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Implementation of Accrual Accounting for Government Departments

MCGUINNESS INSTITUTE

IMPLEMENTATION OF ACCRUAL ACCOUNTING

FOR GOVERNMENT DEPARTMENTS

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TABLE OF CONTENTS

APPENDICES

1 Glossary of Public Sector Accounting Terms

2 Government Administration Committee's 1987 Report of the Inquiry into Departmental Annual Reporting Standards.

3 Statement of Public Sector Accounting Concepts (SPSAC) and Public Sector Accounting Statement - No 1 (PSAS-1)

4 Current Department, Treasury, and Reserve Bank Interface

5 Legal Authority for Government to Spend Money

6 Estimates of Expenditure and Budget Reporting Cycle

7 Types of Budgeting

8 Periodic Financial and Management Reports

9 Proposed Chart of Accounts

10 Accounting Continuum

11 Letter from Maurice Pendlebury, to W McGuinness 17 May 1988

12 Survey of Government Departments FMIS

13 List of Respondents to Survey

14 Ministry of Forestry's Financial Accounts

15 Proposed Accounting Policies

16 Treasury Circular 1986/15 and 1988/4

List of Figures

List of Tables

1.0 INTRODUCTION

At present, there exists across the public sector a potpourri of accounting systems, ranging from cash through to accrual, with many variations in between. This lack of a uniform accounting system for the public service is problematic particularly in terms of providing the Government and taxpayers with a reliable, consistent and valid measure, through standardised consolidated reports of account, of government performance.

The solution seems obvious - a uniform system of accounting is needed for all public sector organisations. Just which system that should be has been the subject of much debate, but in general, opinion seems to favour the accrual basis of accounting.

This report is written under the assumption that accrual accounting will be the system eventually implemented throughout the public sector (see Term of Reference, page 2). However, an examination of the various accounting system options available and the issues surrounding the question of which of these is best suited to public sector needs is given, in order to facilitate discussion prior to a final decision from Government on which system will be implemented.

Some government departments have already made major progress towards implementing accrual accounting. Others, before going ahead with implementation, are awaiting the decision from Treasury and ultimately Cabinet on whether or not accrual will be brought in, while others are not convinced that the benefits of its introduction are worth the costs.

If implementation is to go ahead for all government departments, a critical factor in determining its success will be good communication between departments and Treasury. Excellent guidelines on the system and manner of implementation will need to be prepared for departments. Constant monitoring of implementation by the Financial Management Support Service (FMSS) attached to Treasury will also be necessary to minimise difficulties. During the transition period from existing systems of accounting to accrual, operating and staffing structures will need to change in both Treasury and departments.

Notwithstanding these short-term difficulties, it is the premise of this report that the benefits of introducing accrual accounting will considerably outweigh the disadvantages.

2.0 TERM OF REFERENCE

- To provide Treasury with an action plan for the implementation of accrual accounting in government departments.

3.0 BACKGROUND - THE NECESSITY FOR A REVIEW OF THE PUBLIC SECTOR'S CURRENT SYSTEM OF ACCOUNTING

As a result of Government's proposed reform of the public sector, the funding and reporting process has come under review. The current system and its effects, and suggestions for reform, are outlined in the Treasury paper, "Government Management: Brief to the Incoming Government", Vol. 1, 1987.

The paper's suggestions for reform include:

- An accrual accounting and budgeting system.

- A more effective method of recording short- and long-term cash flows.

- A system whereby managers have meaningful information upon which to set objectives and measure results.

- A system that relates costs to resources (including assets), cost centres and products.

- A system that provides external parties with meaningful financial management information.

From this, it can be deduced that the present system provides neither Government with adequate financial management information, nor public sector managers with sufficient incentives to make the best use of available resources.

These criticisms have been confirmed by the findings of the Government Administration Committee's 1987 "Report of the Inquiry into Departmental Annual Reporting Standards". (A copy of this report is given in Appendix 2 to this report.)

Other criticisms are implied in statements put out in July 1987 by the Society of Accountants - "Statement of public sector Accounting Concepts" (SPSAC) and "Public Sector Accounting Statement No. 1" (PSAS-1). These statements represented an attempt to provide guidelines for the selection and disclosure of accounting policies in the publication of external public sector reports. (Copies of SPSAC and PSAS-1 are attached as Appendix 3.)

Further, it is generally agreed by members of the accountancy profession and management in the public sector that the manner in which accounting information is presently produced does not meet the needs of users.

These critics generally point to accrual accounting as the accounting system which will best meet the problems and issues associated with the present mix of accounting systems within the public sector. The problems and issues which have direct relevance for the implementation of a new method of accounting within the public sector are discussed in the following pages. Those issues that have little relevance are either briefly touched on or not mentioned.

4.0 A NEW METHOD OF ACCOUNTING FOR THE PUBLIC SECTOR - THE ISSUES

This section provides a two-part framework within which the often discussed but complicated issue of the method of accounting best suited to the public sector can be logically presented.

Part One discusses the inappropriateness of the current public sector accounting system. It does not provide an exhaustive list of difficulties. Rather, it highlights the major problems in order to provide background information for readers unfamiliar with them.

In Part Two, an accounting system for the public sector that is appropriate for the needs of users is examined. This examination focuses in particular on the users of government information and their needs, and concludes with a statement of which method, namely accrual, would best suit these needs.

4.1 Part One: The Public Sector's Current Accounting System

The present public sector system is based on the private sector model but contains modifications necessary to handle funding and regulatory constraints. Figure 1 outlines this system and indicates the major differences between the Public and Private sectors, in particular the way in which organisations are financed. Because the public sector is budget-financed, managers and owners look for value for money from goods or services produced as an indicator of success. The private sector, being self-sustaining, has as its measure of success, profitability.

4.1.1 Objectives of the present accounting system

In planning the present public sector accounting system, designers of it appeared to have in mind these four objectives:

1 To make accounting information simple to understand.

2 To allocate cash fairly (as a scarce resource).

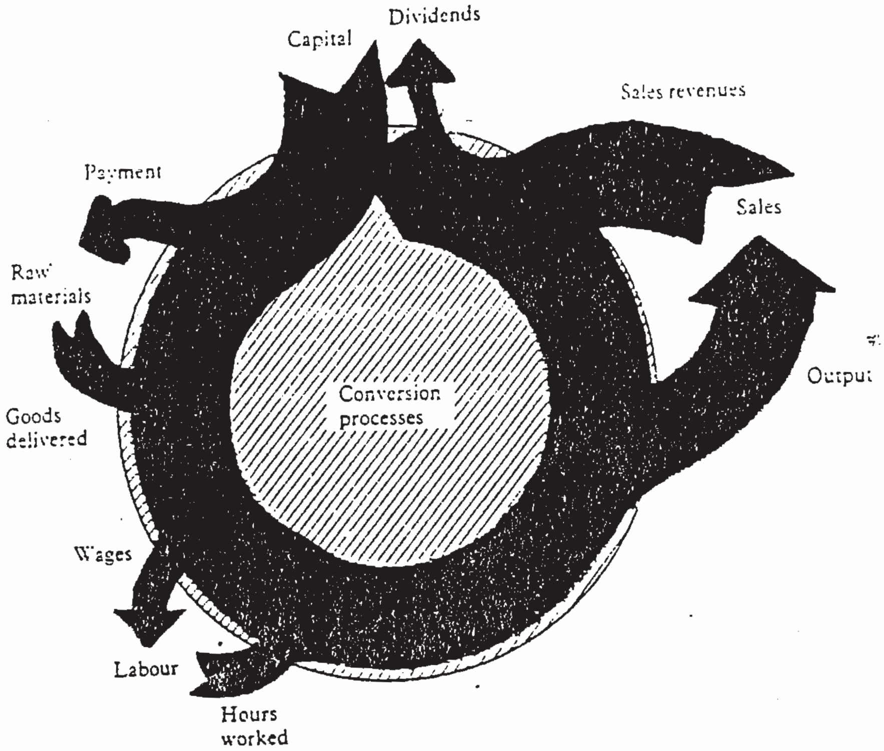
3 To control daily expenditure of public monies.

4 To ensure inexpensive administration of the system.

The accounting system consequently decided on was a centralised cash accounting one, with historical and budget forecasts being represented in cash terms only. As a result, the current system was, and still is, very inexpensive to administer in direct cost terms. Control of public monies is ensured through the centralised control of expenditure. The Treasury and the Audit Office, under the powers set out in the Public Finance Act 1977, have responsibility to Parliament, to ensure daily expenditure is kept within certain limits. This requires the keeping of a computer file of all daily cheques written, to be approved by the Treasury and Audit Office. Refer Appendices 4, 5 and 6 to obtain a more detailed knowledge of the current system.

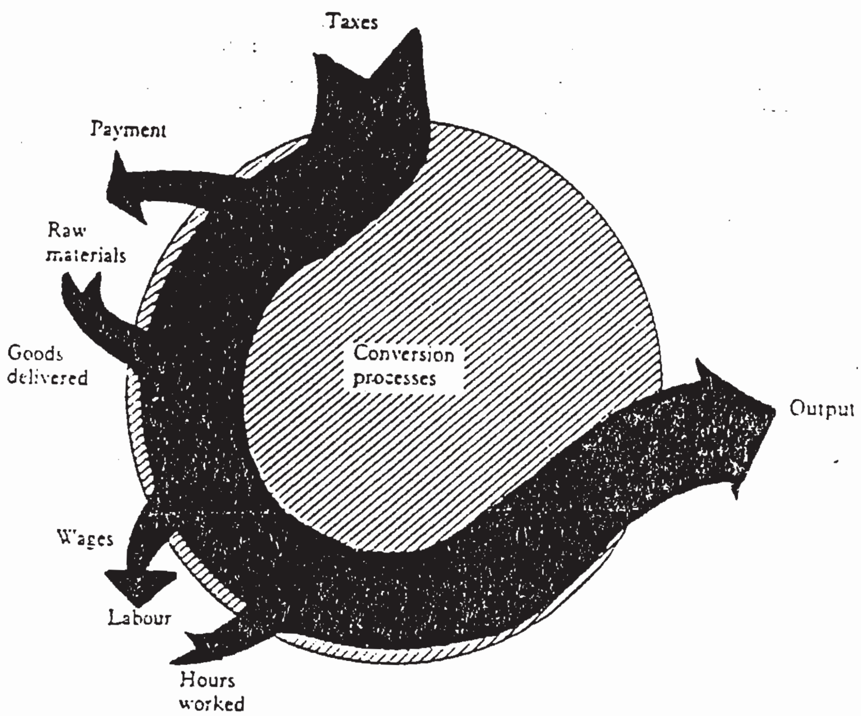
The present system does meet the objectives for which it was designed, however the present system has, over time, been relied upon as a complete Financial Management Information System (FMIS). This reliance has resulted in several problems:

Figure 1: Resource flows in self-sustaining and budget-financed organisations



(a) Self-sustaining organisation

(Private Sector Organisation)



(b) Budget-financed organisation

(Public Sector Organisation)

Excerpt: B. A. Rutherford. Financial Reporting in the Public Sector - (Butterworths) pp(12-13)

- Although extremely cheap in direct terms, the system in indirect terms is expensive to operate. One such indirect cost centres on the poor information supplied by the incremental approach to budgeting. Without good information on which to make decisions, management's chances of making bad decisions or failing to discover serious problems increase substantially. (It is not at all easy to estimate the indirect cost of poor information, but the degree to which accrual accounting is supported indicates that the perceived actual cost is high.)

- The related argument that the present system is simple and easy to understand is valid, but in terms of ease of interpretation, is it not better for users to be able to obtain from the accounts a full picture of the efficiency of an organisation's operations and management rather than an outline sketch?

- Because inter-departmental transactions are not excluded from the Consolidated Account, double counting is common practice.

- A method for funding reserves for capital purchases is not available.

- As there is no cost of capital, there is no incentive to manage funds.

4.1.2 Objectives of the proposed accounting system

Discussions associated with the review of the present system have pointed to the following objectives for a new accounting system (one paper of particular relevance is the Government Administration Committee's 1987 Report, a copy of which is given as Appendix 2):

1 To improve decision-making; in particular, to enhance performance evaluation.

2 To allocate scarce resources (land, assets, labour, staff, top management expertise) to the most productive sectors of an organisation.

3 To control expenditure of public monies.

4 To provide information in a cost-effective manner.

5 To minimise the financial costs of managing cash flow.

The proposed accounting system's set of objectives is much wider than that of the current system, specifically, it calls for the provision of information on all scarce resources; cost-effectiveness; the benefits of providing information to exceed the cost of obtaining it; and a strong change in emphasis from information being easy to understand to information that gives a true picture of an organisation's modus operandi.

4.2 Part Two: The Accounting Problem

Having identified likely objectives of the accounting system, the next step is to make sure that the accounting information supplied does match needs. The difficulty of ensuring a good match can be referred to as the Accounting Problem.

An approach whereby the quality of the match can be determined is that of any standard marketing approach, in which the market for a product is first identified and confirmed before the product is manufactured. Having identified the market (for accounting: users of financial information), the correct raw material for manufacture of the product (for accounting: the source information) must be entered into the production process, and then processed correctly (accounting: through a good bookkeeping method) to produce the required product (accounting: reports containing information about the organisation). This approach is illustrated in Figure 2.

Figure 2: The accounting process

Standard Marketing/Production Approach =

INPUT ....>	PRODUCTION ....>	OUTPUT ......>	TO MEET NEEDS OF MARKET

The Accounting Process =

INPUT ....>	PROCESSING ....>	OUTPUT ......>	TO MEET USER NEEDS
Source ....> Data	Bookkeeping Process - Quality - Quantity (See 4.2.3)	Report - Timing - Format (See 4.2.2)	Needs Defined - Regulatory Constraints - Funding Constraints (See 4.2.1)

This approach to the accounting problem, as well as the issues which are raised by it, are followed in the next three subsections of this report: the information - users and their needs - are looked at in 4.2.1; the compilation and presentation of reports - in 4.2.2; and the content of accounting information resulting from the input and production process - in 4.2.3.

Note: It is important that any constraints on the system be kept in mind. The most obvious ones are the method of regulating expenditure of public monies and the method of funding government departments. These constraints are discussed below.

4.2.1 Information users and their needs

"...the overall standard of departmental [account] reporting is inadequate for the purpose of government accountability to Parliament and the Public." This statement from the report of the Government Administration Committee (see Appendix 2), chaired by Fran Wilde, highlights the necessity of producing reports of account that provide information needed by users.

To determine just what information is needed, both the users of the reports and how they use them must be identified. To date, the traditional process by which this has been done (a process which has been used internationally) has been first to identify specific user groups and then to ascertain their needs by simply asking them what their needs are.

This process has two problems. For one thing, user groups are subjectively identified, which means that some groups which should be included in any examination of user needs are not. For another, asking users what their needs are tends to produce responses which emphasise improvements to existing systems rather than fundamental changes.

In order to identify users and their needs correctly, a process which employs expert qualitative research would seem necessary, even though it is costly and time-consuming.

The outcomes of such a process are outlined in a report prepared for the Financial Accounting Standards Board titled "Financial Accounting in Non-Business Organisations", and written by R N Anthony. Anthony suggests four fundamental types of information required by users in non-business organisations:

1 Financial viability (the ability of the organisation to continue operating in its present form).

2 Fiscal compliance (the extent of the organisation's adherence to funding requirements).

3 Management performance (the ability of management to spend money wisely).

4 Cost of products and services provided by the organisation.

Government will need to decide if it is willing to accept information on users and their needs as provided by the traditional approach cited above or whether it wishes to carry out in-depth, qualitative research along Anthony's lines. However, for the time being, this report assumes that given time and cost constraints, the information will be provided by the traditional approach.

4.2.1.2 Users

An example of this approach can be seen in the 1981 research report by Drebin et al (USA) titled "Objectives of Accounting and Financial Reporting for Governmental Units". The authors identified ten user groups: taxpayers, grantors, investors, fee-paying service recipients, employees, vendors/suppliers, legislative bodies, management, voters, and overseeing bodies.

4.2.1.3 Information characteristics

Experience from this and other research indicates that accounting information provided to users must be:

- Relevant (able to satisfy user needs).
- Objective (any accountant can produce the same accounts from the same data).
- Consistent (current financial reports can be readily compared with those of previous years).
- Comparable (one organisation's report can be compared with that of another's).
- Timely (the report can be produced quickly and efficiently).
- Easy to prepare.
- Economical to prepare (the cost of producing and analysing the information should not outweigh the benefits of having the information to hand).

- Accurate (information can be relied upon to be materially correct).

- Able to control cash expenditure (the spending of public monies can be accounted for by taxpayers).

These characteristics, then, would seem to be those needed in a new accounting system (ie the new public sector FMIS). These characteristics, however, can create problems in that they can be interpreted subjectively. For example, to take the characteristic of "objective", some users would think that the level of objectivity would increase as an organisation moved from a cash-based accounting system to an accrual one, while others would strongly believe the opposite. Also, a comparison of two or more characteristics can highlight a lack of compatibility amongst them. For instance, the need for accurate information is not always compatible with the need for economical data presentation.

Issues such as these need to be resolved, with discussion and consensus on what is meant by each characteristic being necessary before specific guidelines on the implementation of a chosen accounting system is drawn up.

4.2.1.4 Information types and constraints

Once the characteristics of the required information have been satisfactorily defined, an examination of the types or kinds of information traditionally supplied to users is needed. These types are:

(1) Actual (a record of historical information).

(2) Budgetary (an estimate of future information in organisational terms).

(3) Cash Flow (an estimate of future information in cash terms).

In the private sector, external users receive historical information only. From this, they make decisions on management's ability to manage resources successfully. An exception to this general rule is the bank manager who usually requests a cash flow chart and sometimes a budget in accrual accounting terms, especially if he or she intends to provide funds. Internal users (ie management) rely on a statement of the variance between budget and historical results (known as the actual) as an indicator of performance. Here, if management performance is to be accurately judged, the budget and the actual must be based on the same accounting method.

In the public sector, both historical and estimated cash flow information must be reported to the external user, who uses this material to make decisions on management skill and cash requirements. Internal management relies on the variance between historical and estimated cash flow reports to indicate day-to-day performance.

The major difference between the two sectors, and hence the difference in the quality of decision-making, is that the private sector uses accrual accounting, and therefore the above three types of information (1) (2) (3), while the public sector uses cash accounting and consequently only actual (1) and cash flow information (3). Thus, the budget in the public sector is relegated to being no more than an estimate of future cash flow needs.

Cash flow information and cash flow management have become increasingly important in our recent economically unstable times. In an unstable financial environment, cash is a critical asset. It is the lifeblood of any organisation. Too little cash (ie poor liquidity) increases the risk of collapse. In more stable times, and/or times of high inflation, cash management and the Treasury function become important sources of profit or cost reduction. Therefore, cash, in both the public and private sectors will always need to be well managed.

A cash flow estimate, then, must be an integral part of whatever accounting system - whether accrual or not - is eventually implemented in the public sector. Also, any change to the method of accounting for historical data must be followed by a change to the way in which budgetary data is prepared. Government departments which have moved away from preparing historical data, in other than cash terms, will now need to prepare budgets along the same lines. If they do not, management will be unable to judge day-to-day performance.

For the purposes of this report, it is assumed that budgets are not an issue in themselves. Once a method of recording historical data has been determined, it will be used as the basis of budget preparation for future periods.

The new accounting system must provide control over funds so as to ensure public money is spent both with the authority of the chosen government and on behalf of and for the benefit of New Zealand citizens.

This proviso brings to attention two constraints of the public sector FMIS. They are:

i regulation and control over funds spent, and

ii the supply of funds through the funding process.

4.2.1.4.1 Regulatory constraints

At the present time, the Public Finance Act 1977 outlines the account reporting function of government departments. Under Section 97 of the Act, the Minister of Finance can delegate to Treasury authority to manage departments' financial and management accounting requirements. The Public Finance Act has the same role (but different functions) in the public sector as the Companies Act 1955 and Partnership Act 1908 have in the private sector.

The Public Finance Act is very specific in identifying Treasury and the Audit Office as responsible for monitoring cash flow - in particular, for determining that cash expenditure stays within the Vote. This has meant that historical data must remain in cash form, and that cash transactions be totalled daily to ensure departments stay within Vote levels.

Consequently, if a new accounting system is to be implemented in the public sector, it will be necessary for the legal controls over government departments to be stipulated in a new or updated Public Finance Act. Doing this would be one of the most lengthy tasks of developing the new system.

A related issue is the reliability of information provided. For example, how should the reports be audited and who should complete the audit? It would be expected that the reports be audited annually, but what of reports that are produced more frequently for decision-making purposes?

A final related issue is responsibility for setting the accounting policies. Is this the role of Treasury or should it be left to the departments concerned? If the departments' accounts are to be consolidated, then standard accounting policies must be adhered to by all departments.

In short, to facilitate the development of the public sector FMIS, a satisfactory method of regulating government spending must be developed.

4.2.1.4.2 Funding constraints

The means by which government departments are funded give rise to certain constraints that will have a major impact on the development of a new accounting system.

Government departments can obtain funds in three ways - from borrowing; from central government through taxation; and by charging users of services. The method of obtaining funds for any one department is dependent upon the economic, political and social nature of its goods and services.

Present government policy is to minimise funding through taxation and borrowing. Government departments therefore have the choice of either rationalising products and services or directly charging users.

It is well recognised that "user pays" places large demands on an organisation's FMIS. In particular, product costs must be determined, so that pricing and general management decisions can be made. It also becomes necessary to measure performance to ensure that resources are used efficiently and effectively. The mere threat of user pays in the United Kingdom has acted as an incentive for public sector managers to improve their FMIS and consequently make better decisions. For most organisations, this has meant a change from cash accounting towards accrual accounting.

In New Zealand's government departments, the budgeting process has in reality been the funding and spending process. (The funding issue is beyond the brief of this report and has been reviewed elsewhere.) It is unfortunate that the funding process has used the terms Vote and Budget as one and the same, as in reality they have two distinct functions. These functions are:

1 To act as a mechanism for transferring funds to departments (Funding Function) = VOTE.

2 To act a a method of controlling department's activities (Management Function) = BUDGET.

Once the annual Budget has been approved by the Minister of Finance, it becomes the Vote of each department and is fixed for the year. Because the budgeting process is controlled by Treasury, departments are given little freedom to use budgets as a management planning tool.

As a result, the management function of budgets in the public sector has not been given due emphasis. The budgeting process is consequently strongly incremental in approach: it adjusts last year's actuals rather than relating the budget figures to the strategic planning process. Although the process is meant to operate along the lines of the programmed budgeting approach, in practice it rarely does. (Refer to Appendix 7 for a discussion of the major budgeting types.)

Finally, the mechanism of transferring funds to government departments is a constraint on the public sector FMIS, not a determinant of it.

4.2.2 Compilation and presentation of reports

All government departments' annual reports must follow standard accounting policies for the convenience of users, even though it is most unlikely that users would want to compare one department's results with another's. If such a comparison were required, the user would need to take heed of the notes to the accounts, as well as the resources available to the departments and their operating environments. Comparative analyses can prove dangerous if due care is not taken.

The compilation and presentation of accounting reports draws on several issues, specifically those related to timing (when and how often reports should be presented); format, consolidation and content. These are discussed below. (The current periodic reports provided to users are indicated in Appendix 8.)

4.2.2.2 Timing

Key questions regarding this issue are:

1 What frequency of reporting is necessary? (Monthly? Quarterly? Yearly?)

2 Should all reporting organisations report at the end of the financial year?

3 Is the present financial year-end date appropriate? Should it be changed? (The financial year-end reporting date has recently been changed from 31 March to 30 June.)

At present, the Minister of Finance receives from government departments monthly summarised statements of their cash transactions. Following the end of the financial year, a consolidated report of departments' accounts for the year are made public.

4.2.2.3 Format

The presentation (layout, design, language used, etc.) of the reports of government accounts has improved greatly in the past few years, with good reporting being indicated by how easily information can be interpreted and analysed. However, there still remain several concerns, as evidenced by these types of questions:

- Should the report include only the total figures for any one department or should the figures be broken up into subgroups of activity or products? If the latter, who determines the subgroups?

- What other reports should be attached? (A report by the controlling officer of the department or its Minister perhaps?)

- How much public relations material is acceptable? Should departments have a free reign in determining this?

- How should the data be reported?

In regard to the last question, there are three theories as to how this should be done.

1 The Proprietary Theory
Assets - Liabilities = Shareholders' Equity

2 Equity Theory
Assets = Liabilities

3 Fund Theory
(Each funding entity is a fund or series of funds)
Cash Payments less Cash Receipts.

The equity theory is most appropriate to government departments, as it indicates what each department owns and what it owes. What it owes can then be broken up into what is owed to the Crown and what is owed to creditors.

4.2.2.4 Consolidation

The guiding principle for consolidating financial accounts is to ensure that the resulting report gives a true and fair view of the state of affairs of all departments as a whole. When combining financial information from several or all government departments, it is necessary to eliminate those items which represent intergroup balances and intergroup transactions, the most notable of these being:

- Inter-departmental sales
- Inter-departmental profits
- Inter-departmental expenses.

In very general terms, consolidation is the process of adding together the balances of all government department accounts and making adjustments to provide a true and fair view of groups of departments. One of the criticisms of the present accounting system, referred to in Section 4.1.1, is the lack of adjustments. Inter-departmental transactions are not identified separately by departments and, consequently, are not eliminated from the Public Account.

Consolidating public sector accounts raises three questions: Which accounting data should be consolidated? Who will do the consolidation? How should the consolidation be done?

4.2.2.4.1 Question One: Which accounting data should be consolidated?

To provide an answer to this question is beyond the term of reference of this report. It can, however, be said at this point, that government departments will need to be reported on as a group to indicate the management ability of different governments over time.

4.2.2.4.2 Question Two: Who will do the consolidation?

While this task would appear to be part of Treasury's role, it could be contracted out to Government Computing Services or other bureaus, or even tendered for by chartered accounting firms.

A new system of this type would result in the demise of the present Treasury Instruction Manual, the end of SIGMA, and changes to the present staffing and accounting structures within Treasury and government departments. However, some form of standard accounting rules or procedures will be necessary. The Public Sector Accounting Standards (PSAS) could provide this, leaving Treasury to create standard accounting policies for consolidating departmental accounting information. These could be called "Consolidated Accounting Policies".

4.2.2.4.3 Question Three: How will the consolidation be done?

It is envisaged that approximately 35 separate charts of account (ie codes) would be consolidated, but this number would need to be finalised before government departments could define their codes of account. Changes to the chart of accounts for established systems can be difficult. (A first draft of the possible chart of accounts is attached in Appendix 9; see 6.6 for a more detailed solution.)

4.2.3 Content

The issues surrounding the content of reports are a reflection of the type of accounting information users need before they can make reasoned decisions. For example, one user might require information on assets, products, activities and divisions, while another might want information on responsibility areas and statistical information on units sold. The user needs must be specified, as discussed in section 4.2.1.

The major problem with the present content of accounting information in the public sector is that it provides detailed information for only one scarce resource - cash funds. Little information on other resources such as fixed assets, labour and management skills is available, necessitating a new accounting system which offers decision-makers information on all resources.

It is for this reason that accrual accounting has been suggested as a solution. Accrual accounting does not just record what has happened in cash terms from one year to the next, but records the benefit brought forward from previous years, thus indicating the ability of management to handle resources satisfactorily.

5.0 IS ACCRUAL THE ANSWER FOR THE PUBLIC SECTOR? AN EXAMINATION OF THE MAJOR METHODS OF ACCOUNTING

Discussion in Section Four of the issues surrounding the question of implementing a new method of accounting within the public sector indicates that a new method is necessary and assumes that this method should be the accrual basis of accounting.

While accrual accounting is the option advocated, it and three other theoretical options for an accounting system - cash, modified accrual, and commitment - are presented here, in Section Five, so as to provide readers with the information necessary to discuss this topic.

For the purposes of this report, comparative estimated financial accounts have been prepared, with the assistance of the Department of Social Welfare, to provide readers with a practical example of each option. The only difference between the resulting financial reports is the method of accounting. Refer to the glossary of public sector accounting terms in Appendix 1 as necessary.

The four options can in fact be seen as a continuum, with many different combinations (see Appendix 10). They can be distinguished from one another by the point in time at which expenditures and revenues are recognised in the books of account or, in other words, the point at which a given transaction generates a bookkeeping entry.

5.1 OPTION ONE : Cash Accounting

5.1.1 Definition

The cash basis of accounting records on the books revenue and expense items when they are received and paid, without regard to the period to which they apply.

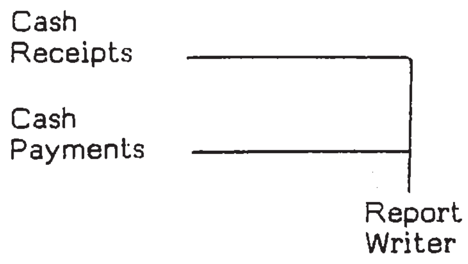
5.1.2 Characteristics

The operating statement is little more than a summarised cash book, and the cash balance available for the organisation to spend equals the fund balance. For the public sector, the bank account is kept by the Reserve Bank: consequently, a government department's fund balance is always nil (except for imprest accounts). Because of this, government departments do not usually report balance sheets.

5.1.3 Systems framework

A cash accounting system requires information to be collected only on cash transactions. As such, a record must be kept of all cash payments and cash receipts to enable useful data to be reported to users of information. The system framework is identical to the current Treasury SIGMA system. The standard cash accounting system, whether manual or computerised, has as its main files those illustrated in Figure 3.

Figure 3: Cash accounting framework



5.1.4 Example of a report

Financial Accounts for the Department of Social Welfare
Receipts and Payments Account (for the period 1 April 1987-31 March 1988)

CASH RECEIPTS	($000)
Programme I	485
Programme II	46,657
Programme III	1,209
Programme IV	-
Programme V	-
Government Funding	7,142,714
Total Cash Receipts	7,191,065
CASH PAYMENTS	
Personnel	
Programme I	141,333
Programme II	55,383
Operating Costs	
Programme I	64,885
Programme III	15,122
Capital	
Programme I	36,322
Programme III	3,225
Transfers	
Programme I	22,051
Programme III	7,943
Grants	
Programme II	2,615,302
Programme III	125,563
Programme IV	114,497
Programme V	3,986,544

Advances and Loans	
Programme II	2,884
Programme IV	11
	7,191,065
SURPLUS OF RECEIPTS OVER PAYMENTS (DEFICIT)	NIL

Balance Sheet

as at 31 March 1988

Assets

Cash	NIL
Total Assets	NIL
Liabilities	
Bank Overdraft	NIL
NET ASSETS	NIL
Represented by:	
Fund Balance	NIL
	NIL

NB These figures are approximates, and were prepared expressly for this report.

5.1.5 Strengths and weaknesses of cash accounting

STRENGTHS

- Is simple to understand and operate.
- Transactions are not subjective: either they are cash or they are not transactions.
- Is cheap to operate in terms of administration and accounting expertise.
- Emphasises cash flows, and so is suited to organisations which have to surrender unspent cash at the end of a reporting period.

- Is easier to audit than information produced by other accounting methods. In particular, it is simpler to ascertain that a transaction is a cash transaction, rather than to prove it is true and fair.

- Indicates cash movements - a prerequisite for good cash management.

WEAKNESSES

- Accounts can be manipulated by spending future monies or postponing past expenditure to the following year.

- With no accounting for capital, assets or liabilities, there is no measure of organisational worth. No information about the flow of real resources into and out of the organisation is provided. If balance sheets are disclosed, no indication is given of the physical or other non-monetary resources available to the organisation. There is no method for reserving funds for capital purchases.

- Product costs are not easily determined.

- Management performance is difficult to measure, other than by overs and unders to budget.

- Profitability is very poorly measured.

- Incentives to manage cash in government departments is lacking because there is no cost of capital (creditors are paid on receipt of invoice).

- Resources obtained by an organisation and which are not paid for in cash do not feature in the financial accounts (eg donations to the Turnbull Library).

- Information is not available on debts owed or owing: government departments are dependent on their creditors to provide timely invoices; however, large "not-allowed-for" invoices often arrive after year-end.

- Inter-departmental transactions are not easily accounted for.

- With the accounting method being based on historical costs only, there is no way of accounting for current costs or market values.

5.2 OPTION TWO : Modified Accrual Accounting

Also called Liquidity Accounting

5.2.1 Definition

The modified accrual basis of accounting reports current assets (except stock), current liabilities, and provides operating statements containing "financial flow" information (ie revenues and expenditure), but not information on other resource flows (eg fixed assets).

5.2.2 Characteristics

Under this option, the cash flows of cash accounting are modified to take account of amounts owed by and to the organisation. Usually, these are collected in a Debtors Ledger (also called Accounts Receivable Ledger) or a Creditors Ledger (also called Accounts Payable Ledger).

In practice, these figures may be estimated at the end of a period (eg annual or the quarter) and recorded by journal entry as a non-cash adjustment. If the estimation is relatively accurate, it is acceptable for reporting purposes. Several methods of preparing a modified accrual accounting basis are available. For example, the method by which both debtors and creditors are estimated is called the Converted Receipts and Payments Method. This provides a variety of combinations of modified accrual accounting - for example, cash plus converted methods (eg, Receipts and Converted Payments) or converted plus ledger methods (eg, Debtors and Converted Payments) or cash plus ledger methods (eg, Receipts and Creditors).

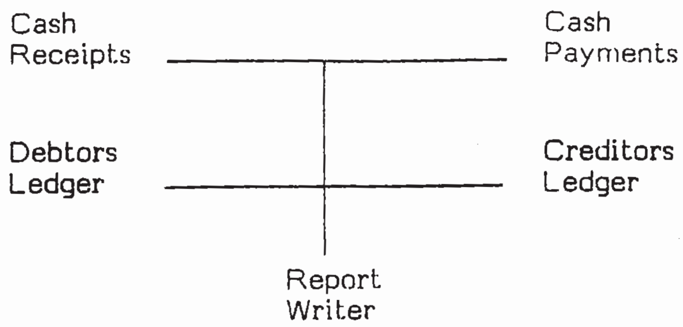
The financial report of an organisation does not necessarily indicate which method is used. Also, any organisation that does produce information on the converted basis does not hold the day-to-day history of debtors and creditors needed for good cash management. This lack of historical information is a problem for government departments because the time needed to follow up a query manually tends to be excessive. It is, therefore, not surprising that debtors and/or creditors systems are among the first to be addressed during accounting system reforms.

Lastly, modified accrual accounts and cash accounts can provide very similar information, provided the books of accounts are kept open long enough for all related creditors, and debtors, transactions to be passed in cash. Although this is not a timely option, most government departments pay creditors in half the time it takes the private sector to do so, and trade creditors can therefore be of minimal value. However, as the public sector is very labour intensive, the effect of accruing salaries and benefits (especially for the Department of Social Welfare) can be substantial.

5.2.3 Systems framework

Modified accrual accounting requires that, as in the cash accounting system, cash transactions be recorded. But unlike cash accounting, this system allows some non-cash adjustments to be added to reports, specifically those relating to debtors and creditors - the next liquid assets after cash. If the adjustments are made from collecting information on debtors and creditors as they occur in a ledger, the system will be constructed as outlined in Figure 4. If the adjustments are estimated (ie, converted), this information is estimated only at the end of the period and added to the report as late non-cash adjustments.

Figure 4: Modified accrual accounting framework



5.2.4 Example of report format

Financial Accounts for the Department of Social Welfare

Income and Expenditure Account (for the period 1 April 1987-31 March 1988)

INCOME		($000)
Programme I	- Mainly rents	485
Programme II	- Maintenance for Period	6,000
	- Liable Parent Contributions	47,617
Programme III	- General Expenses	295
Interest Received on Loans		
- Loans	: Repairs to Houses	60
	: Family Benefit Advance	
Government Funding		
- Agency Operations/Funding of Benefits		
- Cash		6,841,906
- Accrual		293,088
- Funding of Services Provided		
- Cash		276,723
- Accrual		7,783
Total Income for Period		7,473,957
EXPENDITURE		
Personnel		
Programmes I + III		196,716
+ Accruals		3,783
Operating Costs		
Programmes I + III		80,007
+ Accruals		4,000

Agency Operations

Widows Cash Paid Out	104,170	
Plus Accruals (104170*1/24)	4,340	108,510
Invalids Cash Paid Out	195,028	
Plus Accruals (195028*1/24)	8,126	203,154
Sickness Cash Paid Out	159,850	
Plus Accruals(159850*1/52)	3,074	162,924
Unemployment Cash Paid Out	672,694	
Plus Accruals (672694*1/52)	12,936	685,630
Domestic Purposes Cash Paid Out	808,787	
Plus Accruals (808787*1/24)	33,699	842,486
Family Benefit Expenditure		
Paid Out in Cash to Recipients	269,818	
Expenditure to Reduce Home Loans	13,500	
Expenditure to Reduce Other Loans	7,238	290,556
Plus Accruals (290556*1/12*.5)		24,213
(290556*1/24*.5)		12,106
Tax on Income Tested Benefits		
Cash Paid Out	341,857	
Plus Accruals (341857*1/12)	28,488	370,345
National Superannuation		
Cash Paid Out	3,986,544	
Plus Accruals (3986544*1/24)	166,106	4,152,650
Other Grants - Cash	302,158	
- Accruals	1,000	303,158
Other Non-Cash Transactions		
- Bad Debts Written Off		
Maintenance Orders		100
Liable Parent Contributions		600
- Provision for Bad Debts		
Maintenance Orders		100
Liable Parent Contributions		600
Total Expenditure		7,441,638
Profit/(Loss)		32,319

Balance Sheet

as at 31 March 1988

Cash	NIL
Debtors/Accounts Receivable	
Opening Bal. + Period Exp. -Cash Paid -Bad Debts = Closing Bal. - Maintenance Order	
21,600 + 6,000 - 2,953	= 24,647
- Liable Parent Contributions	
125,770 + 47,169 - 38,939	= 134,000
- Loan - Short-Term	
(163,638 + 1,650 - 25,562)	= 139,726
Total Assets	298,373
Less Liabilities	
- Creditors/Accounts Payable	266,054
NET ASSETS	32,319
Represented by:	
Profit/(Loss)	32,319
	32,319

Maintenance Trust Account

Cash Receipts	9,047
Cash Payments	9,047
	Nil

N.B. These figures are approximates, and were prepared expressly for this report.

N.B. The Maintenance Trust Account is money that the Department holds in Trust for external parties. Consequently, it should be reported separately as shown above, rather than hidden as in 5.1.4.

5.2.5 Strengths and weaknesses of modified accrual accounting

STRENGTHS

- Is relatively simple to understand, especially when compared to other non-cash methods.

- Gives a better picture of an organisation's operations than does the cash accounting method.

- The stewardship of monetary working capital is superior to that of the cash accounting method.

WEAKNESSES

- The usage of inputs and generation of outputs are not captured.

- Information can be manipulated by buying or selling fixed assets. Because these transactions are shown in the income and expenditure statement, a record of them is not recorded in future financial accounts.

5.3 OPTION THREE : Accrual Accounting

5.3.1 Definition

Accrual accounting is a system in which the cost of resources consumed in the production of goods or services is matched with the revenues or services generated.

Accrual accounting is also called "Period Accounting" because it matches revenue against expenditure for a specific period of time.

5.3.2 Characteristics

The Income and Expenditure Account indicates the net increase/decrease in resources available to the organisation from the past operating year. Revenues are included in operating statements as soon as the organisation can make a reasonably reliable estimation of the amount it will receive. Expenditure is recorded in the period incurred. Grants are recognised when the organisation is entitled to receive them.

The Balance Sheet incorporates both the monetary and physical assets of the organisation.

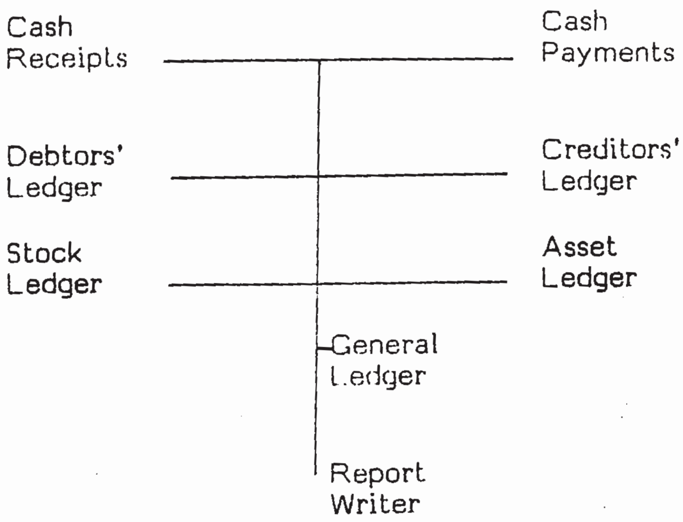
The Ministry of Forestry's 1988 accrual financial accounts are attached in Appendix 14 to indicate the format and policies accepted by the Audit Office.

5.3.3 Systems framework

In addition to recording cash information, the accrual accounting system includes an asset register (sometimes called Asset Ledger), a record of stock (called the Stock Ledger) and a general ledger into which is collected the summary balances of all other ledgers. (See Figure 5.)

The general ledger's large database of financial information, if on computer, can be adjusted by journal entries and manipulated by report writer software, to produce the financial and management reports needed by users. When all information is collected on computer, the system follows the model outlined in Figure 5.

Figure 5: Accrual accounting framework



5.3.4 Example of full accrual accounting reports

Financial Accounts for the Department of Social Welfare

Income and Expenditure Account (for the period 1 April 1987-31 March 1988)

			($000)
INCOME			
Programme I	- Mainly Rents		485
Programme II	- Maintenance for Period		6,000
	- Liable Parent Contributions		47,617
Programme III	- General Expenses		295
Interest Received on Loans			
- Loans	: Repairs to Houses		60
	: Family Benefit Advance		
Government Funding			
- Agency Operations/Funding of Benefits			
- Cash			6,841,906
- Accrual			293,088
- Funding of Services Provided			
- Cash		271,723	
- Accrual		7,783	
(Exclude Cash from Sale of Assets 5000)			279,506
Total Income for Period			7,468,957

EXPENDITURE

<u>Personnel</u>		
Programmes I + III		196,716
+ Accruals		3,783
<u>Operating Costs</u>		
Programmes I + III	80,007	
+ Accruals	4,000	
(Exclude Purchases of Assets)	-60000	24,007
<u>Agency Operations</u>		
Widows Cash Paid Out	104,170	
Plus Accruals (104170*1/24)	4,340	108,510
Invalids Cash Paid Out	195028	
Plus Accruals (195028*1/24)	8,126	203,154
Sickness Cash Paid Out	159,850	
Plus Accruals(159850*1/52)	3,074	162,924
Unemployment Cash Paid Out	672,694	
Plus Accruals (672694*1/52)	12,936	685,630
Domestic Purposes Cash Paid Out	808,787	
Plus Accruals (808787*1/24)	33,699	842,486
Family Benefit Expenditure		
Paid Out in Cash to Recipients	269,818	
Expenditure to Reduce Home Loans	13500	
Expenditure to Reduce Other Loans	7238	290556
Plus Accruals (290556*1/12*.5)		24,213
(290556*1/24*.5)		12,106
Tax on Income-tested Benefits		
Cash Paid Out	341,857	
Plus Accruals (341857*1/12)	28,488	370,345
National Superannuation		
Cash Paid Out	3,986,544	
Plus Accruals (3986544*1/24)	166,106	4,152,650
Other Grants - Cash	302158	
- Accruals	1000	303158

Other Non-Cash Transactions

-	Bad Debts Written Off	
	Maintenance Orders	100
	Liable Parent Contributions	600
-	Provision for Bad Debts	
	Maintenance Order	100
	Liable Parent Contributions	600
-	Provision for Depreciation	36,000
	Total Expenditure	7,417,638
	Profit/(Loss)	51,319

Balance Sheet
as at 31 March 1988

CURRENT ASSETS
Cash NIL

Debtors/Accounts Receivable

Opening Bal. +Period Exp. -Cash Paid -Bad Debts = Closing Bal. - Maintenance Order

21,600 + 6,000 - 2,953 = 24,647

- Liable Parent Contributions
  125,770 + 47,169 - 38,939 = 134,000
- Loan - Short-term
  (163,638 + 1,650 - 25,562) = 139,726

FIXED ASSETS

Loans
Opening Bal. +New Loans -Repayments -Write-offs = Closing Balance

- Repairs to Houses
  10,000 + 1,500 - 562 = 10,938
- Family Benefit Advances
  87,000 + Nil - 4,143 (cash)
  - 13,500 (FB Home)
  - 7,238 (FB other) = 62,119
- Disabled Persons
  2000 + 150 - 119 (cash) = 2,031

Land 16,500

Buildings 42,500 + 17,113 55,000

Plant + Equipment 250,000

Motor Vehicles	18,484
Fixtures and Fittings	34,790
Total Assets	748,235
Less Liabilities	
- Creditors/Accounts Payable	266,054
NET ASSETS	482,181
Represented by:	
Revenue Reserve Brought Forward	370,862
Profit/(Loss)	51,319
Asset Revaluation Reserve	60,000
	482,181

<u>Maintenance Trust Account</u>

Cash Receipts	9,047
Cash Payments	9,047
	Nil

N.B. These figures are approximates, and were prepared expressly for this report.

5.3.5 Strengths and weaknesses of accrual accounting

STRENGTHS

- Records all expenses, both cash and non-cash (eg depreciation) for a specific period of time.
- Records all revenue, both cash and non-cash (eg debtors sales) for a specific period of time.
- Records information on an organisation's wealth, enabling management and owners to make better decisions on resource allocation and management (eg asset management).
- Provides information on inter-generational debt burden (ie debt burden on future generations).
- Is quicker to prepare than the cash method, because after the close-off date, transactions can be estimated.
- Is easier to obtain accurate cost information on products and services, as costs have been matched with revenues.

- Prevents manipulation of accounting information, as all invoices received after year-end but relating to the reporting period are recorded in the financial accounts.

WEAKNESSES

- Is prone to subjectivity through estimation of debtors, creditors, depreciation rates, stock values, and provision of doubtful/bad debts.

- Is expensive in terms of the necessary hardware, software and expertise of staff, as well as of auditors having to review accounts for a true and fair view, rather than to check that cash transactions are recorded correctly.

- Can be difficult for lay staff to interpret the financial accounts, necessitating a more detailed and in-depth analysis of information by expert staff, and the requirement that public sector managers become as adept as their private sector counterparts in accurately interpreting financial accounts.

5.4 OPTION FOUR : Commitment Accounting

5.4.1 Definition

This option involves accounting for anticipated expenditure, which is detailed in a contract or purchase order given by the organisation to an outsider.

It is not usual practice in the private sector to account for commitments, since the signing of a contract or the issuance of a purchase order does not necessarily give rise to a legal obligation to pay.

5.4.2 Characteristics

The Income and Expenditure Account indicates the amount of funds available for completely new expenditure. When resources are received, the outlay is charged directly to the commitments reserve and therefore does not appear in the operating statement. Since commitments have not yet been crystallised as liabilities, they are usually shown in the balance sheet as a reserve rather than as an accounts payable. This process takes place by the finance director "putting-through" a journal entry -

Debiting : Expenditure
Crediting : Commitment Reserve

and then reversing it out of the commitment reserve when the debt becomes payable-

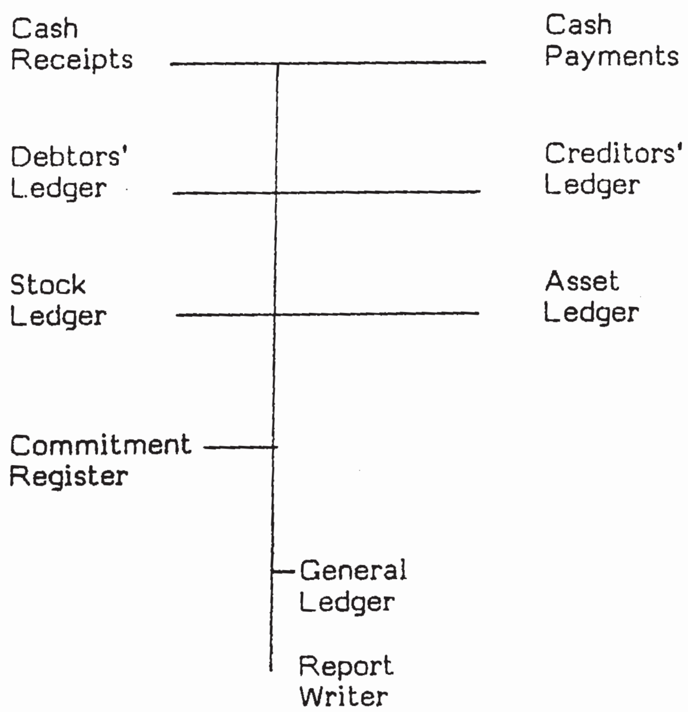
Debiting : Commitment Reserve
Crediting : Accounts Payable/Creditors or Cash.

The public sector Treasury Instructions B13 require that commitments be recorded as a safeguard against allocations being exceeded. Entering into a commitment should never be taken lightly because once an appropriation is granted for a particular purpose, further expenditure is not possible until a fresh appropriation has been granted. Organisations which disregard this aspect of their transactions can find themselves in the position of having more obligations than they can lawfully meet.

5.4.3 Systems framework

In a fully integrated commitment accounting system, a commitment register is added to the accrual systems framework, with the necessary journal entries taking place in the general ledger. This framework is shown in Figure 6.

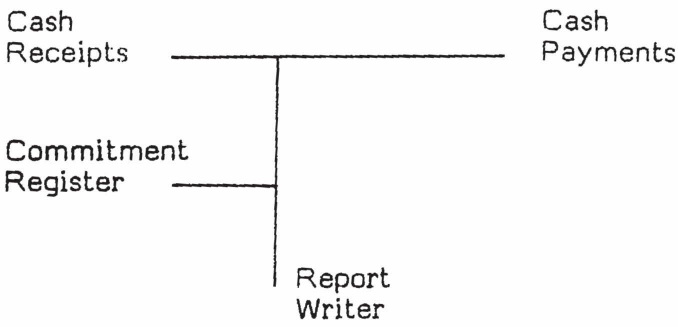
Figure 6: Integrated commitment accounting framework



Because in the public sector, the value of recording commitments lies mainly with allowing management to identify available funds, commitments are rarely included in financial reports to external parties. The commitments are usually only recorded for internal management purposes to identify available funds.

In some public sector organisations, cash accounting is prepared for external users while commitment accounting is recorded manually for internal management purposes. Accrual information is only included as a commitment of anticipated expenditure. When the annual report is prepared for external parties, the commitments are excluded. The systems framework for a cash plus manual commitment accounting system is outlined in Figure 7.

Figure 7: Cash plus manual commitment accounting framework



5.4.4 Example of commitment accounting reports

Although a fully integrated commitment accounting system is unusual, the financial accounts of the Department of Social Welfare would look like the following.

Financial Accounts for the Department of Social Welfare

Income and Expenditure Account (for the period 1 April 1987-31 March 1988)

INCOME			($000)
Programme I	- Mainly Rents		485
Programme II	- Maintenance for Period		6,000
	- Liable Parent Contributions		47,617
Programme III	- General Expenses		295
Interest Received on Loans			
- Loans	: Repairs to Houses		60
	: Family Benefit Advance		
Government Funding			
- Agency Operations/Funding of Benefits			
- Cash			6,841,906
- Accrual			293,088
- Funding of Services Provided			
- Cash		271,723	
- Accrual		7,783	
(Exclude Cash from Sale of Assets 5000)			279,506
Total Income for Period			7,468,957

EXPENDITURE

	Expenditure for the Period	Commitments	Total
Personnel			
Programmes I + III	196,716	1,000	197,716
+ Accruals	3,783		3,783

<u>Operating Costs</u>			
Programmes I + III	80,007		
+ Accruals	4,000		
(assets)	-60,000	1,000	25,007
<u>Agency Operations</u>			
Widows Cash Paid Out	104,170	10,000	114,170
Plus Accruals	4,340		4,340
Invalids Cash Paid Out	195,028	10,000	205,028
Plus Accruals	8,126		8,126
Sickness Cash Paid Out	159,850	10,000	169,850
Plus Accruals	3,074		3,074
Unemployment Cash Paid	672,694	100,000	772,694
Plus Accruals	12,936		12,936
Domestic Purposes Cash	808,787	100,000	908,787
Plus Accruals	33,699		33,699
Family Benefit Expenditure			
Paid Out in Cash	269,818	10,000	279,818
Exp.to Reduce Home Loan	13,500		13,500
Exp.to Reduce Other Loan	7,238		7,238
Plus Accruals	24,213		24,213
Tax on Income Tested Benefits			
Cash Paid Out	341,857	10,000	351,857
Plus Accruals	28,488		28,488
National Superannuation			
Cash Paid Out	3,986,544	212,106	4,198,650
Plus Accruals	166,106		166,106
Other Grants - Cash	302,158	10,000	312,158
- Accruals	1,000		1,000
<u>Other Non-Cash Transactions</u>			
- Bad Debts Written Off			
Maintenance Orders	100		100
Liable Parent Contributions	600		600
- Provision for Bad Debts			
Maintenance Order	100		100
Liable Parent Contributions	600		600
- Provision for Depreciation	36,000		36,000
Total Expenditure	7,405,532	474,106	7,879,638
Profit/(Loss)			(410,681)

<u>Balance Sheet</u>
as at 31 March 1988

CURRENT ASSETS

Cash	NIL
Debtors/Accounts Receivable	
Opening Bal. + Period Exp. -Cash Paid -Bad Debts = Closing Bal. - Maintenance Order	
21,600 + 6,000 - 2,953	= 24,647
- Liable Parent Contributions	
125,770 + 47,169 - 38,939	= 134,000
- Loan - Short-Term	
(163,638 + 1,650 - 25,562)	= 139,726

FIXED ASSETS

Loans	
Opening Bal. + New Loans - Repayments - Write-offs = Closing Balance	
- Repairs to Houses	
10,000 + 1,500 - 562	= 10,938
- Family Benefit Advances	
87,000 + Nil - 4,143 (cash) - 13,500 (FB Home) - 7,238 (FB other)	= 62,119
- Disabled Persons	
2000 + 150 - 119 (cash)	= 2,031
Land	16,500
Buildings 42,500 + 17,113	55,000
Plant + Equipment	250,000
Motor Vehicles	18,484
Fixtures and Fittings	34,790
Total Assets	748,235
Less Liabilities	
- Creditors/Accounts Payable	266,054
NET ASSETS	482,181

Represented by:

Revenue Reserve Brought Forward	358,756
Profit/(Loss)	(410,681)
Asset Revaluation Reserve	60,000
Commitment Reserve	474,106
	482,181

Maintenance Trust Account

Cash Receipts	9,047
Cash Payments	9,047
	Nil

N.B. These figures are approximates, and were prepared expressly for this report.

5.4.5 Strengths and weaknesses of commitment accounting

STRENGTHS

- Depending on the systems framework used (see 5.4.3), commitment accounting can have the advantages of full accrual accounting. If the system is only cash plus manual commitments, it has the advantages of a cash system.

- Does provide the total amount of funds available to be spent, which is useful for organisations that do not operate a good management budgeting system and/or are budget-financed.

WEAKNESSES

- Depending on the systems framework used (see 5.4.3), commitment accounting can have all the disadvantages of a full accrual accounting package with the added cost of a commitment register. If the system is cash plus manual commitments, it will have the disadvantages of a cash system.

- Can be exceedingly difficult to administer and control all committed expenditure.

- Information can be easily manipulated. For example, managers can place orders at the end of year and cancel them in the new year or vice versa.

- Does not reflect the true operations of an organisation, as the future costs are recognised before revenue is recorded.

- Because debts are recognised before they legally have to be paid, the information produced is not legally accurate.

5.5 So Which is The Best Method?

Below are quotes from well-known public sector accounting academics. These indicate the variety of opinion on which accounting method is appropriate, not only for the public sector, but also for the private sector.

Cash Accounting

B A Rutherford
Lecturer in Accounting
University of Kent at Canterbury

> As a result of the disparative characters of the two sectors, the status of the bottom line in an accruals-based operating statement itself differs substantially between the sectors. A shareholder in a profit seeking entity has an interest in the profit and capital of the organisation which varies in proportion to his shareholding and which can be changed only by buying or selling shares, a matter outside the control of the organisation itself. By contrast, the extent to which a constituent benefits from the fund balance of a public sector body will depend entirely on how the body decides to spend the balance - a decision which is under its control and over which the individual has almost no influence. ("Financial Reporting in the Public Sector", p. 44.)

Rutherford also cites A L Thomas who "has shown that the rationale for accrual accounting in the private sector is vulnerable to criticism".

Modified Accrual Accounting

Maurice W Pendlebury
Senior Lecturer in Accounting and Finance
Cardiff Business School

> I do think that full accrual accounting is appropriate (at the moment) for the private sector. However, there is a very well respected body of literature which argues that cash flow accounting might well prove to be a viable alternative. I think that recurrent expenditure items and revenue should be accrued. As far as capital assets are concerned, I am not convinced of the need for a full accruals approach.

Adapted from Pendlebury, Maurice: Letter to W McGuinness, 17 May 1988. (A copy of Pendlebury's letter is given in Appendix 11.)

Full Accrual Accounting

Morton Egol
Partner, Director of Government Services Industry Programme to the Australian Society of Accountants

> Because of a lack of accountability over elected officials, democracies are prone to excessive consumption. Cash-Basis accounting followed by nation-states encourages a misallocation of capital between industrialised and developing countries... nation-states should follow accrual-accounting and develop comprehensive financial reports similar to those required of larger public corporations. This will result in better information upon which to base loan decisions. More importantly, such accounting is a prerequisite to establishing accountability that is the key to effective Government. (From lecture notes to Australian Society of Accountants, 1987.)

There is no doubt that each view has its pros and cons. The pertinent question, however, is which system of accounting is best for the New Zealand public sector? The analysis and discussion provided thus far in this report and comments made in the New Zealand Society of Accountants' "Statement of Public Sector Accounting Concepts" (SPSAC) and the first "Public Sector Accounting Statement" (PSAS - 1) support the move towards accrual accounting (refer Appendix 3). The statements suggest that income and expenditure should be accounted for on an accrual basis (SPSAC 4.21, 4.22), and also, that a statement of financial position which includes all assets and liabilities of the entity be provided (SPSAC 4.31).

Treasury, the Audit Office and other government department staff all point to accrual accounting being the appropriate method. The following are quotes from New Zealand organisations and individuals, given in support of the introduction of accrual accounting.

Government Administration Committee 1987

> The Committee considered that the overall standard of departmental reporting was inadequate for the purposes of government accountability to Parliament and the Public.

D. Ormsby
Assistant Controller and Auditor-General

> Excellent idea - long overdue.

F. Clarke
Assistant Director-General
Department of Conservation

> It [accrual accounting] is essential in order for there to be effective accountability - both internally and externally.

B. Kennerley
Director of Finance
Inland Revenue Department

> The department is committed to the implementation of accrual accounting.

F. Sheppard
Director of Finance
National Library

> Without accrual accounting it will be impossible to monitor our revenue and expenditure in order to fulfil our objectives.

1988 Budget PART 1, page 10

> The Government will make fundamental changes to state sector financial reporting requirements through amendments to the Public Finance Act. The Public Accounts will be reformed. Accrual accounting concepts will be introduced to reveal the full cost of departmental programmes.

6.0 The Implementation of Accrual Accounting in the Public Sector

In Section Four of this report, the need for a new accounting method was discussed without the implications of any particular method of accounting. In this section (Six), the assumption that the new method of accounting in the public sector will be accrual is made, and the implications of its implementation are discussed. To assist in planning the implementation, a survey was carried out of government departments to obtain an assessment of their current and planned FMIS. The departments were asked to identify problems and suggest solutions to them. This section finishes by discussing the critical success factors for implementation and Treasury's role in the implementation process.

6.1 The Long-Term Ideal Framework

As departments are currently required to operate a cash accounting system, many of the present FMIS systems and legal requirements must change. To ensure these changes are not made unnecessarily, the long-term ideal framework needs to be determined.

To reach this framework efficiently and effectively, it will be necessary for Treasury and departments to work together to formulate and implement a plan of action.

Cash and full accrual accounting systems can be combined in many ways. Figure 8, presents an analysis of five alternative frameworks.

Figure 8 : Combinations of cash and accrual FMIS

	ALTERNATIVE FRAMEWORKS				
	1	2	3	4	5
Historical Data	C	CA	CA	A	A
Budget Data	C	C	CA	C	A
Cash Flow Data	C	C	C	C	C

KEY: C = CASH
A = ACCRUAL

Option One: C C C

This option is equivalent to the present government accounting system. It no longer meets users needs, in that it does not provide information on all scarce resources or information upon which managers can make efficient and effective decisions. This option is therefore not appropriate and will not meet the objectives of the proposed accounting system (see also Section 4.1.2 of this report).

Option Two: CA C C

Although an improvement on Option One, in that it would allow historical data to be evaluated in terms of resource utilisation, Option Two does not provide managers with an internal tool for evaluating actual resource data against budget resource data.

Option Three: CA CA C

This option has the advantage of providing budgets on an accrual basis, and therefore offers a tool for the management of government expenditure. However, to administer both cash and accrual accounts can be cumbersome and confusing for users. Only a few computer systems in the marketplace can actually provide cash and accrual information.

Option Four: A C C

This is not a practical option, as the benefits of producing accrual accounting information are not realised. This is because information cannot be compared with actual to indicate management performance. This option has all the costs but few of the benefits.

Option Five: A A C

This option is the one that has long been used successfully in the private sector. It has the advantages of Option Three, without the costs of operating two systems. It would also enable accountants and external users to traverse, with ease, private and public sectors.

Of the five alternative frameworks, only Option Five meets the objectives of the proposed accounting system (see 4.1.2). Options Two and Four do not assess management performance. Option One no longer satisfies the needs of users. Option Three requires the keeping of two types of information, a system likely to result in higher costs and confusion for users.

Option Five is thus taken to be the long-term, cost-efficient framework.

6.2 Strategy for Implementation

The assertion that Option Five is the long-term framework raises the question of the short-term implementation strategy. There are two possible scenarios:

1 accrual accounting could be phased in gradually over time;

2 all departments could change from cash to accrual at one point of time.

The benefit of a phased implementation is that departments would be able to develop systems at their own pace, without placing excessive demands on internal and external resources.

As the preparation of consolidated accounts is critical, any phased implementation would require very specific constraints - for example, the preparation of accounting information to be in modified accrual accounts by the year ended 31 March 1989 and by full accrual by 30 June 1990. This will result in a variety of consolidated accounts over three years (eg, cash 1988, modified accrual 1989, and full accrual 1990), a situation unlikely to be acceptable to users, as performance will not be easy to compare across a three-year period.

The alternative strategy is to change all departmental reports from cash to accrual at one point of time. This would enable consolidated accounts to be prepared; however, it could place excessive stress on departments' internal and external resources. In particular, Finance Directors are noticing increasing demands for relevant information from management and are aware of a decrease in the availability and quality of consultants. Stress can be reduced if the process is well planned and communicated to all participants. (Policies for reducing stress are discussed in Sections 6.4 and 6.6.)

It is a recommendation of this report that the strategy for implementation is to make the change from cash to accrual at one point of time. This would meet the needs of users, and if well managed, would place minimal stress on departments. The process of implementation is discussed in section 6.4.4.

The following section reviews the results of a departmental survey to determine the characteristics (actual and proposed) of each department's FMIS and perceived problems and solutions to those problems, resulting from the implementation of accrual accounting.

6.3 The Present FMIS Position of Government Departments: A Survey

6.3.1 Purpose and Methodology

To assess the current and planned FMIS position of government departments, a survey was completed during April and May 1988. Thirty-seven departments were asked to participate in the survey, of which thirty-three replied. For the purposes of explaining the results, the thirty-five responses are treated as responses from thirty-five government departments. However, one of these departments, a large decentralised one, sent in three responses giving rise to thirty-five responses overall.

The finance directors of each department was asked to complete a written questionnaire. The information compiled from the questionnaire was a combination of quantitative information and qualitative information (ie written answers to questions were classified to provide common types of answers - eg departments' reasons for changing to accrual). A list of the departments participating in the survey is given in Appendix 13, and a copy of the survey questionnaire is given in Appendix 12.

6.3.2 Results

Responses to survey questions enabled the compilation of the following information:

1 Number of departments which have taken on accrual accounting: Of the thirty-four departments that answered question (D:6), three had a complete accrual accounting system up and running for the financial year ended 31 March 1988. Nineteen departments will have a complete accrual system up and running by the 31 March 1989, and thirty-two departments by 31 March 1990. The two departments that do not expect to have a full accrual system until March 1991 are the Departments of Education and Defence.

2 Major reasons given for changing to accrual accounting: Response to question (C: 1) were varied. In order of priority, they were:

- To improve internal decision-making.
- An outcome of the Society of Accountants SPSAC and PSAS-1 recommendations (refer Appendix 3).
- An outcome of the Government Administration Committee's recommendations (see Appendix 2).
- To provide a more efficient means for processing data within government departments.
- To satisfy the "user pays" policy.
- An outcome of Cabinet Decision (cm 86.24.12 [27]) (see Appendix 16).

3 Departments' FMIS: All departments surveyed tend to record debtors and assets before creditors.

Table 1 shows the number of departments which have, or plan to have, within their FMIS, each of these components: SIGMA, General Ledger, Debtors' Ledger, Creditors' Ledger, Assets Register, and Commitment Register.

Table 1: FMIS Components as at 31 March 1988 and 31 March 1989 (planned)

	As at 31 March 1988 (Question A:1)	As at 31 March 1989 (Question: B:1)
SIGMA System	34	29
General Ledger	16	23
Debtors' Ledger	22	28
Creditors' Ledger	9	20
Assets Register	23	31
Commitment Register	18	22

4 Hardware: All twenty-seven government departments surveyed own their own FMIS hardware. Ten use personal computers, five use minis, seven use mainframes and seven operate all three. The normal hardware systems are, in highest use order, Wang, IBM, Unisys, COMPAQ, and Data General. (Questions A:2 a,b,c)

5 Software: The software used by these departments are generally (off-the-shelf) packages. Only four departments' packages were developed completely in-house. A large variety of software packages are used: no one particular software package was identified. (Questions A:2 d, e)

6 Bureaus: Seven departments use bureaus, of which four are operated by the Government Computing Service at Cumberland House. Other bureaus used are the Ministry of Energy, Burroughs, and New Zealand Tourist and Publicity. (Question A:3 a)

7 Method of accounting for assets: Thirty-three of the departments surveyed provided information on their method of accounting for assets. Of these, only eighteen have historical cost information on their fixed assets. However, twenty-four operate asset registers of some kind, with most collecting information on asset description, date of purchase, purchase cost and location. Departments indicated that generally they do not collect information on depreciation methods, rates, and method and amount of valuation. (Question A:4 a)

Most assets are recorded on the asset register when they are purchased or sold. The dollar levels which determine whether an asset is to be treated as an expense or not vary greatly. Responses to Question A:4 c of the survey are summarised in Table 2.

Table 2: Dollar range used to determine whether an asset is treated as an expense

Dollar Range	Number of Departments Using Dollar Range
0 - $100	3
$101 - $200	4
$201 - $500	8
$501 - $1000	2
$1001 - $10000	4

8 Depreciation Rates: A variety of depreciation rates were being used by the departments, as is shown in Table 3. (Questions A:4 d, e, f, g)

Table 3: Depreciation methods and rates used

		(Column A) Method		(Column B) Rates %	
Type	Responded	Methods	Used by	Rates	Used by
Buildings	10	Straight line	10	Under 5%	10
Plant and Equipment	17	Straight line	12	0-10	7
		Diminishing Value	5	16-20	6
				30-40	2
				40+	2

Motor Vehicles	15	Straight line	10	16-20	9
		Diminishing Value	5	21-25	6
Fixture and Fittings	17	Straight Line	7	6-10	4
				11-15	1
		Diminishing Value		16-20	8
			10	21-25	1
				40+	3

N.B. Refer Appendix 1 for Glossary of Public Sector Accounting Terms.

9 Sub-groups of Fixed Assets: The response to question A:5 a indicated the need for standard definitions on what each sub-group should be. Table 4 indicates the percentage of departments that record assets within each sub-group.

Table 4: Asset sub-groups

Asset Sub-group	Number of Departments Using Asset Sub-groups
Land	14
Buildings	17
Plant and Equipment	25
Motor Vehicles	25
Fixture and Fittings	30
Community Assets	1
Others	15

10 Community assets: Only five departments responded to question A: 5 b.

The Ministry of Agriculture and Fisheries cited the 200 mile offshore fishing resource as its community asset; the Department of Conservation, the one-third of New Zealand under its control; the Department of Internal Affairs, Vogel House and Government House; the Department of Tourism and Publicity, the Wairakei Geothermal Reserve; and the Department of Education, schools.

11 Commitment accounting: Twenty-four of the departments surveyed operate commitment accounting, much of which has been automated but not integrated into the financial accounts. (Questions A: 6 a, b)

12 Problems identified and solutions suggested: Problems identified by respondents in the implementation of accrual accounting are listed here, in priority order. (Question D: 4)

. To persuade staff to change from cash to accrual accounting.

. The increased workload of running parallel cash and accrual accounting systems.

. The ability to determine an efficient and effective budgeting and funding interface.

- The confusion resulting from the present lack of direction from Treasury on the reporting system and the lack of standard accounting policies (eg on depreciation).

- The conflict between Treasury's system and decentralised accrual accounting concepts - for example, the requirements that departments use Treasury's District Treasury Offices and cheque-writing facilities.

- The cost and subsequent funding of implementation.

- The high demand for consultants.

Respondents' suggested solutions to the problems in priority order, were: (Question D:5)

- Training, training and more training.

- Extensive use of consultants.

- Commitment and leadership from Treasury, particularly on accounting policies, year-end procedures, SIGMA and Seg items, method of implementing accrual accounting, implementation dates, funding (ie opening and controlling own bank accounts), the removal of Treasury Instructions and the requirement to use District Treasury Offices, and acceptance by Treasury of accrual budgets.

- Sufficient finance to fund implementation.

- A review of the Public Finance Act 1977.

6.3.3 Conclusion

The written responses to the survey confirmed two crucial elements for the implementation of accrual accounting. Firstly, the Directors of Finance are committed to accrual accounting; secondly, they require financial support and direction from Treasury.

6.4 Practical Implications

6.4.1 FMIS requirements

From the results of the survey and discussions with departments, it became obvious that organisations with sound knowledge of their information requirements can, with considerable planning and training, implement an accrual FMIS relatively quickly. For organisations without this knowledge, sufficient time to assess their needs must be made available during planning.

Success, as always, is dependent on good planning. A major requirement of good planning is analysing the environment (ie, determining the type of FMIS currently in place) and knowing the objective (ie, the type of FMIS that will be needed).

6.4.2 Problems associated with collecting information

For Directors of Finance, the most time-consuming task will be deriving accrual information from what has previously been a cash system. The task will include redesigning each department's information system to ensure all information is collected accurately and on time. To provide readers with an understanding of the size and complexity of this task, major accrual items are now discussed in terms of availability of information and difficulty of collection.

6.4.2.1 Revenue

Some government departments will find it difficult to determine what monies they should account for and what they should not, especially as what has been acceptable under the present system does not make for good accounting practice. Specifically, monies have been coded to organisations not responsible for those funds. For example, the Department of Social Welfare has interest received on loans coded to other departments, and maintenance monies received by parents are recorded as cash received by the Department of Social Welfare (under good accounting practice this money would be kept in a separate account, as trust monies; see 5.3.4).

To prevent this problem, mangers must correctly identify the entity they are reporting, and accountants will need to go through their revenue accounts to ensure that existing coding is appropriate.

6.4.2.2 Operating expenses

As with revenues, some operating expenses are not presently coded correctly.

A major problem is that departments have not been recording inter-departmental transactions. As a consequence, public accounts include double counting of a large number of transactions. Even if the cash system were to continue, non-recording of inter-departmental transactions should be corrected.

With the introduction of accrual accounting, it will be essential to develop an improved system, otherwise information on debtors and creditors will also be subject to double counting in the consolidated accounts.

6.4.2.3 Cash

In Section 4.2.1.4, it was emphasised that cash information will always be necessary. It is not the implementation of accrual accounting that will have the impact, but any changes to the funding process. For example, if each department has its own bank account or accounts, where would the necessary controls over expenditure lie?

6.4.2.4 Accounts receivable/debtors

Under the cash-based system, information on accounts receivable is not easily obtained. For many government departments, obtaining this information seems initially impossible. However, most departments do have some form of system to record who owes what money. It was, for example, easy to obtain this information from the Department of Social Welfare. The figure was estimated in March 1988 to be in the vicinity of $159 million.

6.4.2.5 Accounts payable/creditors

Government departments, under the cash-based accounting system, usually pay within two weeks of receipt of invoice. Consequently, trade creditors are usually few in number, and the major accruals are in staff costs. This is the case in strong staff-orientated organisations like the Department of Social Welfare. For this reason, some departments argue that collecting information on accounts payable is not necessary. However, the payroll calendar can have a major effect on the consolidated budget for the year end. Under an accrual system, the salary and wage cost will be balanced out, so that the result can be directly compared to those of previous years.

For example, the Department of Social Welfare's creditors figure would be about $266 million for the 1988 financial year. Salary and wage costs make up a large part of total costs, but when any periodic grants to beneficiaries are added, the accounts payable at the end of the year can be sizable.

6.4.2.6 Inventories/stocks

In the public sector stock is not normally held for resale and, in some cases it may be so specialised that there is no ready market for it, as with certain weapons and ammunition held by the Department of Defence. Under this situation, a rule that stock be valued at the lower of cost or net realisable value would result in stocks being included in the balance sheet at scrap value only, with virtually the whole of the acquisition cost being written off in the period in which they were purchased. Therefore, the full-accrual based system would in fact revert to a modified-accrual basis. However, if the rule were not applied, managers would have the opportunity of manipulating stock values by not writing them down when they did represent a genuine reduction - for example, due to physical deterioration.

6.4.2.7 Other liabilities/loans

Collecting this information will be simple, as departments cannot take loans without the approval of the Treasury, where the information is recorded.

6.4.2.8 Fixed assets

For consolidation purposes and ease of interpretation, Treasury needs to issue a standard definition of what constitutes an asset and to what degree departments should sub-code assets (See Appendix 9 for a draft chart of accounts).

Another major issue is what value should be attributed to an asset? Should it be valued at historical or current cost?

Lastly, depreciation methods and rates must be specified. Depreciation is a tool by which cost can be matched against revenue earned from owning an asset that will be useful to the organisation for longer than one year but not for unlimited years.

In terms of depreciation, there are three types of fixed assets: those that have an unlimited life; those that are used up in year of purchase; and those that have a longer life than one year but do not have an unlimited life. The latter type of assets are called multi-year assets. The purchase of assets, as discussed in the previous section, is treated differently for different accounting methods (see Figure 9).

Figure 9: Treatment of asset purchases for different accounting methods

Usefulness of Asset	Cash Accounting	Modified Accounting	Full Accounting	Commitment Accounting
Unlimited	Expense	Expense	Fixed Asset at purchase price (eg, land)	See NB 2
Single-year	Expense	Expense	Expense in year of purchase	See NB 2
Multi-Year	Expense	Expense	Fixed Asset at book value (see NB 1)	See NB 2 (eg, M.Vehicle)

N.B.: 1 Book value is the historical cost (purchase price) less an amount for depreciation.

N.B.: 2 As commitment accounting does not necessarily include accruals, the treatment of fixed assets in a commitment-based accounting system is dependent on whether accruals are included or not. If they are, then fixed assets will be treated as under the full accrual method. If not, assets would be treated as an expense in year of purchase, as with the cash accounting method.

6.4.2.9 Crown equity/revenue reserve

There needs to be some agreement on the definition of this term. In reality, it represents the net Crown funds held in any one government department.

6.4.3 Cost of implementation

There is no doubt that the process of moving from a cash method to an accrual accounting method is costly, as Table 5, compiled from information obtained in the survey discussed in Section 6.3, demonstrates.

Table 5: Cost of implementation

Estimated Cost of Implementing Accrual Accounting
for the two-year period ending March 1990
(for 33 Government Departments)

Cost of Human Resources	
Consultants	2,302,000
Qualified Accountants	2,440,000
Financial Staff	1,211,000
EDP Staff	617,000
Others	620,000
TOTAL COST OF HUMAN RESOURCES	7,190,000
Cost of Financial Resources	
EDP Hardware	4,116,000
EDP Software	3,860,000
Other	853,000
TOTAL COST OF FINANCIAL RESOURCES	7,829,000
COST OF TRAINING (includes courses,manuals etc)	3,090,000
TOTAL COST OF IMPLEMENTATION	18,109,000

N.B.: These figures should be treated with great care. The departments that have actually been implementing (or have implemented) accrual accounting have higher estimated future costs than those that have not.

6.4.4 Process of implementation

Section 6.2 acknowledges that the most appropriate strategy for implementing accrual accounting is to make the change at one point of time.

The survey outlined in Section 6.3 indicated that nineteen departments will be running an accrual accounting system from 1 April 1989 and a further thirteen by 1 April 1990. This would appear to be a fair assessment of the time-frame, as some departments have not yet begun to implement accrual accounting. The two departments that do not expect to have a full accrual accounting system up and running until March 1991 are the Departments of Education and Defence.

The lead-time cannot be under-estimated, particularly for large departments that currently have a very poor FMIS and a large number of products. The amount of time necessary to carry out each stage of the implementation process is estimated as follows: an information needs assessment (2-4 months); system requirements specified (2-4 months); tender (or approach) plus evaluation of software (and/or hardware) (2-4 months); and installation and overall implementation (4-10 months). In general, then, the full amount of time required for implementation would range from 10 to 22 months, assuming management rate the project top priority. For illustrative purposes, the National Library began the process in December 1986, with completion date targeted for 1 April 1989 - a total of 28 months. The Ministry of Agriculture and Fisheries, DSIR, and the Ministry of Transport support this view.

A change-over date of 1 July 1990 will cause concern for departments that either have the facility to provide cash and accrual information but are finding the costs of running both excessive, or have purchased systems that provide accrual information only. As stated in section 6.1 (Option Three), very few computer systems can easily provide both cash and accrual information.

To resolve these concerns, Treasury should provide guidelines through a printed booklet titled "Requirements for Departments Operating Accrual Accounting" (RDOAA).

Provided a department's accrual accounting system passes a systems check (completed by Treasury and/or the Audit Office), annual departmental reports would be accepted in accrual terms, provided the RDOAA were followed.

The RDOAA would be broken into the following sections:

(1) Departmental Report Requirements

   (a) Timing

   (b) Format

   (c) Content (including Chart of Accounts - Appendix 9; Accounting Policies - Appendix 15)

(2) Consolidation Requirements

   (a) Before 1 April 1990 (in cash per SEG)

   (b) After 1 April 1990 (in accrual per Appendix 9)
   Inter-departmental transactions
   Year-end adjustments and procedures.

Departments following the RDOAA would no longer be constrained by the Treasury Instructions, SIGMA and DTO's. Once the funding regulations have been determined, these departments could choose to write their own cheques.

The recommended process of implementation enables both users and departments to meet their objectives. What is urgently needed is the decision that accrual accounting will be adopted from 1 July 1990. The RDOAA should be disclosed to departments in draft as soon as possible, so as to prevent departments making early decisions that could have major costs in the future. The Directors of Finance in departments must be involved and informed of any changes in policy.

What must be appreciated is that Treasury and departments began at the same point of time to develop, and in many cases implement, accrual accounting. However, as the difficulties of implementation (eg, determining funding and reporting requirements) are greater for Treasury than for departments, the latter have tended to implement practical solutions ahead of Treasury's theoretical solutions. This has and will continue to result in a potpourri of accounting systems across departments. The pace and costs of change are such that Treasury, to some degree, will be constrained to fitting the theoretical funding and reporting process around the departments, updated FMIS.

Departments have, in developing their FMIS, contacted Treasury staff to determine their requirements. However, as no consistent or formal specifications have been made available, departments have had little choice but to continue without these. The longer Treasury requirements are delayed, the harder it will be for Treasury to obtain centralised control over the total government FMIS.

6.5 Critical Success Factors

From discussions with state owned enterprises and departments, the following factors were determined as critical for the successful change-over from a cash-based system to an accrual system of accounting: (the factors are listed in priority order):

1 Commitment to accrual accounting from top management.

2 A system design which is simple and is tightly controlled so that simplicity of design can be maintained.

3 A strong emphasis on staff training to ensure that staff understand accrual accounting concepts.

4 High quality planning.

5 An acknowledgment of project leaders' authority and responsibility.

6 A committed and resourceful project team (who are, for example, determined to keep within time constraints).

Morton Egol, a Director of Government Services Industry Program to the Australian Society of Accountants, provides support for the appropriateness of these factors. In a presentation (30 November 1987) on accrual accounting within government, Egol listed the following requirements for effective implementation of accrual accounting:

- Proven methodology
- Project management
- User involvement
- Custom solution
- Use of consultants
- Adherence to standards
- Phased implementation approach

General discussions and the conclusions arising out of the survey of government departments (see 6.3) also highlight the need for departments to have the support of top management before accrual accounting can be successfully implemented. This requires both the provision of physical resources and the means to cope with difficulties that occur during change-over. It would thus not be advisable to give departmental finance directors sole responsibility for the implementation of accrual accounting. The finance function is often of low status in government departments, and if finance directors are to have any measure of responsibility, they must also have the equivalent authority. In many cases, this will require directors to report directly to the chief executive officer or his or her deputy.

To implement accrual accounting in government departments, then, top management must be committed to changing the accounting method. For those departments that do not perceive a change as necessary, incentives for change or regulations must be provided. Incentives are preferable, however, as some departments could still refuse to action a change-over in light of its other priorities. The Department of Social Welfare, for example, in response to the recommendation of the Report of the Administrative Committee on "Performance and Efficiency in the Department of Social Welfare" (December 1987) stated that at this stage they do not accept the recommendation that the department should implement an accrual accounting and budgeting system:

> The Department intends to commission a study to examine the costs and benefits of introducing an accrual system. The study will also consider and design an implementation strategy if favourable recommendations are made regarding the introduction of the system. At this stage, however, it is difficult to accord this priority for immediate attention, given competing priorities in other areas. ("Departmental Response to the Recommendations of the Administrative Review Committee," p 7.)

This example strongly suggests that along with the provision of incentives, a regulatory approach will also be necessary. The most effective measure of ensuring that accrual accounting is adopted is to set a date ie, 1 July 1990 by which all departments must produce accrual accounts. Incentives and support can and should be provided to make the change from cash to accrual accounting as smooth as possible.

Once the date for accrual accounting has been finalised, it will be the responsibility of each department's chief executive to oversee implementation. While he or she can delegate that authority and responsibility to the finance director, the ultimate responsibility must be his or hers.

6.6 Treasury's role

Treasury has three major roles regarding accountability for public sector expenditure. These are processing accounts information; controlling and reporting on each department's expenditure; and controlling the quality of accounting information supplied by departments.

6.6.1 Processing role

Government departments are responsible for providing Treasury with accounting information. This activity is presently carried out by way of the SIGMA system. However, this system has been in question for some time, to the extent that its operational life is, at maximum, two years. Many respondents to the departmental survey (section 6.3), emphasised that the requirement to use SIGMA causes implementation problems and double workloads for staff, as well as associated high costs. It is recommended that this requirement to use SIGMA be removed as soon as possible.

Removing SIGMA would have these consequences for Treasury:

i a decrease in processing staff;

ii no access to a detailed database of cash information for controlling and reporting on departments - see discussion in 6.6.2.

While Treasury will always have ultimate responsibility for the preparation of consolidated accounts, the preparation and/or processing and/or presentation of these could be contracted out to private firms or other government departments, in which case a considerable reduction to Treasury's accounting staff will be needed.

It can be argued that Treasury should provide consolidated accounts for all public monies, that is, those public monies for all government departments, state owned enterprises and local bodies. The objective, in other words, would be to ensure that all public monies (as against private monies) are consolidated.

6.6.2 Controlling and reporting role

The control of expenditure has, under the State Sector Act 1988, been delegated to the executive officers of government departments. The need for Treasury staff in this area of control will consequently decrease. However, sufficient information must be obtained for the Minister of Finance, via Treasury, to ensure an ultimate check on the efficient and effective expenditure of public monies.

It is envisaged, therefore, that accounting information would be provided to Treasury monthly in the form of departmental balance figures set out in the Chart of Accounts (as shown in Appendix 9). This information would be entered into a database for use by analysts, and could then easily be provided on two A4 sheets by each department monthly and on six A4 sheets for detailed quarterly and annual reports. To provide the financial information efficiently, departments would require sufficient resources, particularly staff, and computer hardware and software. This suggested frequency of reporting is based on the assumption that Treasury's role is a management one only, in order to support the Minister of Finance. Any specialised queries from the Minister or Treasury, would need to be answered by the department concerned.

6.6.2.1 Periodic reporting unit

One of the implications of periodic reporting for Treasury would be the necessity of creating within Treasury a small group of financial analysts able to assess each department's performance and to report monthly to the Minister of Finance through a management report on any areas of concern. The group would also be responsible for the preparation of the Consolidated Annual Report.

6.6.2.2 One-off reporting unit

A special group of project specialists would also be necessary within Treasury to prepare one-off reports on a department or group of departments for the Minister of Finance.

6.6.3 Controlling accuracy

Accuracy can be controlled in two ways: firstly, through the rules and regulations placed on a department (input controls); secondly, through the internal audit of that information (output controls). There is usually an inverse relationship between the accounting policy function and the internal audit function. This means the tighter the rules and regulations on departments, the less the need for in-depth lengthy audits, or vice versa.

The Audit Office function must continue to be completed independently.

6.6.3.1 Accounting policy

The Treasury Instructions will no longer be appropriate and should be abolished. However, Treasury would no doubt continue to be responsible for setting accounting policy. The recommended policies, in light of departmental responses to the survey (Section 6.3) and practical experience, are set out in Appendix 15. Also, a line must be drawn between the role of the New Zealand Society of Accountants (NZSA) and Treasury. There are a variety of opinions on where the roles of each should lie. Three are given here:

Scenario 1 — The NZSA should have no role. Government departments are seen to be the same as private sector subsidiaries reporting on a consolidated entity, for example, Fletcher Challenge. The public sector should therefore simply adopt the Statements of Standard Accounting Practice (SSAP's), as they need neither the Public Sector Accounting Concepts or Public Sector Accounting Standards. The Treasury, in consultation with users, should develop specific accounting policies for government departments as a group entity.

Scenario 2 — NZSA should provide accounting standards but not policies. General standards would thus be required for all government departments, with each department determining its own policies. Treasury should provide consolidated accounting policies only.

Scenario 3 NZSA should provide both standards and policies, removing the need for the Treasury function of providing rules and regulations.

These options have several disadvantages. The more obvious disadvantage for Scenario 2 would be that of comparing departments' accounts and/or users reading a variety of accounts. For Scenario 3 the disadvantage would be having an external group dictating policies without the necessary involvement of government departments or users, in particular the Minister of Finance.

At present, the NZSA has attempted to meet the needs of their members and other users by placing a more comprehensive structure on the public sector FMIS. The NZSA should be commended for its initiative and effort; however, their role in public sector accounting must be questioned and ascertained. At present NZSA's authority comes only from its membership, not from Government.

6.6.3.2 Internal audit function unit

This function should be provided by Treasury through a group of experts that carries out auditing checks on departments.

6.6.4 Recommendations

The following recommendations for Treasury are based on the assumption that accrual accounting will be adopted in the public sector.

1 Determine the regulation process and therefore the constraints on the implementation of accrual accounting (refer Section 4.2.1.4.1 of this report).

2 Determine the funding process and therefore the constraints on the implementation of accrual accounting (refer 4.2.1.4.2)

3 Re-write the Public Finance Act 1977 (refer 4.2.1.4.1).

4 Define:

  i the users of public sector accounting information, (refer 4.2.1.2) and

  ii their information needs (refer 4.2.1).

5 Obtain Cabinet approval for the implementation of accrual accounting. The date for change-over would be 1 July 1990 (refer 6.2).

6 Determine when financial information should be reported (timing: refer 4.2.2.2).

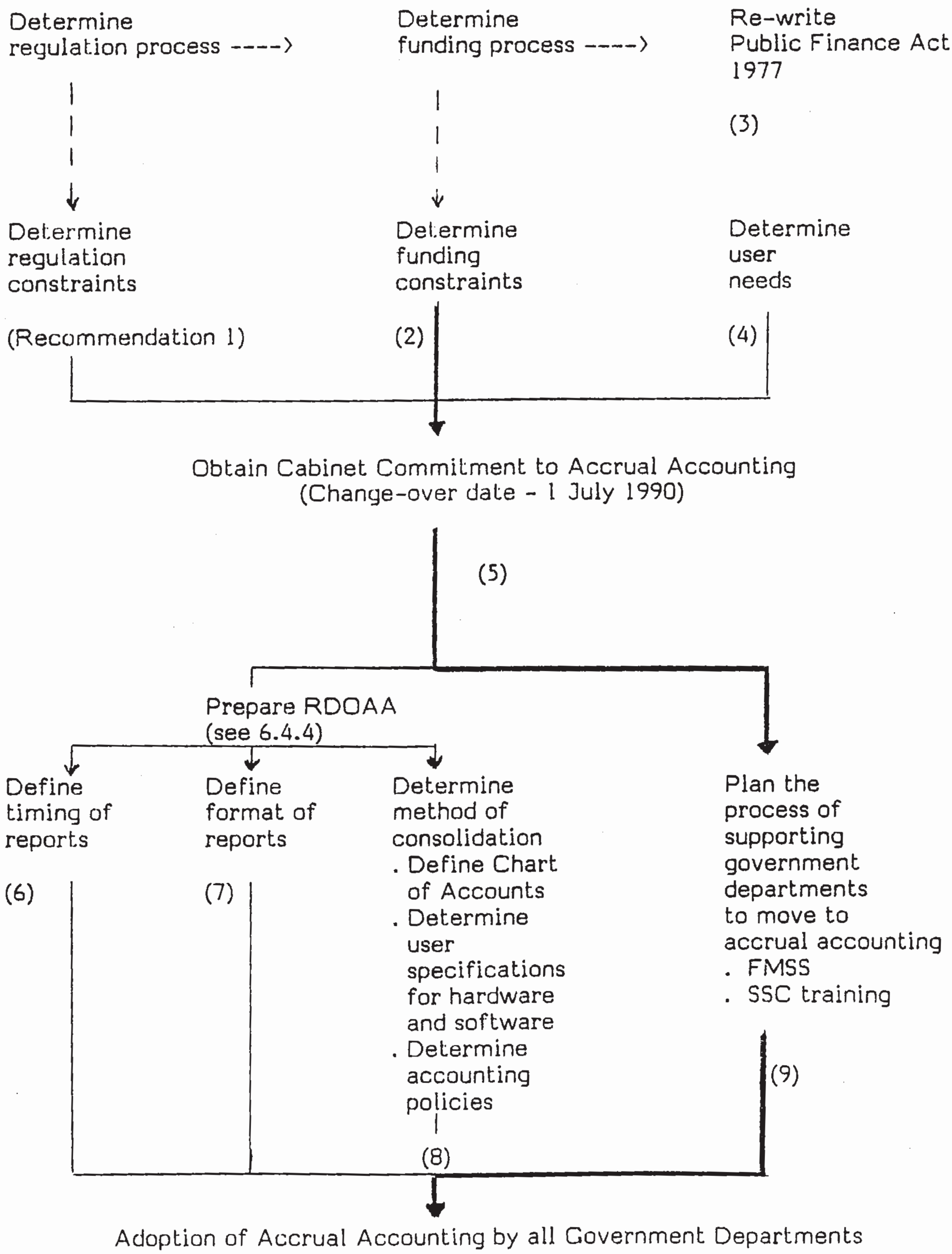
7 Determine the most useful format for reporting information to users (refer 4.2.2.3).

8 Determine the method of consolidating accounting information. See in particular the Chart of Accounts (Appendix 9) and Appendix 15 on the appropriate accounting policies. (See section also Sections 4.2.2.4 and 6.6.1.)

9 Prepare a plan for supporting government departments during and following implementation of accrual accounting. (Note: This responsibility has already been given to the Financial Management Support Service (FMSS) attached to Treasury.)

7.0 Critical Path for Implementation by Treasury of Accrual Accounting

Below are the critical factors that must be implemented by Treasury for a smooth implementation of accrual accounting into the public sector. The critical path is represented by the bold line.



NB: RDOAA = Requirements for Departments Operating Accrual Accounting.

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GLOSSARY OF PUBLIC SECTOR ACCOUNTING TERMS

Accountability — A relationship between two parties, in which one party grants to the other some level of authority to act, the second party agrees to provide information concerning performance, and the first party has a power of sanction if performance is not adequate. (Source: FMSS)

Accounting Policies — The bases, rules, and procedures adopted in preparing and presenting financial statements. Do not include the judgements used in implementation of bases, rules and procedures adopted. (Source: PSAS-1)

Accrual Accounting — A system in which the cost of resources consumed in the production of goods or services is matched with the revenues or services generated. May be contrasted with a cash accounting system in which costs are recorded when payment takes place, irrespective of when the associated benefits occur. (Source: FMSS)

To move from a cash accounting system to an accrual accounting system, the following transactions must be made:

- Exclusion of all cash accruals. These are:

  a Cash paid in advance.
  b Cash received in advance.

- Addition of all non-cash invoiced transactions for the period being:

  a Revenue earned but not received (ie debtors).
  b Expenses incurred, being invoices received but not paid (ie creditors).

- Addition of all non-cash, non-invoiced accruals. These are incurred or earned transactions (eg wages, interest and depreciation). These are called expenses incurred (a liability or a decrease in an asset) or a receivable (an additional asset).

Accumulated Depreciation — A contra-asset account reporting the sum of all depreciation charges since an asset was put in use.

Activity — A sub-classification of expenditure within a programme, eg Vote Education - Programme II - Pre-School Education, Activity: Free Kindergartens. (Source: Estimates Commentary)

Allocation — A part of a lump sum appropriation which is designated for expenditure by specific organisation units and/or for specific purposes, activities or objects.

Annual Report	A statement of the financial conditions and operating results of an enterprise, prepared yearly for submission to interested parties. (Source: Kohler) For most government departments, the financial year starts on 1 April and ends on the 31 March.
Appropriation	An allocation of money by Parliament, requested in the Appropriation Bill, to be spent on a particular purpose. In general, no expenditure of public money can be made unless Parliament has authorised the expenditure by means of an annual or permanent appropriation. (Source: Estimates Commentary)
Assets	Resources controlled by an entity which can, in the future, generate benefits in terms of increased cash flows or levels of service provision. (Source: FMSS)
Audit	In connection with financial statements or other financial information, an examination of accounting records and other supporting evidence for the purpose of expressing an opinion as to whether such statements or information are presented fairly in accordance with an appropriate, disclosed basis of accounting. (Source: Canadian Institute - C.A.S Terminology)
Audit Trail	The route by which data can be traced either forward or backward through the processing cycle. (Source: Canadian Institute - C.A.S Terminology)
Balance Sheet	A statement of financial position disclosing all of the assets and liabilities of an entity, appropriately classified, including contingencies, but excluding community assets. (Source: SPSAC)
Bilaterals	A series of meetings between the Minister of Finance and each spending Minister concerning the determination of the estimates of expenditure for each vote. (Source: Treasury)
Book Value (or cost)	The net amount at which an asset or asset group appears on the books of account, as distinguished from its market value or some intrinsic value. (Source: Kohler)
Budgeting	The formulation of plans and anticipated results for a particular period of time expressed in financial and non-financial terms. (Source: The Treasury - Financial Management Guidelines)
Building	Comprises the outer walls, including linings, outer doors, shop fronts and windows, interior walls, inner fixtures of brick and concrete, foundations, roof, ceilings, floors, cellar, chimneys, sewerage, stairways, plumbing, water and power supplies. (Source: NZ Master Tax Guide)

Capital Budget	The portion of a budget, or a separate budget, devoted to proposed additions to capital assets and their financing. (Source: Kohler)
Cash Accounting (or basis)	A basis of keeping accounts, whereby revenues and expenses are recorded on the books of account when received and paid without regard to the period to which they apply. (Source: Kohler)
Cash Budget	An assignment of cash receipts and payments to periods of time. Used in the Public Sector to monitor expenditure by departments at SEG levels. (Source: Treasury)
Chart of Accounts	A numerical code which reflects an organisations activities and responsibilities. Classifies revenues and expenses in a cash system and in an accrual system, sales, expenses, assets, liabilities and shareholders, funds. (Source: Treasury)
Commercially -orientated Activities	Those which have a direct exchange relationship whereby user fees charged for specific goods and service are closely linked to costs incurred and are an important determinant of quantity consumed. (Source: SPSAC)
Commitment Accounting	Accounting for anticipated expenditure, evidenced by a contract or purchase order given to an outsider. It is not usual practice in the Private Sector to account for commitments since the signing of a contract or issuance of a purchase order does not give rise to a transaction (ie a legal obligation to pay). (Source: Kohler) However, in the Public Sector as "it is necessary for each department to operate a system of control which will ensure that allocations are not exceeded ...... therefore, where justified, adequate commitment records should be maintained". (Source: Treasury Instructions B13)
Community Assets	Infrastructural assets which have no determinable useful life and provide a social service rather than a commercial service. They are frequently large, not capable of subdivision for ready disposal, usually have no readily determinable market value and there may be constraints on the capacity of the reporting entity to dispose of such assets. (Source: SPSAC 4.15) The cost of use of a community asset is shown as maintenance expenditure in the year of purchase rather than depreciation expenditure.
Consolidated Account	The main operating account within the Public Account. All receipts must be credited to this account unless there is specific statutory provision to the contrary eg proceeds of loans, and road user charges. The main revenue items in the account are direct and indirect taxation, interest received, dividends and profits from corporations and trading undertakings, and departmental receipts.

The bulk of Government expenditure is met from this account by way of annual appropriations through votes (see the Estimates of Expenditure B.7 [Pt I], and permanent appropriations made pursuant to various statutes). (Source: NZ Gazette.)

Contingent Liabilities	An obligation relating to a past transaction or other event or condition, that may arise in consequence; as an unclear future event now deemed possible but not probable. If the obligation is probable, it must be recorded as a liability in the accounts. The mere possibility of a future loss, not linked with a past event, does not give rise to a contingent liability (eg a fire). A common contingent liability is a lawsuit growing out of a breach of contract. (Source: Kohler)
Contribution Margin	The difference between sales price and variable cost. (Source: The Accountants Manual) May be expressed on a per unit basis, a total figure or as a ratio.
Cost	Value foregone to achieve an economic benefit.
Cost Benefit Analysis	The weighing of benefits against costs in order to make possible a choice among alternatives that will yield the maximum benefit at the least cost. (Source: Kohler)
Cost Centre	Organisational units where only costs can be identified. There are no revenues.
Cost Objective	The activity, organisational unit, immediate product or service, or ultimate end product, with which a cost is identified. (Source: Kohler)
Cost-plus Pricing	The practice of determining selling price by adding a profit factor (ie mark-up) to costs. (Source: Kohler)
Creditor	One to whom a debt is owed (ie accounts payable). (Source: Kohler)
Creditors' Ledger	(Also called Accounts Payable Ledger) A ledger containing accounts with creditors. (Source: Kohler)
Crown	"Her Majesty the Queen" in right of New Zealand. The Governor General represents the Queen in Council. The Crown includes government departments and government agencies but not local authorities or state owned enterprises. (Source: Treasury)
Current Assets	Those assets which are expected to be realised in cash or sold or consumed within one year of balance date. (Source: SSAP 9)

Current Liabilities	Those obligations which are expected or could be required to be met within one year of balance date. (Source: SSAP 9)
Database	A body of stored data organised for retrieval by computers.
Debtor	One who owes a debt and has a legal duty to pay it, (ie accounts receivable). (Source: Kohler)
Debtors' Ledger	(Also called Accounts Receivable Ledger) A ledger that records a list of customers by account order, who owe money to the organisation in the normal operation of the business. A record is kept of each invoice prepared until the debt owing is acquitted (usually by receiving payment).
Depreciable Assets	Assets which are: a expected to be used during more than one accounting period and; b have a limited useful life; and c are held by an enterprise for use in the production or supply of goods and services, for rental to others or for administrative purposes. (Source: SSAP 3)
Depreciation	The wearing out, consumption or other loss of value of an asset whether arising from use, passing of time or obsolescence through technological and market changes. Is accounted for by the allocation of the depreciable amount of a depreciable asset over its useful life. (Source: SSAP 3) There are two major methods of depreciation: - Straight line depreciation (S.L.) (also called Cost Price - CP) - Diminishing Value (D.V.)
Depreciation Rate	A percentage which when applied to the depreciation base (ie amount of asset to be recovered by depreciation) will yield the depreciation expense for the year.
Diminishing Value (D.V.)	A method of calculating the annual depreciation expense by applying a fixed percentage to the diminishing balance of the asset account (ie being the balance after deducting preceding provisions for depreciation). (Source: Kohler)
Direct Costs	- Costs that can be traced to a particular cost objective (eg product or cost centre). (Source: FMSS)

Direct Labour	Labour cost that can be directly traced to the cost objective of a product or service. (Source: FMSS)
Direct Materials	Material costs that can be directly traced to the cost objective of a product or service. (Source: FMSS)
Economies of Scale	The phenomenon of decreasing average costs of production over a long range of output.
Equipment	See Plant and Equipment.
Estimates of Expenditure	The detailed statement of the amounts the Government wishes Parliament to approve, by means of the Appropriation Bill, for individual departments to spend in the current year. Full title is "The Estimates of the Expenditure of the Government of New Zealand". (Source: Estimates Commentary)
Expense	A cost that has been incurred to provide a service or product.
Financial Accounting	A method of reporting an organisation's past financial position, income and changes in financial position to investors and other interested parties.
Financial Allocation	See Appropriation
Financial Costs	The cost of obtaining finance for an organisation's capital requirements (eg interest, bank fees etc).
Financial Year	Normally a period from 1 April to 31 March.
Finished Goods	Cost of unsold but fully processed goods (makes up part of the stock in the balance sheet under current assets).
Fixed Assets	Those assets which will generate cash flows or service benefits during periods beyond the current financial period. (Source: FMSS) Note: For the Private Sector, SSAP 9 defines fixed assets as "those assets held with the object of earning revenue, directly or indirectly, and not for the purpose of sale in the ordinary course of business".
Fixed Costs	Costs which do not change in response to changes in the level of activity. (Source: The Accountants Manual)
FMIS	Financial and Management Information System.
FMSS	Financial Management Support Services (a unit attached to Treasury).
Furniture and Fittings	Any fixed asset that is used in the indirect operation of the business. The assets are usually easy to remove and provide comfort and support to staff, (eg furniture, floor coverings, blinds and light fittings).

CENTRALISED CONTROLS ON CASH EXPENDITURE

Regional Treasury Office (RTO)

Being Auckland, Wellington and Christchurch

Are responsible for data integrity

- Checks Daily
  * Batch Totals
  * Cash Totals
  * Signatures

Treasury (Head Office Accounts) and Audit Office

- Prepare requisition comprising details of payments to be made plus the daily funding cheque, the cheque must be approved and signed by:

  * Treasury Signatory
  * Audit Office Signatory

Both are required by Act to check the requisition details and the following:

* Public Account overdraft level
* Warrants valid?
* Sufficient imprest supply available?
* Is the imprest account/s limit exceeded?
* Does amount result in overspending?
* Are there any other reasons for withholding the requisition or the daily funding cheque? eg, Suspense Account, PADA Reconciliation, Public Account Credits, Imprest Accounts not balanced?

Reserve Bank

The Reserve Bank produces the Public Account statement including PADA and Imprest accounts. The statements are reconciled by Treasury or the associated government department respectively.

General Ledger	A ledger containing accounts in which all the transactions of a business enterprise are classified either in detail or in summary form. Standard periodic reports are usually prepared from the general ledger that provide financial accounts with such comparative balances as year to date, budgets and previous years figures.
Government Agency	Any department, instrument, or agent of the Government. Also includes a body corporate or organisation that is wholly owned or controlled by the Crown or by any such department, instrument, agent, body corporate, or organisation; but does not include a government department. (Source: Public Finance Act)
Government Departments	Any department or instrument of the Government, or any branch or division thereof, that: a Has its own vote; and b Does not have an account or accounts established by any Act in which all or most of its financial transactions are recorded. But does not include a body corporate or other legal entity (other than the New Zealand Government Property Corporation) that has power to contract. (Source: Public Finance Act)
Gross Government Expenditure	The total amount spent by a department over a period without deducting departmental receipts. In the case of most departments, Parliament appropriates gross expenditure. (Source: Estimates Commentary)
Hardware	Physical components of a computer system (eg mechanical, magnetic, electrical or electronic devices).
Historical Cost Accounting	Financial accounts which have been prepared in accordance with the general principles of the historical cost method. This definition is also extended to cover situations where the historical cost method has been modified by the revaluation of some assets. (Source: CCA 1)
IAS	International Accounting Standards
Indirect Costs	The sum of indirect labour and indirect material.
Indirect Labour	Labour costs incurred but not directly traceable to a specific cost objective. (Source: FMSS)
Indirect Material	Material costs that are not directly traceable to a cost objective (eg finished products). (Source: FMSS)

Intangible Assets	A capital asset having no physical existence, its value being limited by the rights and anticipated benefits that possession confers upon the owner (eg goodwill, patents, trademarks). (Source: Kohler)
Integrated Data Processing	Data processing in which the co-ordination of data acquisition and all other stages of data processing are achieved in a coherent system (eg the one system can accomplish the functions of scheduling, invoicing and accounting).
Interface	Link between two computer systems. An interface might be a hardware component to link two devices or it might be a portion of storage or registers accessed by two or more computer programmes.
Internal Control	Comprises the organisational plan and all the co-ordinate methods and measures adopted within a department to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, encourage adherence to prescribed managerial policies and secure compliance with legislative provisions. (Source: Treasury Instructions C1)
Inventory	(Also called Stock) The total of all raw material, work in progress and finished goods owned by an organisation.
Invoice	A document showing the character, quantity, price, terms, nature of delivery and other particulars of goods sold or of services rendered. (Source: Kohler)
Item	A functional classification of expenditure within an activity eg Vote: Education; Programme II: Pre-School Education; Activity: Free Kindergarten; Items: Personnel. (Source: Estimates Commentary)
Journal	A record of accounting transactions showing the name of accounts, the amounts and any useful supplementary information about the transaction. (Source: Treasury)
Land	An investment in real estate, usually including land improvements completed (eg paving, fencing) before the purchase of real estate, but not including buildings or other limited-life structures. (Source: Kohler)
Ledger	A device for reclassifying and summarising accounting information. It can be in the form of a General Ledger (a chart of account codes), a Debtors Ledger being a collection of debtors by customer, a Stock Ledger by stock item number or a Creditors Ledger by creditor's code.
Liabilities	The obligations of an entity to other parties. (Source: FMSS)

Loans Account	Records the proceeds from all new loans raised (except those raised for redemption of loans) in New Zealand or overseas during the financial year. The payments side of the account records the disbursement of these proceeds by annual and permanent appropriations, and by way of transfers to other accounts within the Public Account. A non-cash item is included on both the receipts and payments side of the account to record the value of capital equipment purchased under credit arrangements. (Source: NZ Gazette)
Loans Redemption Account	Records how loan moneys received specifically for the purpose of repaying or redeeming public debt, together with other receipts credited to the account, have in fact been applied to convert or repay public debt. The account also records cash received and paid in respect of the issue and redemption of Treasury bills. (Source: NZ Gazette)
Long-term Liabilities	Those obligations which are not expected or could not be required to be met within one year of balance date. (Source: SSAP 9)
Management Accounting	Accounting designed for or adopted to meet the information and control needs of management.
Market Value	The price at which a willing seller and a willing buyer will trade.
Materiality	A statement, fact or item is said to be material if, given full consideration of the surrounding circumstances at the time of completion of the financial statements, it is of such a nature that its disclosure, or the method of treating it, would be likely to influence the making of decisions by the users of the financial statements. (Source: SSAP 6)
MIS	Management Information System. Provides both financial and non-financial data for the purpose of gathering, organising, communicating, and presenting information to be used by the organisational units and individuals for the planning, controlling, and reviewing of the organisation's operations. (Source: The Treasury - Financial Management Guidelines)
Motor Vehicles	Includes motor cars, motor trucks, land drover type vehicles, motor cycles, omnibuses, ambulances, fire appliances, and multi-axle drive vehicles, but not items of plant such as tractors, graders, trailors, compressors and earth moving machinery. (Source: Treasury Instructions K2) Note: This definition is wider than that given in the Income Tax Act 1976.

National Roads Fund	(As established under Section 22 of the National Roads Act 1953.) Its purpose is to record certain indirect taxation revenues specifically set aside to fund expenditure on construction and maintenance of roads. The account also records other monies appropriated for these purposes. (Source: New Zealand Gazette)
Net Government	A term which is: 1 gross expenditure less departmental receipts. This definition is the one which appears in the Estimates of Expenditure. 2 used to describe the expenditure definition on which Budget Table 2 is based. In this sense, some deductions additional to departmental receipts are made to gross expenditure. (Source: Estimates Commentary)
Overhead	Any costs of doing business other than direct labour and direct material costs.
Performance Measurement	A system of measuring and analysing performance against stated objectives. Performance indicators for effectiveness are selected events, the occurrence of which best indicate the achievement of the objectives. Performance indicators for efficiency are selected ratios which focus on outcomes in relation to inputs. (Source: The Treasury - Financial Management Guidelines)
Periodic Inventory System	System where stock is valued by actually counting all the stock (usually annually).
Perpetual Inventory System	System where stock is valued throughout the year by keeping a continuous and up-to-date record of stock in and stock out.
PIPS	Personnel Information and Payroll System.
Planning	The process of setting goals and objectives and specifying the actions required to obtain them.
Plant and Equipment	Any fixtures, implements, machinery and apparatus used in the carrying on of any industrial process. Does not include stock which is purchased or specially made for sale. To be plant, an item must be income-earning and have a degree of permanence. (Source: NZ Master Tax Guide)
Posting	The process of making changes to the balances of accounts by posting journals.

Product	A good or service to the utility or value of which an operation or series of operations has contributed. An intermediate (or through) product is one on which further operations are to be performed. A final (or end) product is any good on which all contributory operations have been completed, or any service that has been fully rendered. (Source: Kohler)
Product Cost Per Unit	The total costs of producing a product divided by the number of units produced.
Profit and Loss Account	A financial statement generated from the balances of general ledger revenue and expense accounts to reflect the matching of revenue against expenses <u>over a period of time</u>.
Profit Centres	A segment of a business that is responsible for both revenues and expenses.
Programme	A classification of spending by a department. Each programme relates to a particular area of responsibility of the Department concerned, eg Vote: Education; Programme II: Pre-School Education. (Source: Estimates Commentary)
PSAS	Public Sector Accounting Standards, as developed by the New Zealand Society of Accountants.
Public Account	Refers to the bank account of that name kept at the Reserve Bank of New Zealand. (Source: NZ Gazette)
Public Accounts	The Public Accounts comprise the five operating accounts established by sections 38 to 42 of the Public Finance Act 1977 together with a suspense account created under Section 37(1)(c) of that Act, and the National Roads Fund established by Section 22 of the National Roads Act 1953. The five main accounts are: Consolidated Account; Loans Account; Loans Redemption Account; Reserve Account; and Trust Account. (Source: NZ Gazette)
Public Finance Act 1977	The principal Act which governs the receipts and payment of public money, the raising of loans by the Crown, and the recording and audit of these activities in the Public Account. (Source: Estimates Commentary)
Public Money	All money, or securities of any kind for the payment of money, received by or for or on account of, or payable to, or belonging to, or deposited with, or held by or on behalf of, the Crown or any government department; and includes trust money and securities representing the investment or advance of any public money. (Source: Public Finance Act)

Public Sector-Entities	Comprise - Central government departments of state and local authorities - entities majority-owned by central government or local authorities - public education authorities - any entity established by an Act of Parliament, which is required to provide an annual financial report to Parliament or to a Minister of the Crown (eg Quango's and Statutory Boards). (Source: SPSAC)
Public Security	Any security issued in respect of money borrowed, or a guarantee given, by the Crown; and includes any loan or credit agreement, guarantee, indemnity, bond, note, debenture, bill of exchange, registered Treasury bill, Treasury promissory note, Government Stock, and any other security, representing part of the public debt of New Zealand. (Source: Public Finance Act)
Public Stores	Chattels, livestock, crops, buildings or other structures (including fixtures), owned by the Crown or in the possession or under the control of any government department. (Source: Public Finance Act)
Purchase Order	A document authorising a vendor to deliver described merchandise or materials at a specified price. (Source: Kohler) In the Public Sector, a Purchase Order for goods is called a Stores Order, for services a Works Order and for travel a Travel Warrant.
Replacement Cost	Means the lower of current purchase price of an asset or an asset of an equivalent operating capability.
Reserve Account	Records funds set aside to meet future contingencies. Transfers into this account are made from the Consolidated Account, but if a contingency arises, the funds may be transferred to any of the other accounts within the Public Account. (Source: NZ Gazette)
Residual Value	The estimated realisable value of a depreciable asset at the end of its useful life. (Source: SSAP 3)
Revaluations	Valuations subsequent to the purchase of an asset.
Revolving Fund	Arrangements under which the expenditure for an activity is funded wholly or substantially from the revenue generated by that activity, rather than from an appropriation. (Source: Treasury Circular 1982/41) Every revolving fund must provide separate financial accounts in line with SSAP's.

SEG	Standard Expenditure Group. The classification of expenditure into personnel, operating costs, capital, grants and advances. Each of these categories constitutes a SEG. (Source: Estimates Commentary)
Service Orientated Activities	Those activities which are generally funded from taxes, rates, levies, grants and loans. Any exchange relationship, if it exists, is incidental. (Source: SPSAC)
Shareholders Funds	A monetary amount that records for accounting purposes what the organisation owes its owners.
SIGMA	System of Integrated Government Management Accounting. Contains a summary record of all cash transactions submitted by departments to Treasury for processing.
Software	A set of computer programmes, procedures and associated documentation concerned with the operation of a data processing system.
SPSAC	Statement of Public Sector Accounting Concepts, as developed by the New Zealand Society of Accountants.
SSAP	Statements of Standard Accounting Practice, as developed by the New Zealand Society of Accountants.
Standard Product Cost	A predetermined cost of a product that is constant over a period of time. It is usually used for planning and controlling production and cash management.
Stock	See Inventory.
Stores Order	A purchase order sent to a supplier requesting the purchase of stock.
Straight Line Depreciation	The assignment of equal portions of the fixed assets depreciation cost against the number of years the organisation is expected to benefit from keeping the asset.
Suspense Account	A clearing account for receipts banked. (Source: NZ Gazette)
Tangible Assets	Any asset having a physical existence, being any asset other than an intangible asset. (eg cash, debtors, plant, land etc).
Transfer Price	The price charged by one division of an organisation when it supplies a product or service to another division of the same organisation (Note: The transfer price can be set at cost, market or cost plus.)

Travel Warrant	A purchase order that provides authority to purchase travel.
Trust Account	An account which contains over 50 separate accounts and is primarily used to record monies received or held in trust. Monies paid into the account are generally available to be applied only for the specific purpose for which they were received. (Source: NZ Gazette)
Useful Life	Refers either to the period over which a depreciable asset is expected to be used or to the number of production or similar units expected to be obtained from the asset. (Source: SSAP 3)
Variable Costs	Costs that vary in proportion to the level of activity. (Source: The Accountants Manual)
Variance	The difference between actual results and planned results or the results of past financial years.
Vote	A category of services and purposes relating to a departmental or other function, for which money is appropriated by an Appropriation Act in a financial year. (Source: Public Finance Act)
Work in Progress	Semi-processed stock on the factory floor.
Works Order	A purchase order sent to a supplier by an organisation requesting the use of services.

Appendix 2

I. 6c

Report of the

Government Administration Committee 1987

Report of the Inquiry into Departmental Annual Reporting Standards

SECOND SESSION, FORTY-FIRST PARLIAMENT

(FRAN WILDE, CHAIRMAN)

Laid on the Table of the House of Representatives

Price Code: 11—C

1. ORDER OF REFERENCE

Under Standing Order 322 (6) (c) empowering the Government Administration Committee to have responsibility for the overall review of administration and management in government departments and. other government bodies, the Government Administration Committee resolved to conduct an inquiry into departmental annual reporting standards.

2. COMMITTEE PERSONNEL

2.1 The members of the Government Administration Committee during 1987 were:

Fran Wilde (Chairman)

Helen Clark

Mr McLean

Trevor Mallard

Mr R. F. H. Maxwell

2.3 Staff assisting the Committee were:

Mr D. Taylor, Committee Clerk

Lyn Main, Advisory Officer

3. BACKGROUND

3.1 The Government Administration Committee resolved to examine departmental annual reporting standards in October 1986. The Committee considered that the overall standard of departmental reporting was inadequate for the purposes of government accountability to Parliament and the public. The Committee believed that the majority of departmental annual reports do not provide sufficient relevant information to determine whether public resources have been used efficiently or effectively.

3.2 The State Services Commission offered to establish a working party of officials to examine ways of improving departmental annual reports. The Government Administration Committee accepted this offer and requested that the working party submit a report including its recommendations to the Committee.

3.3 The terms of reference adopted by the working party were:

1. To consider the information required in departmental annual reports to improve departmental accountability to Parliament and to develop minimum disclosure specifications.
2. To make recommendations to the Government Administration Select Committee on desirable minimum disclosure specifications for departmental annual reports which can be implemented for the 1987–88 financial year..

3. To make recommendations on the best method of promulgating such standards.
4. To comment on any direct or indirect costs associated with improving reporting standards.
5. To make recommendations on the work required to further develop reporting standards.

4. CONTENT GUIDELINES FOR DEPARTMENTAL ANNUAL REPORTS

4.1 The Committee received the working party's report in May 1987. The Committee invited the following witnesses to discuss the report at its meetings on 9 June and 16 June:

— Mr D. Swallow, Commissioner, State Services Commission

— Ms J. Whitcombe, Assistant Director, Management Division, State Services Commission

— Mr J. Harper, Senior Advisory Officer, State Services Commission

— Mr M. Matthews, Audit Manager Central Government, Audit Office.

4.2 The Committee believes that annual reports should contain sufficient financial, non-financial and narrative information to allow a comparison to be made between the goals and objectives of the department for the year, and what was actually achieved, together with the use made of resources allocated. Annual reports should be brief, accurate and disclose significant information to allow informed judgements to be made on performance.

4.3 The Committee discussed with the witnesses the proposed content guidelines for departmental annual reports. It was agreed that the guidelines should be:

(a) capable of immediate implementation by departments with a minimum of additional costs;

(b) consistent with other moves towards improved departmental accountability;

(c) capable of implementation in all departmental reports for the financial year ended 31 March 1988.

4.4 The content guidelines specify the nature and range of information required in annual reports. It is emphasised that the guidelines would provide the minimum information required for accountability purposes and that additional information may be added at the discretion of the government departments.

4.5 The Committee felt that the required information could be divided between the narrative sections of annual reports which focus on the performance of the department and the appendices which provide details of resource usage and operational information. The content guidelines are provided in Appendix 1.

4.6 **The Committee recommends that the Government promulgates the content guidelines to government departments.**

5. PROMOTION PLAN

5.1 The Committee considered it crucial that the content guidelines be promoted as well as disseminated to all permanent heads and other relevant personnel of government departments. The Committee asked the working party to prepare a promotion plan. The promotion plan, attached as Appendix 2, was approved by the Committee.

5.2 **The Committee recommends that the State Services Commission co-ordinates the promotion of the content guidelines.**

6. FUTURE WORK ON DEPARTMENTAL REPORTING

6.1 Although this inquiry focused on departmental annual reporting standards, the wider context of reporting by government departments to Parliament was discussed by the Committee. The Committee recognises that the implementation of the content guidelines in departmental annual reports is only the first phase in improving disclosure by departments. The next phase would involve establishing the users' needs for information in the light of the appropriate accountability relationships of government departments to their Ministers and to Parliament.

6.2 The Committee reviewed other reports in the course of its inquiry. The Committee considers the important issues raised in the report of the 1984 Public Expenditure Committee on the Format and Content of the Estimates and the Public Accounts have not been resolved, and must be dealt with in future work.

6.3 The Committee also noted the Controller and Auditor-General's comments on reporting standards in Central Government. In his 1986 and 1987 reports on the Public Accounts (B.1 [Pt.II]), the Controller and Auditor-General recommended that a comprehensive study be undertaken of the appropriate objectives, form and content of financial reporting for Central Government in New Zealand.

6.4 The Committee intends to undertake further work to develop a framework which establishes the appropriate forms of accountability between departmental managers, their Ministers and Parliament.

6.5 The Committee noted that some government departments do not table annual reports. Members felt that The Treasury in particular, should be subject to the same level of parliamentary scrutiny as other departments.

6.6 **The Committee recommends that the Government requires The Treasury to table in Parliament an annual report on its departmental activities.**

6.7 The Committee noted that the Finance and Expenditure Committee recommended in its Report on the 1986–87 Estimates of Expenditure for Vote Parliamentary Service that the printing of departmental annual reports be a cost against the vote of the various departments, rather than the Parliamentary Service. The Committee supports this recommendation.

7. RECOMMENDATIONS

The following recommendations have been made by the Committee:

1. That the Government promulgates the content guidelines, attached in Appendix 1 to this report, to government departments.
2. That the State Services Commission co-ordinates the promotion of the content guidelines.
3. That the Government requires The Treasury to table in Parliament an annual report on its departmental activities.

Appendix 1

CONTENT GUIDELINES FOR DEPARTMENTAL ANNUAL REPORTS

Narrative Information

(i) Role (Mission) Statement:

A statement of the purpose for which the Department exists.

(ii) Goal Statement:

A statement of the intended outcomes of each Programme/major activity of the department stated in the broadest terms.

(Note: This statement should reflect policy outcomes contained in 3 Year Forecasts.)

(iii) Objectives Statement:

A statement of the key results which the department sought to achieve in the reporting period. (Details to be shown in Appendix.)

(iv) The major problems and issues that have arisen during the reporting period and the action taken thereon.

(v) The reasons for any significant delays to, amendment to, deferment or cancellation of, major works or programmes.

(vi) Factors which have affected the achievement of the service objectives of the department during the reporting year.

Historical Material:

General historical material should be kept to a minimum and be included only where it demonstrates the performance of the department.

APPENDICES (should contain the following range of information)

Organisational Information

A Legal Responsibilities:

A statement of the legislation which the department administers (including delegated legislation such as regulations).

B Operating Environment:

A statement of changes which have taken place in the environment within which the department operates, including any changes in legislation and regulations, and significant judicial decisions affecting the department.

C Management and Structure:

A statement of:

- the names and designations of senior officers of the department;
- a simplified organisation chart showing functional responsibilities within the department for major activities;
- a list of committees (statutory and non-statutory) serviced by the department which have met during the reporting period together with the number of times each met.

D Human Resources:

A statement of:

- the reasons for any exceptional movement in wages, salaries or allowances;
- any personnel policies and practices which vary from service-wide procedures;
- industrial relations policies and practices (where these vary from service-wide procedures);
- action taken to implement equal employment opportunity (EEO) practices and a multicultural perspective;
- summary details of the use of external consultants by the department.

E Access and Promotion:

A statement of the kinds of information available to the public/clients about services provided and which also includes an outline of what the department is doing to maintain and improve its relationships with the public and with its clients. This statement should include information on departmental initiatives to provide a multicultural service.

Operational Information

Statement of Service Performance:

The statement of service performance provides qualitative and quantitative measures of service(s) provided for each major activity undertaken by the department during the reporting period. The statement should cover each major (functional) activity—which may be represented by a Programme, a SIGMA Activity or an organisational unit. The statement will cover:

(i) Key corporate plan objectives for the period reported on;

(ii) A **brief** description of the nature and range of each Programme/major activity undertaken;

(iii) The number of employees under each Programme/major activity, by occupational category, with comparative data for the two years prior to the reporting year;

(Note: The reasons for any significant changes should be highlighted.)

(iv) (As far as practicable) qualitative and quantitative measures and indicators of performance showing the level of efficiency and effectiveness;

(Note: The emphasis is on results/outcomes, i.e. what was **achieved.** Process information about what was **done**—concerning the use of inputs or resources—should be avoided.)

(v) Any measures of client satisfaction/dissatisfaction with the department's services;

(vi) The nature and extent of individual and organisational performance review practices used, including information of the Department's internal audit function;

Where appropriate the Statement of Service Performance should also include:

— Particulars of significant completed research and continuing research and development activities together with the resources allocated for that research and those activities;
(Note: "development" as used above refers to the design/production of improved materials, devices, products, processes, systems or services prior to commencing production of new or changed government goods or services.)

— Details, lists or tables of major works (including management systems) in progress;

— A description of action taken to develop or improve resource management practices.

Financial Information

A Statement of Accounting Policies:

Every departmental report must include a statement of the above as part of its presentation of Financial Information. Guidance on what this statement should cover can be obtained from the "Statement of Standard Accounting Practice No. 1 1983" and from the "Statement of Public Sector Accounting Concepts", June 1986, issued by the Council, New Zealand Society of Accountants.

B Statement of Budget and Expenditure:

This is a Statement of budgeted expenditure and revenue and actual expenditure and revenue for the reporting period. This information should be shown in the same format and level of detail as appeared in the previous year's Estimates of Expenditure. The cost of providing the services for each major activity in the Statement of "Service Performance" should be identified. The proportion of costs recovered should also be identified. Comparative expenditure information for the previous year should also be shown where this is available in the same format.

(Note: Where accrual based accounts are prepared, these should be published in the departmental annual report.)

C Commercial Accounts:

Where a department is involved in only commercial activities, or is responsible for administering and reporting the results of a commercial activity, the Financial Statement should be prepared in accordance with any statutory or professional accounting requirements.

D Statement of Assets and Commitments:

A statement of major assets held by the department is required. Where valuations exist, the basis of these should be shown either in the "Statement of Accounting Policy" or as footnotes.

Commitments should be stated together with a clear indication concerning how these are defined (e.g. contractual, contingent liability, creditor etc. . .).

E Notes on Financial Information:

Explanatory details should be supplied where appropriate on all financial topics and comment should be made on all significant or non-routine financial matters not separately identifiable in the above sections. Examples include:

— acquisitions and disposals of major assets;
— trends in income (received and projected);
— services received and given free of charge;
— major commitments not entered in the books of account;
— contingencies;
— work in progress.

(Note: All explanatory detail and comments should be fully cross-referenced.)

F Attestation (Audit Report);

All financial information in departmental annual reports must be attested to by the Audit Office and as from the year ended 31 March 1988, departmental annual reports must include an Audit Office statement.

Appendix 2

PROMOTION PLAN: "CONTENT GUIDELINES FOR DEPARTMENTAL ANNUAL REPORTS"

Below are described the specific actions which will be undertaken to promote compliance with the above guidelines and also noted are ongoing support services to departments.

OBJECTIVE

To produce a commitment to complying with the "Content Guidelines for Departmental Annual Reports" among Permanent Heads and operational managers of government agencies who prepare annual reports to Parliament.

BENEFITS OF THE GUIDELINES

In promoting the adoption of the guidelines, the benefit to departments will be stressed. The central feature is that better understanding of a department's role and of the work it does will result from increased disclosure. The result of such improved understanding by both Parliamentarians and the public should be a clearer focus on just what can and should be expected from departments.

TARGET AUDIENCES

There are three main target audiences for the promotion—

(i) Permanent Heads

(ii) Operational Managers

(iii) Financial Managers.

On the basis of existing positive feedback from the "Social" Permanent Heads it appears that there is general agreement to the need for, and value of, increased disclosure. Promotion to Permanent Heads is considered to be most effectively carried out through one of the meetings of Departmental Heads where Annual Reporting standards will be an Agenda item.

Operational and financial managers must have the best knowledge of programme management and they provide the raw material for departmental annual reports. Their commitment to identifying, compiling and analysing relevant performance-related information will determine the overall quality of departmental annual reports. As there are large numbers of such managers, they can be reached through in-house seminars on the topics and through printed material.

A proposed timetable of actions to promote the new "Content guidelines" is attached.

ROLE OF CENTRAL AGENCIES

State Services Commission:

The State Services Commission will assume overall responsibility for co-ordinating the promotion of guidelines. In addition a Management Advisory Officer will be designated as a contact person for departmental enquiries.

Financial Management Support—FMSS—(Treasury):

The FMSS will contribute to the promotion programme (as staff commitments permit)—particularly the proposed meeting of Permanent Heads and the forum for operational managers.

Audit Office:

The Audit Department will promote compliance with the proposed guidelines are part of its overall initiative towards improving disclosure by departments and developing improved accountability mechanisms.

Treasury:

Treasury will contribute to the seminars for financial managers.

PERFORMANCE MEASURE

The effectiveness of the promotion campaign will be measured as follows:

Process Measures: Seminar attendance; inquiries dealt with; favourable feedback

Outcome Measures: Extent to which 1987–88 departmental reports comply with the guidelines

TIMETABLE

Week 1
- Issue "Content Guidelines" with covering letter to Permanent Heads.
- Publish full page article in the Public Service Official Circular announcing guidelines and the promotional programme.

Week 2
- Hold meeting of Permanent Heads.
- Hold half day forums on improved reporting for operational managers and financial managers.

Weeks 3–5
- Schedule series of specific in-house departmental seminars (if necessary).

Week 6
- Identify and meet personally with all individual officers responsible for preparing departmental annual reports.

ONGOING SUPPORT

Contact person (State Services Commission)

FMSS

General support and advice on request to Audit Department.

BY AUTHORITY:
V. R. WARD, GOVERNMENT PRINTER, WELLINGTON, NEW ZEALAND—1986
73194E—87PT

New Zealand Society of Accountants

PUBLIC SECTOR ACCOUNTING

EXPLANATORY FOREWORD

July 1987

Explanatory Foreword to the Statement of Public Sector Accounting Concepts and Public Sector Accounting Statements

1 AUTHORITY AND SCOPE

1.1 The Statement of Public Sector Accounting Concepts (SPSAC) and Public Sector Accounting Statements (PSAS) describe methods of reporting approved by the Council of the New Zealand Society of Accountants for application to the reports of public sector entities.

1.2 These Statements provide guidance as to the accounting principles that should be adopted in preparing external financial statements for public sector entities. For those entities undertaking commercially oriented activities it is often appropriate to apply the general body of Statements of Standard Accounting Practice. However, financial reporting for entities undertaking service oriented activities should be primarily concerned with reflecting the costs of providing services to the community during the accounting period. For such entities a combination of financial and non-financial information is required to reflect the level and quality of service provided.

1.3 In may cases legislation and directives prescribe the information to be presented. This should be regarded as the minimum to be presented and public sector entities are encouraged to adopt the practices in these Statements.

2 REQUIREMENT

2.1 The Society requires members who are in charge of the preparation of financial statements of a public sector entity or have some responsibility for the issue of such statements (by their association with such financial statements as members of the governing body of the entity, as officers responsible for the management of the entity, as advisors to government on accounting and financial matters or as accountants responsible for the preparation of financial statements, or as auditors) to use their best endeavours to bring reporting practices in to line with the concepts in the SPSAC and the practices prescribed in PSASs. Such members are required to take all reasonable steps within their power to ensure that any material departures from a Statement, the reasons for such departure and its financial effects, are properly disclosed and explained in the financial statements.

Auditors

2.2 The concepts in the SPSAC and the practices prescribed in PSASs should be compared by the auditor with the policies adopted by the entity which is being reported on. Where there is a conflict the auditor should determine whether the policies adopted are appropriate and sufficient to produce information of the quality embodied in the concept of a true and fair view which governs reporting by business enterprises. If this is not the case the auditor is expected to take the steps outlined in the Auditing Standards and Auditing Guidelines.

2.3 There may be very rare circumstances in the preparation of reports in which adherence to the SPSAC or a PSAS does not in the auditor's view provide a true and fair view. In such circumstances the auditor should express a qualified opinion.

3 FUTURE DEVELOPMENTS

3.1 Methods of reporting evolve and alter in response to changing social and economic needs. From time to time new PSASs will be issued, and established PSASs will be reviewed with the object of improvement in the light of new needs and developments.

4 RELATIONSHIP OF PUBLIC SECTOR ACCOUNTING STATEMENTS WITH STATEMENTS OF STANDARD ACCOUNTING PRACTICE

4.1 In general, PSASs should not conflict with SSAPs. In the event of conflict, for the purposes of reports on entities undertaking service oriented activities only, the PSASs will prevail. Reports on entities undertaking commercially oriented activities should follow SSAPs.

New Zealand Society of Accountants

STATEMENT OF PUBLIC SECTOR ACCOUNTING CONCEPTS

SPSAC
July 1987

Statement of Public Sector Accounting Concepts

1 INTRODUCTION

1.1 The public sector comprises many and varied entities which include central government departments, local authorities, public education authorities, statutory boards and corporations. These entities may engage in service oriented and/or commercially oriented activities and will differ from business enterprises as regards both objectives and financing.

1.2 As part of the accountability process public sector entities have obligations to prepare and publish external financial reports. The concepts contained in this Statement emphasise relevant disclosure as the primary means of achieving accountability in the public sector. Environmental conditions which govern an entity's operation and its delivery of services include general constitutional and statutory criteria for the control of public monies. Financial reporting should reflect specific policies and criteria for the allocation of resources, the efficiency of public administration, and for the effectiveness of welfare delivery.

1.3 This Statement identifies the objectives for external financial reporting by all public sector entities, describes the form of reporting consistent with those objectives and is intended to provide a conceptual basis for a series of Public Sector Accounting Statements (PSAS).

1.4 External financial reporting by public sector entities is in many cases prescribed in legislation and other directives. While the obligation to comply with these requirements is recognised, all public sector entities are encouraged to adopt the concepts in this Statement.

2 APPLICATION

2.1 The concepts in this Statement apply to all entities falling within the definition of the public sector contained herein.

3 DEFINITIONS

3.1 *Public Sector Entities*
For the purpose of this Statement public sector entities comprise:
- central government departments of State and local authorities;
- entities majority owned by central government or local authorities;
- public education authorities; and
- any entity established by an Act of Parliament, which is required to provide an annual financial report to Parliament or to a Minister of the Crown.

3.2 *Service Oriented and Commercially Oriented Activities*
Public sector entities engage in service oriented and/or commercially oriented activities. These activities differ according to the degree to which there is an exchange relationship between the entity and the consumers of the goods and services provided. A service oriented activity is generally funded from taxes, rates, levies, grants and loans and any exchange relationship, if it exists, is incidental. In contrast, a commercially oriented activity is characterised by a direct exchange relationship in which the user fees charged for specific gooods and services provided are closely linked to costs incurred and are an important determinant of quantity consumed.

3.3 *Statement of Objectives*
A Statement of Objectives provides a formal expression of the mission and overall objectives of the reporting entity.

3.4 *Statement of Service Performance*
A Statement of Service Performance provides, for each significant activity undertaken by the reporting entity, a report on the degree of success achieved in meeting targets in qualitative and quantitative terms.

3.5 *Statement of Cost of Services*
A Statement of Cost of Services discloses the costs incurred for each significant activity by the reporting entity.

3.6 *Statement of Cash Flows*
A Statement of Cash Flows discloses cash flows from all sources relating to the operating, financing and investing activities of the entity, and encompasses all funds maintained by the entity.

3.7 *Statement of Financial Position*
A Statement of Financial Position discloses all of the assets and liabilities of the entity, appropriately classified, including contingencies, but excluding community assets.

3.8 *Statement of Resources*
A Statement of Resources describes in physical terms the major resources held by the reporting entity.

3.9 *Statement of Commitments*
A Statement of Commitments discloses significant amounts authorised and/or committed to significant future activities, for example, capital projects of the entity.

4 DISCUSSION

Objectives

4.1 The objectives of external financial reporting by public sector entities embody the disclosure of information useful for:

(a) evaluating accountability over the use of public resources in terms of efficient administration and also effective service delivery. Aspects of evaluating accountability include:
- i) assessing financial position and results of operations;
- ii) evaluating effectivness and efficiency; and
- iii) determining compliance with statutory financial restrictions and regulations.

(b) decision-making about the allocation of funds and resources.

4.2 External financial reporting by public sector entities is concerned with general purpose reports intended to meet the information needs of a wide range of potential users. Reports prepared by public sector entities may be intended for the wider community or for specific users identified in legislation. The set of users may be categorised as follows:

- citizens, whether classified as electors, taxpayers, ratepayers, or as recipients of the goods, services or benefits provided by public sector entities;
- providers of resources to these entities;
- the elected or appointed representatives of the above groups through such bodies as local authorities and Parliament and by devolution, government departments;
- analysts and members of the media concerned with analysis, review, and dissemination of the information provided in reports.

It is recognised that many of these users individually lack the authority necessary to demand and achieve satisfaction of their particular information needs.

4.3 Adherence to the concept of a true and fair view is an essential requirement of financial reporting by business enterprises. It is important that the financial reports of public sector entities should also achieve the quality of information implicit in this concept.

4.4 In order for financial reports to be useful the information provided should possess the following basic qualities: understandability, reliability, relevance, timeliness, consistency and comparability.

Financial Reporting

4.5 While the general body of Statements of Standard Accounting Practice can readily be applied to reporting on commercially oriented public sector activities, they centre on the measurement of profit, and are therefore less appropriate to service oriented activities. This Statement is intended, in particular, to establish concepts for reporting on service oriented activities.

4.6 The first consideration that should concern the preparer of financial statements for a public sector entity is whether the entity conducts commercially or service oriented activities or whether it conducts an amalgam of both. Because of the wide variety of intermingled service and commercially oriented activities covered by public sector entities, it would not be practicable in this Statement to define criteria that would provide adequate specific guidance in the making of this decision for all the activities covered by those entities. The decision, finally, must rest with the issuers of the financial statements.

4.7 Budgets generally set the basis of a rate, tax, levy, or other source of funding, (for example a loan, or user charge) and are often made public on determination. It is considered that a comparison between budgeted and actual financial results for the reporting period is an important step in the accountability process. Financial statements should therefore show the budget for the reporting period together with the actual results for that period and the previous period.

4.8 Public sector entities conducting service and commercially oriented activities should show the aggregate result of operations and financial position for commercial and service oriented activities.

Reporting Commercial Activities

4.9 Even though public sector entities undertaking commercially oriented activities may be operated in a manner very similar to private sector entities, their activities will typically be affected by social considerations. For example, the entity may be directed to continue to provide uneconomic services and the price setting process generally may be subject to social influences. Hence Statements of Objectives and Service Performance should be provided, as well as applying the general body of Statements of Standard Accounting Practice.

Reporting Service Activities

4.10 As the emphasis of public sector entities conducting service oriented activities is to provide a community service, external reporting by such entities should measure the level, quality and cost of goods and services provided to the community.

4.11 For entities conducting service oriented activities, relating the goods and services provided to the costs of the goods and services is of greater significance than the matching of income against expenditure. A significant element of the funding for these entities is normally provided from rates, taxes, levies and grants. These sources may be supplemented by user charges. In setting charges, notional concepts of return on capital may be employed but social considerations tend to be dominant. The methods of financing expenditure should be shown separately. Accordingly, public sector service oriented activities should disclose the following information:

- the objectives of the entity;
- the level of services planned in both quantitative and qualitative terms;
- the budgeted costs and financing required to achieve the planned levels of services;
- the level of services actually provided;
- the actual costs and associated financing in the provision of the services for the reporting period and the previous period.

Performance Measures

4.12 There are, at present, few guidelines developed as to the manner of preparation and presentation of performance measures and there could be difficulty in the initial period in determining measures of physical and qualitative performance. This is a field of reporting which is still very much in the process of development but it is important that these measures should report achievements rather than workloads and inputs.

4.13 A number of factors arise in the application of performance measures. These include the following considerations:

- there may be no adequate direct measure and therefore surrogates may have to be used;
- social perceptions may change and with them the relevance of particular performance measures;
- there should be a balance between the information provided and the cost of that information.

These factors notwithstanding, the provision of performance measures is an important attribute of a report on the activities of a public sector entity. Therefore such measures should be included in the reports on both commercially and service oriented activities.

Community Assets

4.14 The fixed assets held by a public sector entity are many and varied. Some are held for service oriented purposes, some for commercially oriented purposes and some for both.

4.15 Some of the assets are infrastructural assets which have no determinable useful life and provide a social service rather than a commercial service. These assets are referred to as community assets. They are frequently large, not capable of subdivision for ready disposal, usually have no readily determinable market value and there may be constraints on the capacity of the reporting entity to dispose of such assets.

4.16 Determination of whether an asset is or is not a community asset is a matter of judgement. In determining whether an asset is a community asset regard should be had to the following factors:

- the period of use of the asset;
- the degree to which there is a market in which the asset could be sold;
- whether or not it is within the capacity of the reporting entity to dispose of the asset;
- the purpose for which the asset is used.

4.17 Depreciation of an asset is the wearing out, consumption or other loss of value of the asset and is accounted for by allocation of the depreciable amount over the useful life of the asset. Although community assets could be subject to the wearing out process, this is usually made good by maintenance. Hence, depreciation should not be charged on community assets (as opposed to other fixed assets) and instead the cost of use should be reflected in expenditures on maintenance.

4.18 The primary function of service oriented public sector activity is to meet social needs. These needs will vary over time. What may be perceived as a need of one generation may or may not be a need for the next generation. It is also for this reason that it is inappropriate to depreciate community assets as this could result in the accumulation of funds. Inter-generational equity would be distorted if the 'present' generation were to set aside funds for the accumulation of wealth for the benefit of future generations who might no longer need the goods and services being provided. It is considered that the provision of well maintained assets fully paid for provides a significant legacy for the future and that each generation should meet the social needs that it perceives to be important.

4.19 Community assets should be reported in non-financial terms in the Statement of Resources, and where feasible, some estimate of the value to the community shown.

Measuring Service Activity Costs

4.20 The reporting emphasis of a public sector entity undertaking service oriented activities is on the cost of providing goods and services to the community during the reporting period. Costs should include administrative and operating costs, maintenance expenditures, financial charges, and depreciation for assets other than community assets.

4.21 Costs should be recognised in the same period that the associated goods and services are provided. This is achieved by accrual accounting.

4.22 While primary emphasis will be on measuring costs of providing goods and services, income should also be accounted for on an accrual basis, as this most fairly reflects the resources available to the reporting entity during the period.

Financial Statements For All Public Sector Entities

4.23 It is appropriate to assess the performance of any entity within the context of the objectives of the entity.

All public sector entities should provide a Statement of Objectives. Objectives exist in a hierarchy with the highest level objective being the mission or purpose of the entity. The mission is the basic purpose of the entity and may include a description of the general nature of the goods and services to be provided by the entity, and the identifiable beneficiaries.

Other objectives range from long-term strategic overall objectives to short term specific departmental and unit targets. These specify the ends to be met if the entity is to achieve its mission, and give rise to the targets against which the performance of the entity can be assessed. The Statement of Objectives should list only the mission and overall objectives of the reporting entity whereas the Statement of Service Performance should include specific targets for comparison with achievements.

4.24 In common with private sector entities, the financial reports of public sector entities should include a Statement of Accounting Policies to provide readers with information as to the accounting bases applied.

4.25 Each public sector entity should report on the assets and operations for which it is responsible. Furthermore, where assets are owned by one entity and used by another both entities should report on their involvement with that asset. Assets may be used, although not owned, by separate entities for different functions. The entity in which ownership vests should account for the period costs and revenues associated with owning the asset and allocating them, if appropriate, to user entities. Any costs incurred and revenues received by the entities using the assets should be disclosed.

4.26 Each public sector entity should disclose significant free services received (provided) where such services are in substance a subsidy granted to (by) the entity.

Financial Statements for Service Activities

4.27 The financial statements of public sector entities undertaking service oriented activities should reflect the emphasis on measuring the cost of services provided. This will entail relating expenditure to the level of service provided during the reporting period rather than measuring profit. A Statement of Cost of Services should be provided to reflect the cost of providing services for each significant activity identified in the Statement of Service Performance and should include costs expressed in unit terms. In order to present the full financial picture of a given activity, it is necessary that revenue generated by that activity, such as user charges, should be included in the Statement of Cost of Services. To properly relate costs to services the revenue should not be netted against the costs but shown separately.

4.28 Public Sector entities engaged in service oriented activities should provide a statement disclosing the net costs of the service oriented activities undertaken together with the total general revenue inflows from sources such as taxes, rates and operating subsidies and grants. The statement should show the disposition of the balance with separate disclosure of loan repayments, other capital transactions and appropriations to special funds.

4.29 A Statement of Cash Flows should be provided in order to facilitate assessment of the continuing financial viability of the entity.

The statement should disclose the cash flows from all sources relating to the operating, financing and investing activities of the entity, and encompass all funds maintained by the entity.

4.30 A Statement of Financial Position should be provided which should include all of the assets and liabilities for the entity appropriately classified, but exclude community assets. This statement, together with the Statement of Resources, reflects the service entity's resources expressed in a combination of financial and physical terms.

4.31 The resources available to public sector entities undertaking service oriented activities are best described not simply by costs of assets held but by also reporting resources in physical terms. A Statement of Resources should therefore be provided.

4.32 To assist in the assessment of the continuing financial viability of the reporting entity, a Statement of Commitments should be provided. This Statement should disclose authorisations and/or contracts for significant capital expenditures so far as these items have not been recognised in the financial statements.

5 STATEMENT OF PUBLIC SECTOR ACCOUNTING CONCEPTS

The concepts set out in the following paragraphs should be read in the context of the foregoing paragraphs of this Statement and the Explanatory Foreword issued by the Council of the New Zealand Society of Accountants in respect of this Statement and Statements of Standard Public Sector Accounting Practice.

5.1 The objectives of external financial reporting by public sector entities are to provide information useful for:
i) assessing accountability; and
ii) making economic decisions.

5.2 Consistent with these objectives, public sector entities should report as follows:

i) *Entities undertaking commercially oriented activities:*
Reports on these activities should be prepared on the basis of the general body of Statements of Standard Accounting Practice and, in addition, include Statements of Objectives, Service Performance, and budgetary information.

ii) *Entities undertaking service oriented activities:*
Preparation of the following statements would be consistent with meeting the objectives set out in the discussion part of this document:
— a statement of objectives
— a statement of accounting policies

— a statement of service performance
— a statement of cost of services
— a statement of cash flows
— a statement of financial position
— a statement of resources
— a statement of commitments.

iii) *Consolidated Statements:*
Public sector entities conducting service and commercially oriented activities should show the aggregate result of operations and financial position for commercial and service oriented activities.

5.3 The information presented in the external financial reports of public sector entities should provide information of the quality embodied in the concept of a true and fair view which governs reporting by business enterprises.

5.4 The general criteria to be applied in preparation of the Statement of Objectives, the Statement of Service Performance and each of the other Statements referred to in paragraph 5.2(ii), have been described in this Statement of Public Sector Accounting Concepts. In particular:

- prominence should be given to relating expenditure to services provided rather than income;
- accrual accounting should be used:
- statements should contain budget information for the reporting period together with the actual results for the reporting and previous periods;
- fixed assets (other than community assets) should be depreciated on the basis on SSAP-3 (1984) *Accounting for Depreciation;* depreciation should not be provided on community assets.

The specific basis for preparation of these statements will be described in the series of Public Sector Accounting Statements to be issued by the Council of the Society.

HUTCHESON, BOWMAN & STEWART LTD.,
WELLINGTON, N.Z.

New Zealand
Society of
Accountants

PUBLIC SECTOR
ACCOUNTING STATEMENT
NO. 1

PSAS-1

July 1987

Determination and Disclosure of Accounting Policies for Public Sector Service Oriented Activities

1 INTRODUCTION

1.1 It is fundamental to the understanding and interpretation of financial statements that those who use them should be aware of the accounting policies on which they are based.

1.2 The purpose of this Statement is:
(a) to provide guidelines for the selection of appropriate accounting policies for public sector service oriented activities;
(b) to require all public sector bodies conducting service oriented activities to adequately disclose the accounting policies followed.

1.3 This Statement seeks to achieve this by:
(a) establishing those general policies used in the preparation of financial statements:
(b) establishing the criteria for the selection of particular accounting policies;
(c) requiring as an integral part of the financial statements, a Statement of Accounting Policies which provides clear explanations of the accounting policies followed in so far as these are significant for the purpose of giving a true and fair view.

1.4 This Statement does not establish accounting standards for individual items as these are dealt with in other Statements. It provides a basis for disclosure to be adopted in all financial statements.

2 APPLICATION

2.1 The standard in this Statement applies to all financial statements issued by public sector bodies undertaking service oriented activities other than statements issued purely for internal management reporting purposes.

2.2 The provisions of this Statement of Standard Public Sector Accounting Practice shall become operative for financial statements covering periods beginning on or after 1 April 1988.

3 DEFINITIONS

3.1 *Accounting Policies*
Accounting policies are the bases, rules and procedures adopted in preparing and presenting financial statements. They do not include the judgements used in implementation of bases, rules and procedures adopted.

3.2 *Interim Reports*
Interim reports are financial reports of results for periods ending and/or financial positions as at dates within the normal financial year and prepared for external use.

4 DISCUSSION

4.1 The accounting policies adopted by an entity can have a significant impact on the results and financial position as reported in its financial statements. For a proper appreciation of those statements it is therefore necessary that users be made aware of:
(a) the general accounting policies which underlie the preparation of the financial statements;
(b) the particular accounting policies followed in respect of the individual items in the financial statements, especially where there are acceptable alternatives for dealing with any such items.

General Accounting Policies

4.2 The general accounting policies which underlie the preparation of financial statements for public sector service oriented activities relate to:

(a) *Measurement Base*
The measurement bases normally used are historical cost adjusted for the revaluation of certain assets and current costs. The use of these bases is appropriate where the entity has sufficient funds available or receivable to enable it to maintain current operations at their current level.

It is assumed that the entity has neither the intention nor the necessity of substantially liquidating its assets or of materially curtailing the level of services provided to the public.

(b) *Matching of Costs and Revenues with Services Provided*
A most significant feature of financial statements of public sector service oriented activities is the reporting of the costs of services provided and the means used to finance those costs. The most acceptable means of accounting for this is through accrual accounting, that is:

- costs of services are recognised as they are incurred and included in the reporting period in which the service was provided;
- revenues specifically earmarked for particular services are recognised when earned and related to the costs of those services;
- general revenues from rates, levies or grants are recognised when assessed or conditions of grants fulfilled;
- surplus or deficit for any reporting period should be the difference between general revenues earned, assessed or granted and the cost of services provided in the same period.

Where a basis other than accrual accounting as defined above is adopted, the reasons for adopting an alternative method should be disclosed and the effect where possible quantified.

4.3 The Statement of Accounting Policies should define the reporting entity and give the statutory base under which the financial statements are prepared.

4.4 Following this initial statement there should be a statement describing explicitly the general accounting policies adopted in the preparation of the financial statements with respect to:
(a) measurement base;
(b) matching of costs and services and recognition of general revenues.

Particular Accounting Policies

4.5 Users of financial statements are assisted in making reliable evaluations or judgements when the financial statements clearly disclose both the general and the particular accounting policies adopted by the entity.

4.6 While general accounting policies are those broad bases, rules, and procedures that underlie the periodic financial statements of all entities, particular accounting policies relate to the bases, rules, and procedures that are adopted by a specific entity for use in the preparation of its financial statements.

4.7 There may be a number of alternative policies available to an entity relating to a particular subject. The policy selected from the range of alternatives available represents the particular accounting policy for that entity relating to that subject. An entity should select and describe those accounting policies which are appropriate to its operations.

4.8 The Appendix to this Statement provides an example of a statement of accounting policies. This example is not exhaustive, and the policies stated may not necessarily be appropriate under all circumstances.

4.9 Certain important criteria should be considered in selecting the most appropriate particular accounting policy from the range of alternatives:

(a) *Substance Over Form*
Transactions and other events should be accounted for and presented in accordance with their substance, that is, their financial and economic reality, and not necessarily in accordance with their legal form.

(b) *Relevance*
Financial statements should provide users with information which may assist in making evaluations or decisions.

(c) *Consistency*
Particular accounting policies adopted by an entity should normally be consistent from one period to another, and should be applied to all items of a similar nature. However, consistency in itself, should not be used as an argument for the retention of a particular accounting policy which is no longer appropriate.

(d) *Prudence*
The uncertainties which surround many transactions

should be recognised by the application of prudence in the selection of the particular policies to be used.

4.10 The individual policies selected form the particular accounting policies of the entity.

Changes in Accounting Policies

4.11 The Statement of Accounting Policies should state whether or not accounting policies used are consistent with those used in previous periods. If there have been changes in either the general or particular accounting policies used there should be full disclosure in accordance with paragraphs 4.12 and 4.13 of this Statement.

4.12 An accounting policy previously adopted in the preparation and/or presentation of financial statements may require change as a result of:
(a) it being no longer appropriate in terms of the criteria outlined under paragraph 4.8;
(b) a decision in the interest of improved financial reporting;
(c) the introduction of, or variation in, statutory or other regulatory requirements;
(d) the introduction of, or variation in, Statements of Standard Accounting Practice or Public Sector Accounting Statements issued by the New Zealand Society of Accountants.

4.13 Where a change is made in an accounting policy which has a material effect on the financial position or results, it is necessary to disclose:
(a) the nature of the change;
(b) the reason for the change;
(c) the monetary effect of the change, if quantifiable, on the financial position or results.

4.14 Where a change is made in an accounting policy which does not have a material effect in the current accounting period but which may have a material effect in subsequent periods it is necessary to disclose:
(a) the nature of the change;
(b) the reason for the change.

The monetary effect of the change should be disclosed in the year it first becomes material if such disclosure is necessary to the understanding of the financial statements.

4.15 An adjustment to an established formula used in arriving at an estimate can have a significant effect on financial statements. While such an adjustment is not a change in an accounting policy, disclosure of such a change may be essential to an understanding of the financial statements.

Disclosure

4.16 The objective of disclosure in respect of accounting policies is to provide users of financial statements with sufficient information to:
(a) ensure the financial statements are informative, reliable and not misleading;
(b) determine whether or not a basis exists for comparability with the financial statements of:
   (i) other periods:
   (ii) other entities.

4.17 There should be disclosure of all significant accounting policies irrespective of whether or not alternative policies are available.

4.18 The Statement of Accounting Policies is an integral part of the financial statements and should be given a prominent place in those statements.

4.19 The Statement of Accounting Policies should include sections dealing with:
(a) general accounting policies;
(b) particular accounting policies;
(c) changes in accounting policies.
An example of a Statement of Accounting Policies appears in the Appendix to this Statement.

4.20 Where there is a change in an accounting policy from that previously adopted the current accounting policy should be reported under the appropriate heading within the general or particular accounting policies and the details regarding the change in policy reported as changes in accounting policies.

4.21 Where changes in accounting policies give rise to a material effect there should be cross reference between the body of the financial statements and the Statement of Accounting Policies.

4.22 Sufficient detail should be given in respect of each accounting policy to ensure that there is no ambiguity.

4.23 Interim reports should state whether or not accounting policies used are consistent with those used in the previously published financial statements. If there have been changes in either the general or particular accounting policies there should be full disclosure in accordance with paragraphs 4.12 and 4.13 of this Statement.

4.24 Care is required in the selection of accounting policies, as an incorrect or inappropriate selection is not rectified by the mere act of disclosure.

Timeliness

4.25 If financial reports are to be useful, they must be issued soon enough after the reported events to affect decisions. Timeliness alone does not make information useful, but the passage of time usually diminishes the usefulness that the information otherwise would have had.

5 STANDARD PUBLIC SECTOR ACCOUNTING PRACTICE

Determination and Disclosure of Accounting Policies

The standards set out in the following paragraphs should be read in the context of the foregoing paragraphs of this

Statement and the Explanatory Foreword issued by the Council of the Society in respect of Public Sector Accounting Statements.

5.1 Financial statements should include a clear and concise statement of all significant accounting policies adopted by an entity in the preparation of its financial statements.

5.2 The Statement of Accounting Policies should comprise:
(a) a statement defining the reporting entity and the statutory base under which the financial statements are prepared;
(b) a statement of the general accounting policies adopted;
(c) a statement of the particular accounting policies adopted;
(d) a statement of changes in accounting policies since the date of the last financial statements, or, if there have been no changes, a statement to that effect.

5.3 The statement of general accounting policies should describe explicitly those general policies adopted in the preparation of the financial statements with respect to:
(a) measurement base;
(b) matching of costs and revenues of services with services provided and recognition of general revenues.

5.4 The statement of particular accounting policies should describe the bases, rules, and procedures adopted by the entity.

5.5 Where a change is made in an accounting policy which has a material effect on the financial position or results it is necessary to disclose:
(a) the nature of the change;
(b) the reason for the change;
(c) the monetary effect of the change, if quantifiable, on the financial position or results.

5.6 Where a change is made in an accounting policy which does not have a material effect in the current

accounting period, but which may have a material effect in subsequent periods, it is necessary to disclose:
(a) the nature of the change;
(b) the reason for the change.
The monetary effect of the change should be disclosed in the year it first becomes material if such disclosure is necessary to the understanding of the financial statements.

5.7 Interim reports should state whether or not the accounting policies used are consistent with those used in the previously published financial statements. If there have been changes in either the general or particular accounting policies there should be full disclosure in accordance with paragraphs 5.5 and 5.6 of this Statement.

APPENDIX

Note: This Appendix does NOT form part of the Standard but is provided to give guidance in the application of the Standard. This Appendix is not exhaustive, nor are the examples given of selected policies necessarily appropriate under all circumstances. It is emphasised that care must be exercised in adopting these examples to ensure that they are appropriate to each particular case.

An Example of a Statement of Accounting Policies for a Public Sector Entity Operating Service Oriented Activities

STATEMENT OF ACCOUNTING POLICIES

General Accounting Policies

These financial statements comprise the following activities of the XYZ City Council:

- Art Galleries
- Cemeteries
- Drainage and Sanitation
- Libraries
- Parks and Recreation
- Street Works
- Transport Department
- Water Supply

The financial statements have been prepared in terms of Section 223(e) of the Local Government Act 1974, and Regulation 10 of the Local Government (Territorial Authorities) Accounting Regulations 1979.

The measurement base adopted is that of historical cost. Reliance is placed on the fact that sufficient funds are available or will be received to maintain current operations at their current level. Accrual accounting is used to measure costs of services provided and recognise revenues.

Particular Accounting Policies

General Revenues

Rates and levies are recognised when assessments are issued. Government grants are recognised when eligibility has been established grantor agency.

Accounts Receivable
Accounts receivable are stated at expected realisable value.

Investments
Investments are stated at cost.

Consumable Inventories
Inventories acquired for subsequent use in provision of services are stated at average cost.

Depreciation of Fixed Assets
Depreciation is provided on a straight line basis at rates that will write off the cost of the assets, less their estimated residual values, over their estimated useful lives. The useful lives of the major classes of assets have been estimated as follows:

Plant and equipment	x years
Motor Vehicles	y years
Furnishings	z years

Depreciation has not been provided on roads, sewerage schemes, public amenities, as these assets are maintained at operational levels in perpetuity and the cost of this maintenance is included as a cost of providing the services to which these assets relate.

Changes in Accounting Policies

There have been no changes in accounting policies. All policies have been applied on bases consistent with those used in previous years.

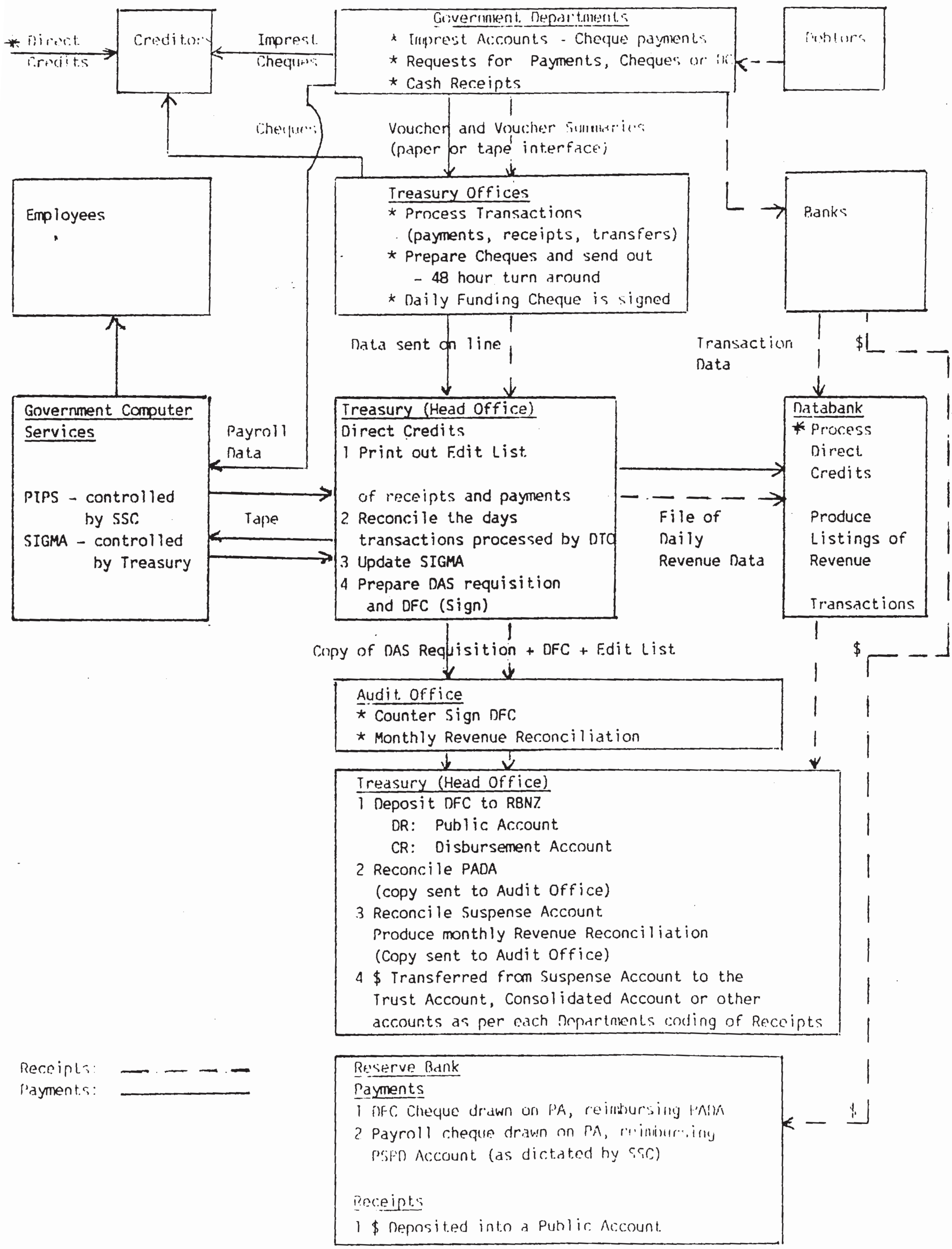
alternatively

Inventories, which were previously carried at cost on a first in first out base are now carried at average cost.

The effect of this change in the current year has been to increase the cost of services provided by $... with a resultant reduction in the surplus for the year compared with that which would have been reported using the previous policy. The consequent adjustment to the value of inventories at the beginning of the accounting period has been treated as a prior period adjustment (refer note .).

With this exception there have been no changes in the above accounting policies which have been applied on bases consistent with those used in previous years.

CURRENT DEPARTMENT, TREASURY AND RESERVE BANK INTERFACE



Notes:	DAS	=	Daily Accounting Statement
	DFC	=	Daily Funding Cheque
	PADA	=	Public Account - Disbursement Account
	PSPDA	=	Public Service Pay Disbursement Account
	NB	=	Excludes transfer voucher system as no longer common practice.

LEGAL AUTHORITY FOR GOVERNMENT TO SPEND MONEY

1 April	The Public Finance Act allows for expenditure by vote to be made equivalent to the unexpended balance of last year plus one quarter of the amount so appropriated last year (Section 54).
	Possible Imprest Supply Bill (refer note below).
	The Imprest Supply Bill must be introduced before 30 June.
30 June	Appropriation Bill introduced in Parliament. (Section 53 of the Public Finance Act). This may be before or after the 30 June.
30 September	Possible further Imprest Supply Bill (refer note below).
	Appropriation Bill (Supplementary's) introduced into Parliament (Section 53 of the Public Finance Act).
	Passing of Appropriation Bills.
31 December	
	Ongoing approval of unauthorised expenditure by the Minister. (Section 55 of the Public Finance Act).
31 March	

Note: If insufficient appropriation funds are available before an Appropriation Act has been passed for the year, Parliament can pass a separate Imprest Supply Act. (Authorised under Section 53(4) of the Public Finance Act.) The Imprest Supply Acts provides interim authority for expenditure until the Appropriation Bill is made an Act. If insufficient funds are available after the passing of the Appropriation Act, another Appropriation Act must be passed.

ESTIMATES OF EXPENDITURE AND BUDGET REPORTING CYCLE

<u>August</u>
Obtain from Government departments their three year forecasts in current dollars.

↓

<u>October/November</u>
Update forecasts for supplementary's.

↓

<u>November</u>
Incorporate in forecasts the wage and price assumptions.

↓

<u>December</u>
Report to Minister.

↓

<u>January to May</u>
Negotiations between Ministers

Treasury ⟷ Government Departments

↓

<u>June</u>
Annual Final Estimates.

↓

Report on Budget night and introduce Appropriation Bill.

↓

<u>July</u>
Obtain from Government Departments monthly cash flows.

→

<u>August</u>
Consolidate and present deficit track.

Advise Minister of monthly variance from actual in the monthly Report to the Minister.

↓

<u>October/November</u>
Update Deficit Track for cash flow affect of supplementary's.

↓

<u>December</u>
Pass Appropriation Bill.

↓

<u>April</u>
Report to Minister on over and under spending by Government Departments for last financial year.

TYPES OF BUDGETING

Budgeting Concepts

A paragraph on each of the budgeting methods often referred to when discussing public sector accounting theory follows.

Zero based budgeting

This form of budgeting requires that operative budgets be prepared from a zero base. Essentially, the assumption is made that the budgetary process is starting anew. Resources are therefore not necessarily allocated in accordance with previous patterns, and each existing item of expenditure has to be actually rejustified.

The major advantage of a zero-based budgeting system is that it does not assume last year's allocation of resources is necessarily appropriate for the current year. It forces managers at all levels to identify their specific objectives, to quantify them, and to evaluate cost-effective means of achieving them. Unfortunately, when applying the method in practice, the system has been compromised so much that the original concept has been rendered unrecognisable

Incremental Budgeting

Here, management focuses on the incremental difference between last year's budget and the proposed changes, rather than looking at the whole budget. Although this method is usually simple to implement and inexpensive, it results in standard practices becoming ingrained, because once implemented, their efficacy is never subject to critical analysis.

Programme Budgeting

This method is known as PPBS (Planning, Programming and Budgeting System). It provides a framework within which choices can be made to ensure that limited resources are allocated in such a way that they will produce the greatest beneficial impact on the overall objectives.

To Implement PPBS -

Stage One: Determine objectives of the organisation.

Stage Two: Develop the programme structure by grouping the same objectives into programme categories.

Stage Three: Break down programme categories into specific activities known as programme elements.

Advantages of Programme Budgeting:

- Provides information on the objectives of the organisation.
- Cuts across conventional lines of responsibility and departmental structures by drawing together the activities that are directed towards a particular objective.

- Exposes programmes that are overlapping or contradictory in terms of achieving objectives.

- Concentrates on long term effects.

- Provides information on the impact that existing alternative programmes will have on objectives, and the associated programme costs.

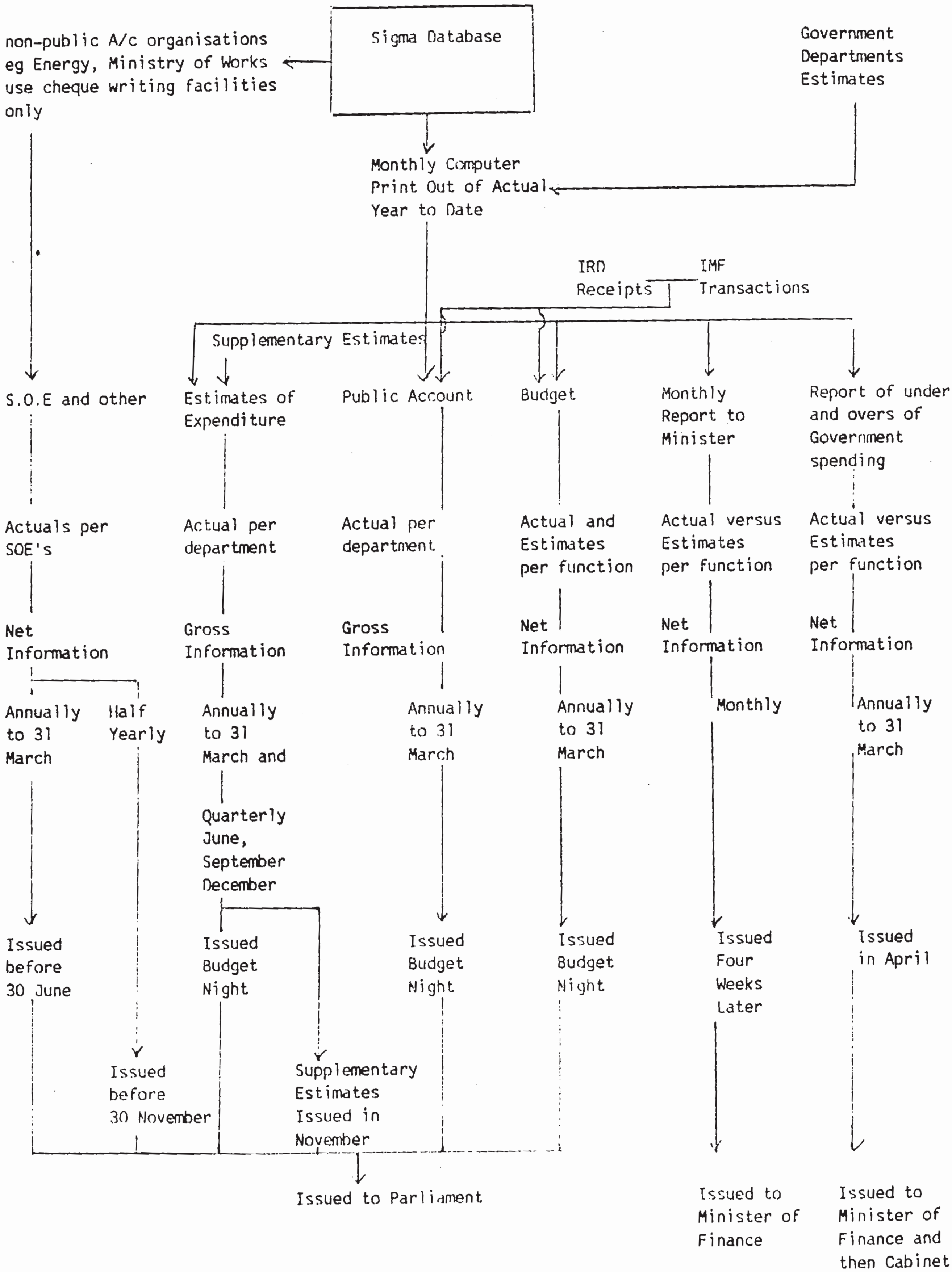
- Enables resource allocation choices to be made on the basis of cost/benefit relationships.

The problems of implementation will result when determining objectives, when isolating programme categories and programme elements, when measuring outputs, and when selecting alternatives. Programme budgeting is often criticised for ignoring the political and organisational realities of complex human organisations.

Excerpt: Jones, Rowan and Pendlebury, Maurice, 'Public Sector Accounting' Pitman Publishing Inc, 1985.

Appendix 8

PERIODIC FINANCIAL AND MANAGEMENT REPORTS



Notes

1 The Reserve and Debt management section inside Treasury also provides reports to overseas interested parties, particularly on Debt Securities and/or Warrants. The information to produce these reports is obtained from SIGMA, the Reserve Bank, government departments, and SOEs. (Details from Ian Storkey and Kandu Patel)

2 The IMF (International Monetary Fund) Section provides reports to the Minister on overseas meetings. Financial information is usually obtained from the section's own records (ie IMF transactions) or the Public Accounts Financial Report.

3 The IMF transactions are recorded in the Public Account and the Budget-Table 1 under 'miscellaneous investment transactions'.

4 There appear to be assets and liabilities that are recorded by both the Reserve Bank and Treasury or by neither. This problem is recognised and work is being carried out in this area. (Details from Chris Pinfield)

The IMF has six types of debt:

a General A/c of IMF - sometimes shown in the Public A/c Financial report.

b Special Drawing Rights - shown in Reserve Bank A/c.

c World Bank - New Zealand Capital Fund.

d New Zealand Aid Donations to World Bank.

e Holding of World Bank Bonds.

f Loans outstanding from World Bank.

Items not on Reserve Bank books or Public Account financial reports are investment of shares in World Bank and Asian Development Bank, liabilities of promisory notes, and unpaid proportions of capital subscriptions.

PROPOSED CHART OF ACCOUNTS

APPENDIX 9

10 REVENUE

- 11 Operating Revenue
  - 111 Products
  - 112 Services
- 12 Non-Operating Revenue
  - 121 Tax Monies
  - 122 Other
- 13 Government Funding

20 EXPENSE

- 21 Cost of Goods Sold
  - 211 Material
  - 212 Labour
- 22 Selling Expenses
- 23 Administration Expenses
  - 231 Wages and Salaries
  - 232 Building Related Expenses (include insurance, security, cleaning)
  - 233 Depreciation
- 24 Finance Expenses
  - 241 Interest on Loans
  - 242 Bank Charges
- 25 Non-Operating Expenses
  - 251 Donations
  - 252 Loss on Sale of Assets

30 ASSETS

- 31 Current Assets
  - 311 Cash in Hand
  - 312 Debtors
  - 313 Stock on Hand
  - 314 Prepaid Expenses
- 32 Investments
  - 321 Shares in Companies

33 Fixed Assets

331 Land
332 Buildings
333 Plant and Equipment
334 Fixtures and Fittings
335 Motor Vehicles
336 Community Assets

34 Intangible Assets

341 Goodwill

40 LIABILITIES

41 Current Liabilities

411 Bank Overdraft
412 Creditors
413 Accrued Expenses

42 Long Term Liabilities

421 Government Loans
422 Bank Loans (NZ)
423 Other NZ Loans
424 International Loans

50 CROWNS EQUITY

51 Capital Reserves
511 Asset Revaluations

52 Revenue Reserves
521 Retained Earnings

ACCOUNTING CONTINUUM

Cash Accounting Reliability: High Timeliness: High Relevance: Medium	Cash Receipt less Cash Payments I Deduct Cash Transactions that are: a Prepaid Expenses - an Asset ie Cash in Advance b Cash Received in Advance - a Liability II Add Non-Cash but Invoiced Transactions: a Debtors - an Asset ie Revenue Earned but not received b Creditors - a Liability ie Expenses incurred but not paid
Accrual Accounting Reliability: Medium Timeliness: Medium Relevance: High	III Add Non-Cash and Non-Invoiced Transactions: a Asset Expiration (called Depreciation) b Revenue earned but not yet invoiced (called a receivable). c Expenditure spent but an invoice has not yet been received (called expenses incurred) NB: The Point of Legal Liability is when Goods are delivered or Services used IV Add Purchase Commitments (ie purchase order issued)
Commitment Accounting Reliability: Low Timeliness: Low Relevance: Medium	V Add Planning Commitments

Definitions to these Subjective Factors

Reliability: Accuracy of information provided

Timeliness: Time taken after the end of the period to prepare accounts

Relevance: Ability to satisfy user needs

NB: Reliability, Timeliness and Relevance would be judged differently by different users. The above measures are given by an external user of Financial Accounts.

UNIVERSITY OF OTAGO

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Appendix 11

When replying please quote
MP:BMB

17 May 1988

Wendy McGuinness
Machford Holdings Ltd
P O Box 29040
WELLINGTON

Dear Wendy

Thank you for your letter of 29 April. It's a pity we did not have more time to discuss your interest in accruals accounting more fully at the seminar. I suppose my main problem with the adoption of full accruals accounting for governmental activities is that there is very little evidence of any theoretical justification for its use. As an academic this worries me. In the private sector the full accruals accounting model is an essential part of the profit determination process. It also is justified in terms of maintaining the capital of shareholders. Neither of these features are necessarily appropriate for governments. A secondary problem relates to the issue of practicability. This is the argument most often used for maintaining the status quo and yet I feel that if the theoretical superiority of full accruals accounting for governments was established then the practical difficulties argument would carry very little weight.

My attempts to answer the specific issues you raised in your letter are as follows:

1. The international experience of the implementation of full accruals accounting is very limited. There are examples of modified accruals accounting in use whereby debtors and creditors are accrued. Most UK local authorities, for example, accrue their property tax (rates) revenues and many of them accrue their accounts payable to arrive at expenditure for the year. A recent (December 1987) GASB Exposure Draft * recommends the use of accruals accounting for all recurrent items (it makes no recommendation on capital asset accounting). This means accruing not only accounts payable but also revenues, including income taxes and sales taxes. These taxes are to be accrued to the year when the sales on which the tax is due takes place, or the year when the earnings on which income tax is due takes place.

   The GASB also issued a discussion memorandum in August 1987 which relates specifically to the question of capital asset accounting. Many of the arguments for and against the full accruals accounting approach for such assets are discussed in this document and rather than try to summarise these I enclose a photocopy for your use.

2. I must have appeared too condemnatory in my views of accruals accounting I do think that full accruals accounting is appropriate (at the moment) for the private sector. However, my intention was to point out that

there is a very well respected body of literature which argues that cash flow accounting might well prove to be a viable alternative and if the two methods were reported side by side for a number of years it is possible that the cash flow statements would eventually prove to be the more widely used. The proponents of cash flow accounting for the private sector recommend the use of statements which report separately the different types of cash flows, e.g. operating cash flows, capital flows, taxation flows etc. This is similar to the illustrative example included in the appendix to the NZ Society of Accountants October 1987 version of SSAP No.10. As far as my personal beliefs for the public sector are concerned I think that recurrent expenditure items should always be accrued. There is little justification in reporting payments only. I think that revenues should be accrued wherever possible, e.g. property taxes, but that research would be required to examine the feasibility and costs associated with the accrual of income taxes and sales taxes. As far as capital assets are concerned I am not convinced of the need for the full accruals approach. I think that a very useful reform would be to require a clear distinction to be made between recurrent and capital items and also to require the financial reports of governments to show the different types of cash flows in a manner similar to SSAP No.10. Thus financial reports of governments would consist of a statement of cash flows, categorised by types of flow, which could be compared with budgets, and a statement showing operating expenditure and income (or receipts wherever accrual is not feasible). This would, not of course, result in the production of a conventional balance sheet, but is this necessary? Perhaps all that is needed is a statement which shows firstly those assets that can be valued at either their historic cost or some form of current value, and secondly a statement which simply listed the various types of infrastructure or community assets but made no attempt to value them.

An approach as outlined above might offer a useful and relatively easily achievable reform. It might also, if it was still felt necessary, offer a better starting point for moving towards a full accruals accounting model.

I hope you can make some sense of all of this which is, of necessity, a very condensed summary of my views. Good luck with your consultancy assignment. If you would like to discuss any of these points further I will be at the University of Otago until the end of this month, or I can be contacted at the address shown on the attached card.

Yours sincerely

Dr M W Pendlebury

* The full reference of the exposure draft and the address from which copies can be ordered is as shown on the enclosed photocopies of the title pages.

Appendix 12

Survey of Government Departments' Financial and Management Information Systems

This survey has been written to obtain information on the current and proposed FMIS (Financial and Management Information Systems) of Government Departments. In particular, Treasury is interested in the extent to which accrual accounting has been implemented.

Please return this survey in the attached self addressed envelope by 9 May 1988.

The survey has been divided up into the following sections: -

A What are the characteristics of your department's FMIS as at 31 March 1988?

B What will be the characteristics of your department's FMIS as at 31 March 1989?

C What is the motivation for changes between 31 March 1988 and 31 March 1989?

D What problems have or could arise in the implementation of accrual accounting?

E Comments

A glossary of Public Sector Accounting terms has been attached, to assist you in completing this survey.

If you have any questions or queries in regard to this survey please contact:

Wendy McGuinness
The Treasury
Phone: 722-733 Ext 8064

A What are the Characteristics of your Department's FMIS as at 31 March 1988?

Q.1 Please tick the appropriate boxes to indicate the components of your Departments Current Financial and Management Information System.

i	Treasury SIGMA system (ie Cash Accounting)	☐	1	(1-3)
ii	General ledger	☐	2	
iii	Debtors ledger	☐	3	
iv	Creditors ledger	☐	4	
v	Assets Register	☐	5	
vi	Commitment Register	☐	6	
vii	Purchasing Systems	☐	7	
viii	Others	☐	8	
	....			
ix	....	☐	9	
x	....	☐	10	

2 Does your department own computer hardware to run the systems, detailed in Q.1. (If no, go to Q3).

Yes ☐ No ☐ (4)

2a What type of hardware does your system use? (please tick) (5)

Personal Computer	☐	1
Mini	☐	2
Mainframe	☐	3

2b What is the standard name for the hardware used to run the FMIS system? (eg IBM System 36) (6)

....

2c Was the hardware purchased specifically to run the FMIS system?

Yes ☐ No ☐ (7)

2d Does your system use package software or was the software written inhouse, or both?

(please tick)

inhouse	package	both	(8)
☐	☐	☐	

2e What type of software does your system use? (please tick)

i	SPL (Systems Programming Limited)	☐	1	(9-11)
ii	McCormack & Dodge	☐	2	
iii	Ugen/Decfin	☐	3	
iv	Dolmas	☐	4	
v	Masterpiece	☐	5	
vi	Command	☐	6	
vii	Others (Please State)	☐	7	
viii	 8	☐		
ix	 9	☐		
x	 10	☐		
xi	 11	☐		
xii	 12	☐		

Q3 Does your department use a bureau system to process, on your behalf, all or parts of your FMIS? Please do not include the Treasury SIGMA system in answering this question. (If no, go to Q4).

Yes	No	(12)
☐	☐	

3a Please name the bureau your department uses to run your FMIS. (13)

....

Q4 Does your Department have an assets register? (If no, go to Q5).

Yes	No	(14)
☐	☐	

4a What information does your department collect in the asset register? (please tick)

i	- Description of Asset	1	(15-17)
ii	- Date of Purchase	2	
iii	- Purchase Cost	3	
iv	- Depreciation Method	4	
v	- Depreciation Rate	5	
vi	- Annual and Accumulated Depreciation	6	
vii	- Method of Valuation and Amount	7	
viii	- Location	8	
ix	- Controller (by officer/division) etc	9	
x	- Other (please specify)	10	

....

(Tick one of the following) (18)

4b When is your Asset Register updated?

on the purchase or sale of an asset?	1
monthly?	2
annually as at 31 March?	3
other? (please specify):	4

4c When you make an asset purchase that will last longer than 12 months, at what dollar level do you record it as an expense (ie write-off cost in year of purchase) as against an asset (ie depreciate cost over a number of years)?

(Tick one of the following)

0 - $100.00	1	(19)
$ 101 - $200.00	2	
$ 201 - $500.00	3	
$ 501 - $1000.00	4	
$ 1001 - $10,000	5	
+ $10,000	6	

4d What asset valuation methods does your organisation use?

(Please tick the appropriate boxes)

Book Value	☐	1	(20-22)
Market Value	☐	2	
Replacement Cost	☐	3	
Government Valuation	☐	4	
Other (please specify)	☐	5	

....

....

4e What depreciation method do you generally use?

(Tick One) (23)

Straight Line (SL)	☐	1
Diminishing Value (DV)	☐	2
Other (please specify)	☐	3

4f What depreciation rates do you generally use?

(Tick One)

IRD (Inland Revenue Standard Rates)	☐	1	(24)
Determined by Top Management	☐	2	
Other (please specify)	☐	3	

4g Please specify

a which depreciation method is used in the following cases (Column A); and

b which depreciation rates are used (Column B)

	(Column A) Method	(Column B) Rates %
Buildings	(25)	(26)
Plant and Equipment	(27)	(28)
Motor Vehicles	(29)	(30)
Furniture & Fittings	(31)	(32)

Q5 The nature of Fixed Assets

5a Which of the following fixed asset sub-groups does your department use to group its fixed assets? (Please tick the appropriate boxes)

i	- Land	[ ]	1	(33-35)
ii	- Buildings	[ ]	2	
iii	- Plant and Equipment	[ ]	3	
iv	- Motor Vehicles	[ ]	4	
v	- Furniture and Fittings	[ ]	5	
vi	- Community Assets	[ ]	6	
vii	- Others (please specify with reasons)	[ ]	7	

5b If your department owns community assets, please provide a brief description of the type and approximate historical cost of community assets held. (Details can be attached to this survey if necessary).

The objective of asking this question is to determine the characteristics of community assets held rather than obtaining an accurate and detailed list.

....

....

....

....

....

....

....

5c Do you have information available on the historical costs of the Departments Fixed Assets for the last 5 years?

Yes	No	
[ ]	[ ]	(36)

6 Does your government department record commitments? (Please refer to the Glossary definition of Commitment Accounting). (If no, please go to Question 7)

Yes	No	(37)
[ ]	[ ]	

6a Does your department record Commitments on a: (Tick one) (38)

- computer file [ ] 1
- manual register [ ] 2
- both [ ] 3

6b Do you record commitment information in your departments (Tick which apply)(39)

- financial reports [ ] 1
- management reports [ ] 2
- both [ ] 3
- neither [ ] 4

7 Is your department preparing budgets using accruals?

Yes	No	(40)
[ ]	[ ]	

8 What human resources do you currently have in your department? (Please state approximate number).

No. of staff employed by the Department? No = ____________ (41-43)

No. of Qualified Accountants (ie A.C.A) No = ____________ (44-46)

No. of Party Qualified Accountants No = ____________ (47-49)

No. of accounting staff (excluding fully or partly qualified accountants) No = ____________ (53-55)

(Accounting staff includes all staff inputing and processing financial data for the purpose of reporting to management or Government. Consequently, the staff involved in inputing and processing operational data (eg Social Welfare payments) would be excluded in answering this question).

9 What is the size of your departments vote for the 1987/88 Year. (please specify to dollars) (56-61)

$............................

B What will be the Characteristics of your departments FMIS as at 31 March 1989?

Q1 Please tick the appropriate boxes to indicate the expected components of the Departments FMIS as at 31 March 1989? (62-64)

i	Treasury SIGMA System (ie Cash Accounting)		1
ii	General ledger		2
iii	Debtors ledger		3
iv	Creditors ledger		4
v	Asset Register		5
vi	Commitment Register		6
vii	Purchasing Systems		7
viii	Others (please specify)		8

C What is the motivation for changes between 31 March 1988 and 31 March 1989?

If answers to questions in Section A (Q1) and Section B (Q1)are different, please answer the following questions, otherwise go to Section D.

Q1 Please tick only two boxes to indicate the major reasons for changing from the current cash accounting system towards accrual accounting. (65-67)

Due to internal management wanting (Tick Two Only)

i	- to improve decision making	1	☐
ii	- to process data more efficiently	2	☐
iii	- to have an information database on Debtors and Creditors	3	☐
iv	- Others (please specify)	4	☐

Due to external influences

v	- User Pays Policy	5	☐
vi	- Revolving Fund Management	6	☐
vii	- Government Administration Committee 1987 on the inquiry into Departmental Annual Reporting Standards - Fran Wilde Chairman	7	☐
viii	- Society of Accountants - PSAC + PSAS	8	☐
ix	- Treasury circular 1986/15 - Asset Management in Government Departments and Agencies	9	☐
x	- Cabinet Decision cm 86/24/12 [27] - Asset Management in Government Departments and Agencies	10	☐
xi	- Change in status of the Organisation (please specify)	11	☐
xii	- Others (please specify)	12	☐

D Problems experienced or foreseen in the movement from a cash accounting system to an accrual accounting system

Q1 What human resources will you require above current staff levels to implement complete accrual accounting in two years (ie 24 months)?

	Please Number	State Approx Cost ($)
Consultants - FMIS	(68-69)	(80-86)
Qualified Accountants	(70-71)	(87-93)
Financial Staff/Clerks	(72-73)	(94-100)
Consultants - EDP	(74-75)	(101-107)
EDP Staff	(76-77)	(108-114)
Others (please specify)	(78-79)	(115-121)
TOTAL COST OF HUMAN RESOURCES		

Q2 What financial resources will you require above current levels to implement complete accrual accounting in two years (ie 24 months)?

Please State Approx Cost ($)

EDP Hardware $ ________ (122-128)

EDP Software $ ________ (129-135)

Others (please specify) $ ________ (136-142)

TOTAL COST OF FINANCIAL RESOURCES ________

Q3 What training requirements will you need to implement complete accrual accounting in two years (ie 24 months)?

Please State Approx Cost ($)

Courses $ ________ (143-149)

Software Training Tools $ ________ (150-156)

Manuals $ ________ (157-163)

Others (please specify) $ ________ (164-170)

TOTAL COST OF TRAINING ________

Q4 What problems do you foresee in the movement from a cash accounting system to an accrual accounting system?

....

....

....

....

Q5 How can these problems if evident, be solved?

....

....

....

....

Q6 At what future time could a complete accrual accounting system be up and running for your Government Department. (Refer to the Glossary definition of accrual accounting).

(please tick one)

Year ended	31 March 1988	[ ]	1	(171)
Year ended	31 March 1989	[ ]	2	
Year ended	31 March 1990	[ ]	3	
Year ended	31 March 1991	[ ]	4	

E Any Comments

Q1 Any comments you would like to make in regard to the implementation of accrual accounting for Government Departments?

....

....

....

....

Thank you for your help in completing this survey. The results will be invaluable in assisting us to assess to desirability of implementing accrual accounting.

Please leave your name and contact number below for further correspondance.

Name:
Designation:
Government Department:
Contact Telephone Number and Extension:

Appendix 13

LIST OF RESPONDENTS TO SURVEY

1	MINISTRY OF AGRICULTURE AND FISHERIES Private Bag, Wellington Phone 720 367	TIM WARMINGTON Director Corporate Finance
2	AUDIT OFFICE Private Bag, Wellington Phone 724 979	DENNIS ORMSBY Assistant Comptroller and Auditor-General PETER TOBIN Finance Officer MARTIN MATTHEWS Director Central Government
3	DEPARTMENT OF CONSERVATION PO Box 10420, Wellington Phone 713 200	FORDE CLARKE Assistant Director General
4	CROWN LAW OFFICE PO Box 5012, Wellington Phone 721 719	ROB TAYLOR Office Manager
5	CUSTOMS DEPARTMENT Private Bag, Wellington Phone 736 099	ARVIN JINA Executive Officer, Finance NOEL FOOTE Director of Administration
6	MINISTRY OF DEFENCE Private Bag, Wellington Phone 726 499	ALAN TWOHILL Assistant Secretary of Finance LEN JONES Chief Financial Accountant STU PATTERSON Chief Management Accountant
7	MINISTRY FOR THE ENVIRONMENT PO Box 10 362, Wellington Phone 734 090	MICHAEL WILES Manager Corporate Services
8	OFFICE OF THE PARLIAMENTARY COMMISSIONER FOR THE ENVIRONMENT PO Box 10241 Phone 711 669	BOB McCHYMONT Director
9	MINISTRY OF ENERGY Private Bag, Wellington Phone 727 044	JAYANATHA GONSALKORALE General Finance Manager
10	MINISTRY OF FOREIGN AFFAIRS Private Bag, Wellington Phone 728 877	REX MARTIN Director of Finance

		HELEN BRADY Deputy Director of Finance
		EDDIE ELLISON Assistant Director of Finance
11	HEALTH DEPARTMENT PO Box 5013, Wellington Phone 727 627	JOHN MOLES Director of Finance
		PAT USSHER Deputy Director of Financial Services
		RON PRINCE Assistant Director Supply
		PETER GREEN Executive Officer Revenue & Expenditure
12	INLAND REVENUE DEPARTMENT PO Box 2196, Wellington Phone 730 920	BRIAN KENNERLEY Director of Finance
		PETER CRAIG Assistance Director of Finance
		AUDREY LOVE Executive Officer, Services
		SHIRLEY WONG Executive Officer, Revenue
13	JUSTICE DEPARTMENT Private Bag, Wellington Phone 710 929	BRENDON ORR Director of Finance
14	OFFICE OF OMBUDSMAN PO Box 10 152, Wellington	JOYCE MCEWAN Administrative Officer
15	POLICE DEPARTMENT National Headquarters Private Bag, Wellington Phone 749 499	PETER HAY Chief Accountant
16	SURVEY AND LAND INFORMATION Private Bag, Wellington Phone 735 022	STEPHEN WOOLLEY Acting Director Finance
17	TREASURY Private Bag, Wellington Phone 722 733	RICHARD MORRIS Director Finance

18	DEPARTMENT OF INTERNAL AFFAIRS Private Bag, Wellington Phone 738 699	PAUL BRYANT Director of Finance Vacant Assistant Director of Finance G L REINKEN Investment Officer
19	MINISTRY OF TRANSPORT Private Bag, Wellington Phone 721 253	MARILYN FOREMAN Director of Finance
20	GOVERNMENT COMPUTING SERVICE Private Bag, Wellington Phone 738 821	Vacant Manager Finance & Planning JIM BROUGH Accountant
21	HOUSING CORPORATION PO Box 5009, Wellington Phone 721 294	K C CARR Director of Finance
22	TRADE & INDUSTRY DEPARTMENT Private Bag, Wellington Phone 720 030	DAVID PENNINGTON Director, Finance
23	LABOUR DEPARTMENT Private Bag, Wellington Phone 737 800	JOHN KYNE Corporate Treasurer
24	VALUATION DEPARTMENT PO Box 5098, Wellington Phone 738 555	ANDY BADRICK Executive Officer, Finance
25, 26, 27	TOURIST & PUBLICITY DEPARTMENT Private Bag, Wellington Phone 728 860 <u>NB</u> Three surveys were completed by this department due to its decentralised structure	JIM HICKS Assistant Director Finance (Investigations) DENNIS LEY Assistant Director of Finance ANNELIESE STEPHAN Investigating Accountant (Traits) P J COTTERELL Accountant
28	STATISTICS DEPARTMENT Private Bag, Wellington Phone 729 119	DIANE MERRIN Director Finance

29	MINISTRY OF WOMEN'S AFFAIRS Private Bag, Wellington Phone 734 112	MIRIAMA EVANS Deputy Secretary
30	STATE SERVICES COMMISSION PO Box 329, Wellington Phone 725 639	GEOFF PALMER Accountant
31	EDUCATION DEPARTMENT Private Bag, Wellington Phone 735 499	VIRGINIA BREEN Acting Director of Finance
32	NATIONAL LIBRARY OF NEW ZEALAND Private Bag, Wellington Phone 722 101	FIONA SHEPHERD Director of Finance
33	MAORI AFFAIRS DEPARTMENT Private Bag, Wellington Phone 733 009	MATTHEW ARCHER Director of Finance
34	MINISTRY OF FORESTRY Private Bag, Wellington Phone 721 569	DES LEAHY Director Finance KEVIN LENIHAN Finance Officer, Management JIM GREEN Finance Officer
35	PARLIAMENTARY SERVICES Parliament Buildings, Wellington Phone 719 999	TOM MORRISEY Accountant

<u>Surveys were sent to but not received from the following Departments:</u>

GOVERNMENT PRINTING OFFICE
Private Bag, Wellington
Phone 737 320

PUBLIC TRUST OFFICE
PO Box 5024, Wellington
Phone 727 377

DSIR
Private Bag, Wellington
Phone 729 979

SOCIAL WELFARE DEPARTMENT
Private Bag 21, Postal Centre, Wellington
Phone 727 666

MINISTRY OF FORESTRY

OPERATING STATEMENT

For the Year Ended 31 March 1988

	Notes	Policy	Research	Forestry Services	Establishment Costs	Inter-Ministry Transactions	Consolidated Total
		$000	$000	$000	$000	$000	$000
INCOME							
From Government	7	1,392	19,876	10,357	672		32,297
From other sources	1	102	5,302	4,998		(1,245)	9,157
GST received		7	338	276	—	—	621
		1,501	25,516	15,631	672	(1,245)	42,075
EXPENDITURE							
Salaries		955	15,538	7,064			23,557
Other operating		442	7,545	4,956	592	(1,245)	12,290
Grants	2			1,081			1,081
Depreciation		121	1,142	894			2,157
Remission of Loan Principal	8			6			6
GST paid		117	2,185	1,124	80		3,506
GST owing		24	449	249	14	—	736
		1,659	26,859	15,374	686	(1,245)	43,333
NET COSTS/(SURPLUS)		158	1,343	(257)	14	-	1,258

The notes on pages to form part of and are to be read in conjunction with these statements.

B.

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STATEMENT OF FINANCIAL POSITION
AS AT 31 MARCH 1988

	Notes 3	1988 $000	1987 $000
FUNDS EMPLOYED			
Notional Capital	4	40,620	36,368
Asset Revaluation reserve	5	1,668	-
TOTAL		42,288	36,368
EMPLOYMENT OF FUNDS			
Fixed assets	6	23,685	19,290
Investments	8	18,636	16,530
Current assets -			
Accounts receivable		1,232	100
Inventory		725	725
Deposits		810	735
-Total Assets		45,088	37,380
Less current liabilities -			
Accounts payable		2,800	1,012
TOTAL		42,288	36,368

The notes on pages to form part of and are to be read in conjunction with these statements.

Russ Ballard, Secretary of Forestry

D.J. Leahy, Director of Finance

NOTES TO FINANCIAL STATEMENTS

NOTE 1

INCOME FROM OTHER SOURCES

	$000	$000
Fees and services	7,206	
Rents	231	
Other receipts	761	
		8,198
Non-Funded Income		
Interest - Forestry Encouragement loans capitalised	994	
Provision for doubtful debts	(35)	
		959
		9,157

NOTE 2

GRANTS

	$000
Grants paid under the Forestry Encouragement Grant Regulations 1970	219
Settlement of claims relating to failure of AAC preservative treated timber.	862
	1,081

NOTE 3

FUNDS

The Ministry commenced on 1 April 1987. The 1987 comparative figures represent the assets taken over from the New Zealand Forest Service on that date. Notional capital is the net Government equity in the Ministry.

NOTE 4

NOTIONAL CAPITAL

	$000
Net Government equity, 1 April 1987	36,368
Investment funds provided by Government (Note 7)	5,493
Investment funds provided by customers	17
	41,878
Less net operating costs	1,258
Net Government equity, 31 March 1988	40,620

NOTE 5

ASSET REVALUATION RESERVE

	$000
Balance, 1 April 1987	Nil
Assets revalued during year	1,668
Balance, 31 March 1988	1,668

B.

NOTE 6

FIXED ASSETS

	Land	Improvements to Land	Buildings	Plant and Equipment	Motor Vehicles	Furniture Fittings	Total
	$000	$000	$000	$000	$000	$000	$000
Cost or Valuation							
Balance 1 April 1987							
At cost	51	170	12,023	6,467	3,118	683	22,512
At valuation		990		1,511	198		2,699
Additions		77	399	3,763	241	421	4,901
Disposals					(159)	(22)	(181)
Revaluations	1,668						1,668
Balance 31 March 1988	1,719	1,237	12,422	11,741	3,398	1,082	31,599
Accumulated depreciation							
Balance, 1 April 1987			1,201	2,995	1,440	285	5,921
Depreciation expense			281	1,347	373	156	2,157
Write-back on disposal					(148)	(16)	(164)
Balance 31 March 1988			1,482 ✓	4,342 ✓	1,665 ✓	425 ✓	7,914
Net book value	1,719	1,237	10,940	7,399	1,733	657	23,685

NOTE 7

PAYMENTS FROM GOVERNMENT

	Policy	Research	Forestry Services	Establishment Costs	Total
	$000	$000	$000	$000	$000
Operating Income	1,392	19,876	10,357	672	32,297
Capital Investment	62	3,471	1,736	224	5,493
	1,454	23,347	12,093	896	37,790
Public Account Deposits not actioned			60		60
Net Appropriation - Vote: Forestry	1,454	23,347	12,153	896	37,850

NOTE 8

INVESTMENTS

Amounts advanced under the Forestry Encouragement Loans Regulations, 1967.

	$000
Balance transferred from the NZ Forest Service, 1 April 1987	16,530
Amounts advanced	1,123
Interest capitalised	994
Loans repaid	(5)
Loans remitted	(6)
	18,636

AB.

V.

NOTE 9

CONTINGENT LIABILITIES

The Ministry is currently subject to claims for failure of AAC treated timber. It is expected that the Ministry will be required over the next 10-15 years to contribute, at this time indeterminable amounts, towards these claims.

Under the provisions of the Forestry Encouragement Loans Regulations 1967, repayment of half the loans and all interest is waived after 20 years provided the trees are clearfelled at maturity. No provision has been made for such waivers.

MINISTRY OF FORESTRY

STATEMENT OF CASH FLOWS FOR YEAR ENDED 31 MARCH 1988

	$000	$000
Cash flows from operating activities		
Cash was provided from:		
Funds from Government	32,297	
Receipts from customers	8,466	
		40,763
Cash was distributed to:		
Payments to suppliers and employees	(39,716)	
Payments of grants	(1,047)	
		(40,763)
Net cash flows from operating activities		0
Cash flows from investing activities		
Cash was provided from:		
Funds from Government	5,493	
Proceeds from sale of fixed assets	12	
Collections on loans	5	
	5,510	
Cash was applied to:		
Cash outflow for fixed assets	(4,433)	
Loans to clients	(1,077)	
	(5,510)	
Net cash used in investing activities		0
Cash flows from financing activities		
Cash was provided from:		
Imprest advances from Government	61	
Net increase in client deposits	14	
Net cash available from financing activities		75
Net increase in cash held		75
Add opening cash brought forward		735
Ending cash carried forward		810

STATEMENT OF COMMITMENTS AS AT 31 MARCH 1988

$400,000 in capital expenditure is committed in 1988/89 to complete the conversion of the Forest Research Institute, Rotorua from geothermal heating to natural gas heating.

(C6110/bb0)

STATEMENT OF FINANCIAL POLICIES

The financial statements on pages to comprise the programmes of the Ministry of Forestry undertaken under authority of the Forests Act 1949 to advise and support the forestry sector. The programmes are:

Policy Advice, Research, Forestry Services, Establishment costs (1987/88 only)

Provision was made in 1987/88 in Vote: Forestry for the costs of winding up the NZ Forest Service. This task was undertaken by a Residual Management Unit responsible to the State Services Commission. These costs are not included in the statements.

The statements are prepared to satisfy the requirements of the 1987 Report of the Government Administration Committee on departmental reporting standards and all relevant Statements of Standard Accounting Practice issued by the New Zealand Society of Accountants.

TRAINING ACTIVITIES AND TIMBER PRESERVATION AUTHORITY

On 1 April 1988 the forest industry training activities carried out at the Forestry Training Centre, Rotorua were transferred to the Waiariki Polytechnic.

The Timber Preservation Authority ceased to exist on 31 March 1988.

Loss of these activities will have no material effect on future viability of the Ministry.

STATEMENT OF ACCOUNTING POLICIES

1. General Accounting Policies

The general policies adopted in the preparation of these financial statements are:

- Unless otherwise stated the measurement base adopted is that of historic cost.
- Accrual accounting is used to match expenses and revenue.
- Reliance is placed on the Ministry being a going concern.

2. Particular Accounting Policies

The following are the particular accounting policies which have a material effect on the measurement of operating results and financial position:

Consolidation: The financial statements show the consolidated operating results of the programmes after eliminating all significant inter-programme transactions. Head Office administration costs have been apportioned to the activities.

Fixed Assets: Land which is stated at the latest five yearly Government valuation, is subject to final allocation from the former NZ Forest Service. Other fixed asset costing less than $1,000 per item, except for EDP software for which the amount is $500, are expensed in the year of purchase. All other fixed assets are stated at cost less accumulated depreciation except for improvements to land and plant and equipment at the Timber Industry Training Centre which are stated at special valuation.

Depreciation: Depreciation is provided using the straight line method after allowing for residual value where appropriate. Expected average economic lives and residual values for the main classes of assets are:

	Years	Residual Value
Buildings	40-60	10-15%
Plant and equipment	5-10	Nil
Motor Vehicles	6-10	Nil
Furniture, fittings, data processing equipment	4-5	0-5%

AB.

[illegible]

Intangibles: No Value has been attributed to trading contracts or other intangible assets.

Investments: Forestry Encouragement Loans are shown at amounts advanced plus accrued interest. Forestry Encouragement Grants are expensed. From 1 April 1983 Forestry Encouragement Grants superseded Forestry Encouragement Loans and deductability of forestry expenditure for income tax purposes. From 8 November 1984 Forestry Encouragement Grants were abolished and replaced by tax deductability.

Accounts Receivable: Accounts receivable are stated at expected realisable value, after providing for doubtful debts.

Inventory: Stores at the Forest Research Institute are stated at weighted average cost. The value of opening stores is an estimate. No provision is made for other stores which are purchased for immediate use.

Forestry Research: Research and development is expensed to operations.

Liabilities: Liabilities are stated at estimated amounts payable and include all known liabilities which can be reliably estimated. Current liabilities include the amounts payable in the next financial year.

3. Taxation

Income tax: No liability is incurred for income tax in respect of any operations.

Goods and Services Tax (GST): GST owing to the Inland Revenue Department at 31 March 1988 is disclosed in the operating statement. The amount will be funded by Government in 1988/89.

4. Changes in Accounting Policy

The Ministry commenced operations on 1 April 1987. There were therefore no changes in accounting policies during the year.

REPORT OF THE AUDIT OFFICE

The Audit Office, having been appointed in terms of section 25, Public Finance Act 1977, has audited the financial statements of the Ministry of Forestry appearing on pages to .

The audit was conducted in accordance with generally accepted auditing standards and practices.

In the opinion of the Audit Office, the financial statements, fairly reflect the financial position as at 31 March 1988 and the financial results of operations of the year ended on that date.

Graham Vaughan-Jones
Assistant controller and Auditor-Genreal

23 June 1988

PROPOSED ACCOUNTING POLICIES

Accounting Entity

The financial statements are those of .....

General Accounting Policies

The financial accounts are based on the general principles of historical cost accounting, including the going concern concept and the accrual basis of accounting. These policies have been applied on a consistent basis except as disclosed.

Particular Accounting Policies

a Basis of Consolidation

The consolidated accounts include the accounts of:

Foreign Exchange Translation

Financial statements are translated into New Zealand currency at the rates of exchange ruling at balance date. Exchange gains or losses arising from the translation of foreign currency financial statements are held in a Currency Translation Reserve.

b Valuation of Assets

General Purpose Lands and Buildings

Lands and Buildings are revalued to the estimated market value on 30 June (balance date) in each year. The revaluation is taken on an asset by asset basis, and the net gain arising on the revaluation is credited to a Fixed Asset Reserve.

Plant and Equipment, Motor Vehicles and Fixture and Fittings

Plant and Equipment, Motor Vehicles and Fixture and Fittings are valued at cost less accumulated depreciation.

Community Assets

Community Assets are valued at historical cost, with a full explanation of each community asset held being disclosed in the notes to the accounts. (Note: This policy is at variance with SPSAC 4.19.)

Investments

Publicly listed investments are valued at the average buyer and seller price recorded at balance date. Non-publicly listed investments are valued at the lower of historical cost or net realisable value.

Stock on Hand (Inventories)

Trading stock, raw materials and work in progress are valued at the lower of cost, net realisable value or replacement price, determined on the first-in-first-out basis. Cost includes direct manufacturing costs and manufacturing overhead at normal operating levels.

Debtors (Accounts Receivable)

Debtors are valued at estimated net realisable value. Potential doubtful debts which could arise in subsequent accounting periods should be provided for. All known losses are written off to Earnings in the period in which it becomes apparent that the debts cannot be collected.

Intangible Assets

The value of intangibles is established at acquisition, and either amortised or written off as an extraordinary item at that date. Any balance is carried forward as Deferred Income or Deferred Charges.

c Valuation of Liabilities

Liabilities are to be recorded at repayment value as at balance date.

d Income Determination

Depreciation

All assets purchased under the value of $501.00 should be expensed. For items $501.00 and over, the asset must be depreciated, using the following methods and rates of depreciation:

Asset	Depreciation Method	Depreciation Rate
Buildings	Straight Line	2 percent
Plant and Equipment[1 2]	Straight Line	20 percent
Motor Vehicles[1]	Straight Line	20 Percent
Fixture and Fittings[1]	Straight Line	20 percent

Note: 1 A variance of up to 50 percent (ie 10 percent) can be either added or deducted from the above table for over or under-utilised assets on Plant and Equipment, Motor Vehicles and Fixture and Fittings.

2 Computer Equipment is included under Plant and Equipment.

TREASURY CIRCULAR 1986/15 AND 1988/4

7 July 1988

Treasury Circular 1988/4

Officer for Enquiries: Joanne Scott (Extn 8063)

THE TEN FOR ONE RULE

Introduction

The ten for one rule is a budget rule which was formulated in the 1970s and allows departments to switch resources between operating and capital expenditure over time. Specifically, it allows departments to benefit from the sale of assets (by increasing future expenditure), or to purchase assets by taking a cut in future expenditure. The rule derives its name from the ten percent real rate of return which is used when calculating reallocations between years. It developed informally and detailed information about how it operates has never been circulated. As a result, the rule has not been applied consistently.

Recently there has been concern over this lack of consistency and it was decided that the rule should be reviewed. This review has included an assessment of the different ways in which assets purchased under the ten for one rule can be replaced.

This circular sets out how the rule should now be applied. It contains a brief section explaining how the rule has been applied in the past and a more detailed section explaining current application of the rule. The appendix contains an example.

Previous Rules

1 Disposal of Assets

If an asset worth $10,000 was disposed of, a department could;

a) take a one off increase in expenditure of $10,000

b) take a permanent increase in expenditure of $1,000.

2 Acquisition of Assets

A department could take a permanent reduction in operating expenditure of $1,000 for the purchase of an asset worth $10,000.

3 Replacement of assets was sometimes dealt with by requiring the department to take a further funding cut at the end of the asset's useful life. Alternatively, "depreciation" was charged, and the asset replaced without a further funding reduction.

Current Rules

1 Disposal of Assets

Where an asset worth $10,000 is voluntarily disposed of a department may:

a) take a one off increase in funding of $10,000

b) take a permanent increase in funding of $1,000

c) take a funding increase of greater than $1,000, but for a shorter period, the amount to be calculated using a ten percent real rate of return.

Increases in funding resulting from the sale of an asset may be allocated across either capital or operating expenditure, although this should be decided in advance and agreed to as part of the reallocation.

Funding adjustments are calculated in terms of constant dollars. Any funding increases are subject to the usual Price Level Change (PLC) factor.

2 Acquisition of Assets

Where a department wishes to purchase an asset it must first subject the proposal to the normal type of cost benefit analysis. Funding obtained under the ten for one rule can be regarded as a "loan" which is to be repaid with a ten percent real rate of return. The "loan" is to be repaid, by way of decreases in operating expenditure, over the expected useful life of the asset.

"Repayments" or funding decreases are to be calculated on a table mortgage basis so that a constant amount (consisting of principal and interest) is repaid each year. Departments may make different arrangements (eg larger funding cuts in early years and lower cuts in future years) although the time period is still constrained to the useful life of the asset.

3 Replacement of Assets

As the loan period coincides with the asset's useful life the "loan" should be repaid by the time replacement becomes necessary. Once the "loan" is repaid, departments may choose either to purchase another asset or have the funding cut reinstated. Where another asset is purchased, funding adjustments will be recalculated. If the department chooses to have the funding cut reinstated they are entitled to the initial cut adjusted for the impact of the PLC over that period. Departments should keep records of the PLC in each year and the impact of the PLC on the funding adjustments.

Departments are responsible for obtaining information on the expected useful lives of assets they wish to purchase. Obsolescence due to technological changes as well as the physical life of the asset should be taken into account when determining the asset's useful life. All applications of the ten for one rule should be discussed with the Treasury Officer dealing with the departmental vote. As funding for replacement is not available until the "loan" is repaid, estimating the useful life of an asset requires reasonable care.

Should departments wish to sell assets before the agreed time has elapsed any outstanding funds provided for the purchase of the asset are to be deducted from the departmental budget in the next Estimates round. Alternatively a new funding arrangement can be made.

INTERACTIONS WITH THE BUDGET PROCESS

While applications to use the ten for one rule may be made at any stage of the year, the funding adjustments associated with such decisions must be approved through the Estimates. In any given year, proposals to purchase assets may be dependent upon fiscal considerations.

Departments are to keep a record of all funding adjustments made under the ten for one rule. Each year a summary sheet of all funding adjustments made under the ten for one rule should be submitted with Draft Estimates. This should include details of the original adjustments, the PLC for each year within the time period and the date at which funding adjustments are due to cease.

TRANSITIONAL ISSUES

Funding arrangements which have already been agreed to under previous ten for one rules will remain unchanged. Departments already operating under ten for one agreements should however, forward complete details of funding adjustments made to their Investigating Officer.

FURTHER ISSUES

Before requests for funding are made, proposals should first be subjected to a routine analysis of estimated costs and benefits. Analysis of costs should include all extra costs associated with acquiring and operating an asset (eg extra staff, additional space, increased security). The question of internal production or external provision of goods and services required for use within the department also requires careful consideration. Internal provision may cost less in some instances, but in other cases; internal provision will only appear to be cheaper, because departments do not yet meet all resource costs.

Where goods and services provided by the departments are sold to outside organisations, they should be priced on the basis of full cost recovery. This includes an assessment of depreciation and a return on capital, even if the department is not explicitly meeting these costs. This implies that revenue from some goods and services will exceed the cash cost of producing them.

L M Adcock
for Secretary to the Treasury

APPENDIX I EXAMPLE

If a car worth $20,000 is purchased with an estimated useful life of 8 years and the PLC is , say, 5% over those eight years then the annual payments (in constant dollars) are $3749 . This amount includes interest on the outstanding balance each year. If prior to the purchase the department's expenditure is $1,000,000 and the vehicle is not replaced, the following calculations would apply.

YR				FUNDING
0	1 000 000	+ 20 000	=	1 020 000
1	(1 000 000	- 3749) x 1.05	=	1 046 064
2	1 046 064	x 1.05	=	1 098 367
3	1 098 367	x 1.05	=	1 153 285
4	1 153 285	x 1.05	=	1 210 950
5	1 210 950	x 1.05	=	1 271 497
6	1 271 497	x 1.05	=	1 335 072
7	1 335 072	x 1.05	=	1 401 825
8	1 401 825	x 1.05	=	1 471 916
9	(1 471 916	x 1.05) + 5539	=	1 551 051
10	1 551 051	x 1.05	=	1 628 603

If the department wished to purchase another vehicle ($30,000, estimated life eight years) then the annual repayment would be $5623 and the calculations as follows:

8	1 471 916	+ 30 000	=	1 501 9169
9	(1 471 916	x 1.05)+ 5539 - 5623	=	1 545 428
10	1 545 428	x 1.05	=	1 622 699

APPENDIX II ANNUAL REPAYMENTS

Factors to be used when calculating the equal annual repayments are given below. To calculate annual funding adjustments multiply the amount of the loan by the factor shown for the appropriate number of years.

Number of years	Factor
1	1.1000
2	.5762
3	.4021
4	.3155
5	.2638
6	.2296
7	.2054
8	.1874
9	.1736
10	.1627
11	.1540
12	.1468
13	.1408
14	.1357
15	.1315
16	.1278
17	.1247
18	.1219
19	.1195
20	.1175
25	.1102
30	.1061

7 July 1988

TREASURY CIRCULAR 1986/

T 4/2 - Restricted Distribution

Officer for Enquiries: T.I.O. for the Vote

Officer for General Enquiries: David Heymann Extn 783
Murray Parker (after September 24)

PERMANENT HEADS

ASSET MANAGEMENT IN GOVERNMENT DEPARTMENTS AND AGENCIES

Introduction and Purpose of Circular

1 In its statement on Government Expenditure Reform 1986, the Government stated that "Under the current system of public accounting and centralised controls, departments have few incentives to manage assets actively or to raise revenue, and in some cases are constrained from doing so", and that "New incentives would be set in place to improve departmental asset management policies."

2 The purpose of this circular is to outline a first stage in introducing these incentives, and to allow departments to substitute between current and capital expenditure. The measures have been agreed by the Cabinet Policy Committee, and include the following:

a all departments are to produce registers of all significant assets, by 30 October 1986 where possible, and with extensions of time to be approved by the Minister of Finance subject to adequate justification and a firm alternative completion date;

b it is intended to introduce a current cost charge of 10 percent of asset value plus principal repayment or depreciation (for which departments would be reimbursed) in the 1987/88 estimates;

c departments will be able to substitute between current and capital expenditure by increasing their current expenditure by $1 for every $10 of receipts gained from asset sales. Alternatively they can purchase $10 of another fixed asset for every $10 of asset sold.

Background: Accounting Systems

3 The financial accounts of Government corporations and those parts of departments operating under revolving funds are prepared on an accrual basis. Those accounts include the cost of funds employed (as interest and dividends) and the cost of physical assets used up (as depreciation).

4 Other Government agencies' accounts are prepared on a cash basis. Cash accounts mostly do not include the cost of capital employed or used up in an activity. Traditionally, managers of activities which are accounted for on a cash basis have had little flexibility in their resource use because the mix of resources allocated to them (personnel, other current inputs, and new capital) has been determined for them through the Budget process.

5 Accrual accounting therefore has advantages over cash accounting in that it gives a more complete picture of costs and provides greater incentives for managers to regularly review their asset holdings to ensure they are providing an adequate rate of return. The improved accountability which better accounting systems assist in providing can enable the Government to give managers greater flexibility in substituting between capital and current expenditure.

6 Cabinet has agreed that officials should investigate and report back on any required changes to existing accounting systems of Government (including whether the Government should adopt accrual accounting principles) to ensure more effective financial reporting and management of assets owned by the Crown. This may well be the longer term direction taken, but in the interim the measures listed in paragraph 2 above, which are not inconsistent with such possible reform of the public accounts, are being introduced.

Asset Registers

7 In order to manage assets effectively, departments need to know what assets they own. With incentives such as the "10-for-1 rule" it will be in departments' interests to maintain accurate asset registers for land, buildings, and other fixed and current assets. Furthermore, since compensation will be provided for capital charges on the basis of asset registers at 1 April 1987, there is an incentive for departments to complete the registers in time for the 1987 Budget Cycle.

8 In two separate recommendations on 7 July 1986, Cabinet directed government agencies to produce a register of land, property and other capital assets currently held by them, and Cabinet Policy Committee agreed that all departments should complete asset registers of land, buildings and other significant assets by 30 October 1986 with exceptions to be approved by the Minister of Finance subject to adequate justification and a firm alternative completion date. Cabinet also agreed that officials should examine and report back on requiring departments and other government agencies to attach to their annual reports to Parliament a schedule of assets currently held.

9 Assets include both fixed and current assets, but departments should exercise some discretion as to the level of detail required by the word "significant" for the purposes of this exercise. We suggest a cut-off level of about $10,000, for either single assets, or for a collection of the same items as stocks on hand. With incentives such as the 10-for-1 rule it will be up to departments to decide what level of assets are included below this. The level of detail in the initial register will also be influenced by the time constraints on the exercise. Given the delay between the decisions being taken and being promulgated in this circular, Treasury will support reasonable extensions of time, but the final constraint derives from the action required for the 1987 Estimates.

10 The categories of assets to which the circular applies are as follows:

- Fixed Assets

. land and buildings;

. plant and machinery;

. motor vehicles;

. furniture and fittings;

. other (eg ships, aircraft).

- Current Assets

. stocks on hand;

. debtors.

Registers should be for fixed assets held as at 1 September 1986, although, if this creates problems for departments who have assembled assets registers at a different date departments should inform their investigating officer. For current assets, departments should provide an indication of the average level of stocks on hand and debtors. Departments should note that registers for many of these assets are already required by Treasury and Government Stores Board Instructions, and Cabinet Policy Committee has directed Treasury to discuss with the Controller and Auditor General the role of the Audit Office in reporting compliance with these instructions. The relevant instructions include the following:

- Treasury Instructions

. B.34 and M.9 Land and Buildings;

. K.3(5) Motor Vehicles.

- Government Stores Board Instructions

. 21-24 Stocks on hand;

. 21-26 Furniture and fittings;

. 21-27 Other non-consumable stores.

Valuation of Assets

11 Departments should value assets for the purposes of this circular at historical costs (ie purchase costs). These valuations may be adjusted for general price movements at some later date, so purchase dates should be included. Realisable values can be used where they are a reasonable estimate of replacement costs. Murray Parker is the contact officer for questions on valuation. The basis of valuation should be made explicit in the department's asset registers (or in the reply to Treasury).

12 The procedures for substituting between current and capital expenditure will be introduced in such a way that the incentives will act on assets purchased or sold at the margin. That is, the credit departments get for asset sales will depend on what the asset is actually sold for, and the current cost charge on a purchased asset will depend on the price paid for the asset. Therefore, the valuation method of the existing stock of assets for these purposes is not critical.

13 Copies of asset registers should be sent to Treasury (Attention: Mike Wintringham) and to SSC (Attention: Tony Gavin) so that they can be assembled for Cabinet Policy Committee to note. The register sent in can be at a high level of generality, arranged under the headings in paragraph 10. For example, under motor vehicles, departments might list sub-categories of cars, vans and trucks with the number of vehicles and estimated value under each sub-category. Departments should, however, have the raw data to back up this summary material.

Current Cost Charge and the "Ten-for-One" Rule

14 Assets held by departments are costing the Crown money, which is currently not shown in the Estimates. The money is made up of a number of components. One is the "opportunity cost" of the capital - the potential return from using the resources tied up in an asset in some other use. Another is the depreciation cost. Each year, there is a change in the value of the existing stock of assets held by the Government, but this cost does not appear until the year in which the asset has to be replaced, when the entire replacement cost of the asset comes to charge.

15 Cabinet Policy Committee has directed Treasury to investigate and report more fully on the introduction of a current cost charge on asset holdings for introduction in the 1987/88 Estimates. The current cost charge could consist of a charge of 10 percent of asset value plus depreciation to be paid into the Consolidated Account, for which departments would be reimbursed, in a similar way to the provision for GST.

16 Alternatively, the current cost charge could be based on a table mortgage model, with a department conceptually borrowing from the Public Account to purchase an asset, and paying off the interest and principal over the lifetime of the asset. In principle, this model could be extended to allow funding of other one-off expenditures, in addition to assets.

17 The introduction of the current cost charge will show the value of consumption of resources by the Government more clearly, and will provide a step towards funding departments on an accruals basis. However, more importantly, the charge will provide departments with the ability to switch between current and capital expenditure. The details of how the charge will be introduced, and whether it will be based on the depreciation and return on capital model, or the table mortgage model, will be worked on between how and the 1987 Estimates. Comments from departments will be sought and welcomed.

18 The charge will provide an automatic mechanism for the operation of the compensatory savings "ten-for-one" guidelines included in past Budget Cycle rounds, where, "once the assets have been sold and cash received as departmental receipts, receipts from the disposal of land and buildings and other assets, (are eligible as compensatory savings) with $10 of such receipts generally to equate to $1 of current". Such additions to current expenditure are a permanent addition to the base.

19 Similarly, departments would get approval for additional capital expenditure, as long as they were prepared to meet the current cost charge out of other current expenditure, or if they could get approval for the current cost charge as a new policy. This element of the policy might be affected by particular fiscal constraints in any one year. In effect it amounts to the Government lending money for capital expenditure, with a department servicing the loan out of its current allocation and in times of particular fiscal difficulty, the Government might want to ration the loan funds available.

20 This guideline also provides for $10 of receipts from asset sales to be eligible as compensatory savings for $10 of other capital. This has been endorsed by Cabinet Policy Committee. However, approval to spend money on this basis, (or as current spending under the 10-for-1 rule until the current cost charge is introduced next year) will still require inclusion in the Main or Supplementary Estimates, or as Unauthorised Expenditure.

21 As with any proposals where the money has been Appropriated but approval for a particular spending proposal is required, Treasury will support provision for expenditure financed by asset sales on the basis described above in departmental estimates, while still reserving the right to comment on the proposed purposes to which that money is to be put.

22 Details of the implementation of a current cost charge on assets and corresponding amendments to Treasury Instructions in time for next year's Estimates will be considered over the coming months.

1Summary of Action Required

Departments should:

a work on preparing an asset register of all significant assets, aiming to produce something (even if only a list of assets, leaving purchase date and valuation until later) by 30 October 1986;

b note that Cabinet has asked officials to examine a requirement for departments and other Government agencies to attach a schedule of assets to their annual reports to Parliament;

c note that work is continuing on the introduction of a current cost charge on assets in the 1987 Estimates, and that this will allow departments more discretion to substitute between current and capital expenditure;

d discuss with their Treasury Investigating Officer if they want to get credit for receipt from asset sales in 1986/87, for purposes of either purchasing new assets or increasing current expenditure.

Lesley Adcock
for Secretary to the Treasury

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