, INTOSAI’s 3000E Performance Audit Guidelines sound a warning but leave the public sector auditor rather defenceless when it notes: “The auditor should adopt an attitude of professional scepticism throughout the audit, recognizing that circumstances may exist that could cause the information relating to performance to be materially misstated”. As well as the indeterminate nature of these pronouncements, some other considerations have the potential for compounding the absence of materiality as observed in the two cases reported here. For example, in Exposure Draft ISA320 *Materiality in Planning and Performing an Audit* (2006) it is noted that “in the case of a public sector entity, legislators and regulators are often the primary users of its financial reports. Furthermore, the financial statements may be used to make decisions other than economic decisions”. If these statements hold true for public sector financial statements it can be expected that they are equally applicable to performance reports and thus they reinforce the evidence of our cases that the performance reports are part of a communication between the coordinating and reporting agencies in which considerations of what might be material to the general public do not arise.

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<sup>6</sup> Within the criteria labelled “Balanced” there is a sub-criteria noting that the emphasis on information presented should be proportional to its importance and materiality (OAGC, 2001).

One of the challenges for this paper has been to engage with a literature since the literature on materiality related to performance reporting is scant. As a result, our attention is drawn to a higher level where prior authorities have argued that accountability is fraught (Ahrens, 1996; Sinclair, 1995; Funnel and Cooper, 1998) and have identified a ‘regulatory disclosure paradox’ (Power, 2008). That literature presents evidence that the more information required of organisations frequently results in less knowledge about them. These presentations of accountability can be enriched by the view shown here that weak conceptions of materiality may make it easier to allow for narratives of impression management to eclipse technical accounting content that should otherwise be guided by conceptions of materiality. However, impression management is an unavoidable part of reporting in any context (unless reports will be made by others not influenced by the unit being reported upon). Impression management influences even auditors since first drafts are produced for them. By using Goffman, we have learned that reports are representations of organisations’ self and their identity; further, it is shown here that weak notions of materiality in the public sector permit managers and central agencies to turn reporting exercises into representations that suits their interests (refer also to Skærbæk, 2005 and Beattie et al. 2008).

Although assurance of performance reports is probably an essential requirement to ensuring provision of materiality, it may not be sufficient. Instead, the analysis here has shown that reporting and central agencies have incentives to avoid materiality as a characteristic of the outputs that will be publicly available. Thus, strong direction will be required to ensure that materiality is valued by both types of agency and is consequently delivered within the performance reports. Although not proven by the cases compared here, *a priori* it would seem that an absence of materiality need not necessarily be always the case in public sector performance reporting. An essential feature of the delivery of materiality in public sector performance reports is a requirement to report outcome data rather than merely relying on a concentration of input and output data. However, the strategic frames of both the central and reporting agencies need to be understood before the result of performance reporting regimes can be analysed effectively. Further, this research confirms Callon’s (1998) point that overflows are inevitable and it is difficult to predict the shape of the overflows. Given this difficulty, it is likely that even with prescriptive definition to concepts of materiality in public sector performance reporting, some other imperfections will emerge during the reporting process in which the strategic imperatives of the reporting and central agencies will overwhelm the interests of the unrepresented public. Whether these imperfections will mean materiality is diminished or some other desirable characteristic of the performance reports is impaired, it is difficult to predict. Nevertheless, the less than perfect experiences of past public sector performance reporting stand as probable indicators that efforts to achieve meaningful and useful performance reporting in the public sector have a long way to proceed. Of importance in those future efforts will be the dual recognitions that some overflows will inevitably impact on the effectiveness of the performance reports that and the communicative nature of those reports will need to be understood before they can be improved. Those two recognitions may point towards future research that will be beneficial if the absence of materiality in performance reporting is to be redressed.

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