

Working Paper 2024/11

# Illustration of the Government's Financial Reporting System

<b>Title</b>	<p><i>Working Paper 2024/11 – Illustration of the Government’s Financial Reporting System</i></p> <p>This paper supports <i>Discussion Paper 2024/01 – Risks Hiding in Plain Sight: Does a commitment under the Paris Agreement to purchase offshore carbon credits create a requirement to report that commitment in the financial statements of the New Zealand Government?</i></p> <p>This paper forms part of the Institute’s ReportingNZ project.</p>
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## 1.0 Introduction

The purpose of this paper is to illustrate the system of financial reporting of the Government of New Zealand. This working paper provides detailed background for *Discussion Paper 2024/01 – Risks hiding in plain sight: Does a commitment under the Paris Agreement to purchase offshore carbon credits create a requirement to report that commitment in the financial statements of the New Zealand Government?*

## 2.0 Legislation

The financial reporting system of the Government is embedded in the Public Finance Act 1989. The purpose of this Act is:

### Section 1A Purpose

- (1) The purpose of this Act is to consolidate and amend the law governing the use of public financial resources.
- (2) To that end, this Act—
  - (a) provides a framework for **parliamentary scrutiny** of—
    - (i) the Government’s expenditure proposals; and
    - (ii) the Government’s management of its assets and liabilities; and
  - (b) establishes lines of responsibility for effective and efficient management of public financial resources; and
  - (c) specifies the principles for responsible fiscal management in the conduct of fiscal policy and requires regular reporting on the extent to which the Government’s fiscal policy is consistent with those principles; and
  - (d) specifies the **minimum financial and non-financial reporting obligations** of Ministers, departments (including departmental agencies, interdepartmental executive boards, and interdepartmental ventures), Offices of Parliament, Schedule 4 organisations, and Schedule 4A companies; and
  - (e) provides for the application of financial management incentives and for the accountability of Schedule 4 organisations and Schedule 4A companies; and
  - (ea) places limits on the ownership of the companies named in Schedule 5; and
  - (f) safeguards public assets by providing statutory authority and control for the—
    - (i) borrowing of money; and
    - (ii) issuing of securities; and
    - (iii) use of derivatives; and
    - (iv) investment of funds; and
    - (v) operation of bank accounts; and
    - (vi) giving of guarantees and indemnities. [bold added]

## Background

Treasury's November 2023 paper *A Guide to the Public Finance Act (the 2023 Guide)*, explains some of the history of the 1989 Act and how it should be interpreted. There are two key parts to the Act (Part 2 and Part 3) that are relevant to the treatment and reporting of the commitment discussed in *Discussion Paper 2024/01*.

Part 2 of the Act is described in the *2023 Guide* as:

Part 2 of the Public Finance Act 1989 is founded on two key planks: **transparency and accountability**. It seeks to achieve this by requiring:

- regular public reporting by each Government on their long-term fiscal objectives and short-term fiscal intentions and the extent to which these objectives and intentions are consistent with the principles of responsible fiscal management, and
- reporting on a wide range of economic and fiscal information ...

More specifically Part 2 promotes sound fiscal policy and fiscal transparency by:

- requiring that each Government pursue its policy objectives in accordance with the principles of responsible fiscal management set out in the Act
- **imposing regular fiscal reporting obligations on the Treasury and the Minister of Finance**. The reports and statements required to be presented to the House of Representatives include:
  - an annual fiscal strategy report
  - an annual budget policy statement
  - a periodic statement on the long-term fiscal position
  - a periodic investment statement on the Crown's assets and liabilities
  - regular economic and fiscal updates at least twice each year, and
  - an annual statement of tax policy changes in the Budget economic and fiscal update. [bold added]<sup>1</sup>

The *2023 Guide* also explains the linkage between annual reporting and fiscal risks:

### Fiscal risks

The fourth principle [see s 26G(1)(d) below] requires that each Government identifies and manages prudently the fiscal risks facing the Government. Fiscal risks can arise in relation to:

- **financial position**, for example, changes in the value of assets and liabilities and the potential for **off-balance sheet items** such as guarantees to **give rise to liabilities**, or
- operating flows, for example, changes in the tax base and the risk of certain expenditures exceeding budget.

By ensuring that fiscal risks are monitored and managed, this principle helps to reduce the level of uncertainty associated with the Government's future financial performance and position. [bold added]<sup>2</sup>

Part 3 is described in the *2023 Guide* as:

1. The Government is required to produce **monthly and annual consolidated financial statements for the Government reporting entity**.
2. These financial statements provide information on the Government's assets and liabilities, revenue and expenses and cash flows.
3. In common with appropriations and financial forecasts, the financial statements are prepared using the accrual basis of accounting and in accordance with generally accepted accounting practice (GAAP).
4. Many of the items reported in the financial statements of the Government are similar to the items reported in the financial statements of other entities. However, the Government also reports on some rights and obligations and transactions that are unique to governments including taxes obtained from the use of sovereign powers and non-exchange transactions such as welfare benefits.
5. The Auditor-General is responsible for expressing an independent opinion on the annual financial statements of the Government. [bold and underline added]<sup>3</sup>

Relevant sections from the Public Finance Act 1989 that relate to fiscal updates include:

#### Section 26G Principles of responsible fiscal management

- (1) The Government must pursue its policy objectives in accordance with the following principles (the principles of responsible fiscal management):
  - (a) reducing total debt to prudent levels so as to provide a buffer against factors that may impact adversely on the level of total debt in the future by ensuring that, until those levels have been achieved, total operating expenses in each financial year are less than total operating revenues in the same financial year; and
  - (b) once prudent levels of total debt have been achieved, maintaining those levels by ensuring that, on average, over a reasonable period of time, total operating expenses do not exceed total operating revenues; and
  - (c) achieving and maintaining levels of total net worth that provide a buffer against factors that may impact adversely on total net worth in the future; and
  - (d) **managing prudently the fiscal risks facing the Government; and**
  - (e) when formulating revenue strategy, having regard to efficiency and fairness, including the predictability and stability of tax rates; and
  - (f) when formulating fiscal strategy, having regard to the interaction between fiscal policy and monetary policy; and
  - (g) **when formulating fiscal strategy, having regard to its likely impact on present and future generations; and**
  - (h) **ensuring that the Crown's resources are managed effectively and efficiently.** [bold added]

#### Section 26M Budget policy statement

- (1) The Minister must present to the House of Representatives a budget policy statement—
  - (a) not later than 31 March in each financial year; or
  - (b) if Parliament is not in session on 31 March and a budget policy statement has not been presented in that financial year, as soon as possible after the commencement of the next session of Parliament.
- (2) The budget policy statement must, for the financial year commencing on 1 July after the statement is presented, state the broad strategic priorities by which the Government will be guided in preparing the Budget for that financial year, including—
  - (a) the overarching policy goals that will guide the Government's Budget decisions; and
    - (aa) the wellbeing objectives that will guide the Government's Budget decisions; and
  - (b) the policy areas that the Government will focus on in that year; and
  - (c) how the Budget for that year accords with the short-term intentions referred to in the most recent fiscal strategy report or the amended short-term intentions under subsection (3).
- (3) The budget policy statement must,—
  - (a) if the long-term objectives referred to in section 26J(1)(a) have changed from those stated in the most recent fiscal strategy report, indicate those amended long-term objectives and explain how they accord with the principles of responsible fiscal management; and
  - (b) if the short-term intentions referred to in section 26K(1) have changed from those indicated in the most recent fiscal strategy report, indicate those amended short-term intentions and explain how they accord with the principles of responsible fiscal management and the long-term objectives in the most recent fiscal strategy report or the amended long-term objectives under paragraph (a); and
  - (c) if the details of the Government's strategy for managing expenditure, assets, and liabilities (see section 26KA) have changed from those stated in the most recent fiscal strategy report, indicate those amended details.

- (4) The wellbeing objectives referred to in subsection (2)(aa) must relate to social, economic, environmental, and cultural wellbeing and to any other matters that the Government considers support long-term wellbeing in New Zealand.
- (5) The budget policy statement must explain how the wellbeing objectives are intended to support long-term wellbeing in New Zealand.

#### **Economic and fiscal updates**

##### **Section 26N Statement on long-term fiscal position**

- (1) Before the end of the second financial year after the commencement of this section and then at intervals not exceeding 4 years,—
  - (a) the Treasury must prepare a statement on the long-term fiscal position; and
  - (b) the Minister must present each statement to the House of Representatives.
- (2) The statement must—
  - (a) relate to a period of at least 40 consecutive financial years commencing with the financial year in which the statement is prepared; and
  - (b) be accompanied by—
    - (i) a statement of responsibility signed by the Secretary stating that the Treasury has, in preparing the statement under subsection (1), used its best professional judgements about the risks and the outlook; and
    - (ii) a statement of all significant assumptions underlying any projections included in the statement under subsection (1).

##### **Section 26O Economic and fiscal update [known as the Budget Economic and Fiscal Update (BEFU)]**

- (1) The Minister must, in accordance with subsection (2), present to the House of Representatives an economic and fiscal update prepared by the Treasury for each financial year.
- (2) The Minister must present the economic and fiscal update immediately after he or she has delivered the Budget for the financial year to which the update relates, or at any time prior to that time on the same day.
- (3) The update must—
  - (a) contain economic and fiscal forecasts that relate to—
    - (i) the financial year to which the update relates; and
    - (ii) each of the next 2 financial years; and
  - (b) contain a statement of tax policy changes in accordance with section 26R; and
  - (c) be accompanied by a statement of responsibility.
- (4) The update must state—
  - (a) the day on which the contents of the update were finalised; or
  - (b) the days on which the contents of different specified aspects of the update were finalised

##### **Section 26S Half-year economic and fiscal update**

- (1) The Minister must, not earlier than 1 November nor later than 31 December in each financial year,—
  - (a) arrange to be published a half-year economic and fiscal update prepared by the Treasury; and
  - (b) present the update to the House of Representatives.
- (2) However, if a half-year economic and fiscal update has not been presented by 31 December in a financial year because Parliament has not been in session since the date that the update was published, the Minister must present the half-year economic and fiscal update as soon as possible after the next meeting of Parliament.

- (3) The half-year economic and fiscal update must—
  - (a) include the information required by sections 26O(3)(a) and (4), 26P, 26Q, and 26U to be included in the economic and fiscal update prepared under section 26O, except that—
    - (i) the reference to estimated actual figures in section 26Q(3)(d)(i) must be read as if it were a reference to actual figures; and
    - (ii) the actual figures required by section 26Q(3)(d)(ii) are not required; and
  - (b) be accompanied by a statement of responsibility.
- (4) However, the Minister is not required to arrange the publication of the half-year economic and fiscal update in any financial year if, in the period of that financial year beginning on 1 October and ending on 31 December, a **pre-election economic and fiscal update**—
  - (a) has been published under section 26T; or
  - (b) is required to be published under that section.

### Section 26Q Fiscal forecasts

- (1) The fiscal forecasts contained in the **economic and fiscal update** prepared under section 26O must, for each of the **3 financial years** to which they relate, include **forecast financial statements**.
- (2) In addition to the forecast financial statements required by subsection (1), the fiscal forecasts must include—
  - (a) a statement of borrowings that reflects the forecast borrowing activities for each of those financial years;
  - (b) any other statements that are necessary to fairly reflect—
    - (i) the forecast financial operations for each of those financial years; and
    - (ii) the forecast financial position at the end of each of those financial years.
- (3) The fiscal forecasts must also include—
  - (a) **a statement of commitments** from the most recent monthly financial statements of the Government that are required to be prepared under section 31A; and
  - (b) **a statement of specific fiscal risks of the Government** as at the day on which the forecast financial statements are finalised—
    - (i) that sets out specific fiscal risks that relate to—
      - (A) the Government decisions and other circumstances required by section 26U to be incorporated in the economic and fiscal update prepared under section 26O; and
      - (B) **any other contingent liabilities (including any guarantees or indemnities given under any Act);** and
    - (ii) that discloses the rules used to determine what is and is not a fiscal risk; and
  - (c) **a statement of all significant accounting policies** (including any changes from the accounting policies contained in the annual financial statements of the Government most recently presented to the House of Representatives or published under section 31); and
  - (d) in relation to each forecast financial statement required by subsections (1) and (2)(a) and, if appropriate, subsection (2)(b),—
    - (i) comparative budgeted and estimated actual figures for the financial year immediately before the first of the financial years to which the fiscal forecasts relate; and
    - (ii) comparative actual figures for the financial year that is 2 years before the first of the financial years to which the fiscal forecasts relate; and



- (e) a statement of all significant assumptions underlying the fiscal forecasts; and
  - (f) a statement that shows the sensitivity of the fiscal aggregates to changes in economic conditions.
- (4) The fiscal forecasts must be for the same reporting entity as the annual financial statements of the Government to be prepared under section 27 for the first of the financial years to which the fiscal forecasts relate. [bold added]

#### Section 26W Requirements for statement of responsibility

- (1) The statement of responsibility required by section 26O or section 26S or section 26T must be signed by—
- (a) the Minister; and
  - (b) any other Minister designated for all or any of the purposes of subsection (2)(a) to (c); and
  - (c) the Secretary.
- (2) The statement of responsibility must comprise—
- (a) a statement by the Minister, and any other Minister designated for the purpose of this paragraph, that the following matters have been communicated to the Secretary:
    - (i) all policy decisions with material economic or fiscal implications that the Government has made before the day on which the contents of an economic and fiscal update or of the relevant aspect of the update were finalised; and
    - (ii) all other circumstances with material economic or fiscal implications of which the Minister and that other Minister (if any) were aware before that day; and
  - (b) a statement by the Secretary that the Treasury has supplied to the Minister, and to any other Minister designated for the purpose of this paragraph, an economic and fiscal update—
    - (i) that incorporates the fiscal and economic implications of the decisions and circumstances referred to in paragraph (a); but
    - (ii) that does not incorporate any decisions, circumstances, or statements that the Minister and any other Minister designated for the purpose of section 26V have determined under that section should not be incorporated in that update; and
  - (c) a statement of the responsibility of the Minister, and of any other Minister designated for all or any of the purposes of this paragraph and paragraphs (a) and (b),—
    - (i) for the integrity of the disclosures contained in the update; and
    - (ii) for the consistency with the requirements of this Part of the information contained in the update; and
    - (iii) for the omission from the update under section 26V of any decision, circumstance, or statement.
- (3) The statement referred to in subsection (2)(b) must be accompanied by a statement that the economic and fiscal update has been prepared by the Treasury—
- (a) using its best professional judgements; and
  - (b) on the basis of economic and fiscal information available to it before the day on which the contents of the update or the relevant aspect of the update were finalised.

#### Section 27 Annual financial statements of Government

- (1) The Treasury must, as soon as practicable after the end of each financial year, prepare annual consolidated financial statements for the Government reporting entity for that financial year.
- (2) **The annual financial statements of the Government must—**
- (a) be prepared in accordance with generally accepted accounting practice; and
  - (b) include the forecast financial statements prepared under section 26Q, for comparison with the actual financial statements; and

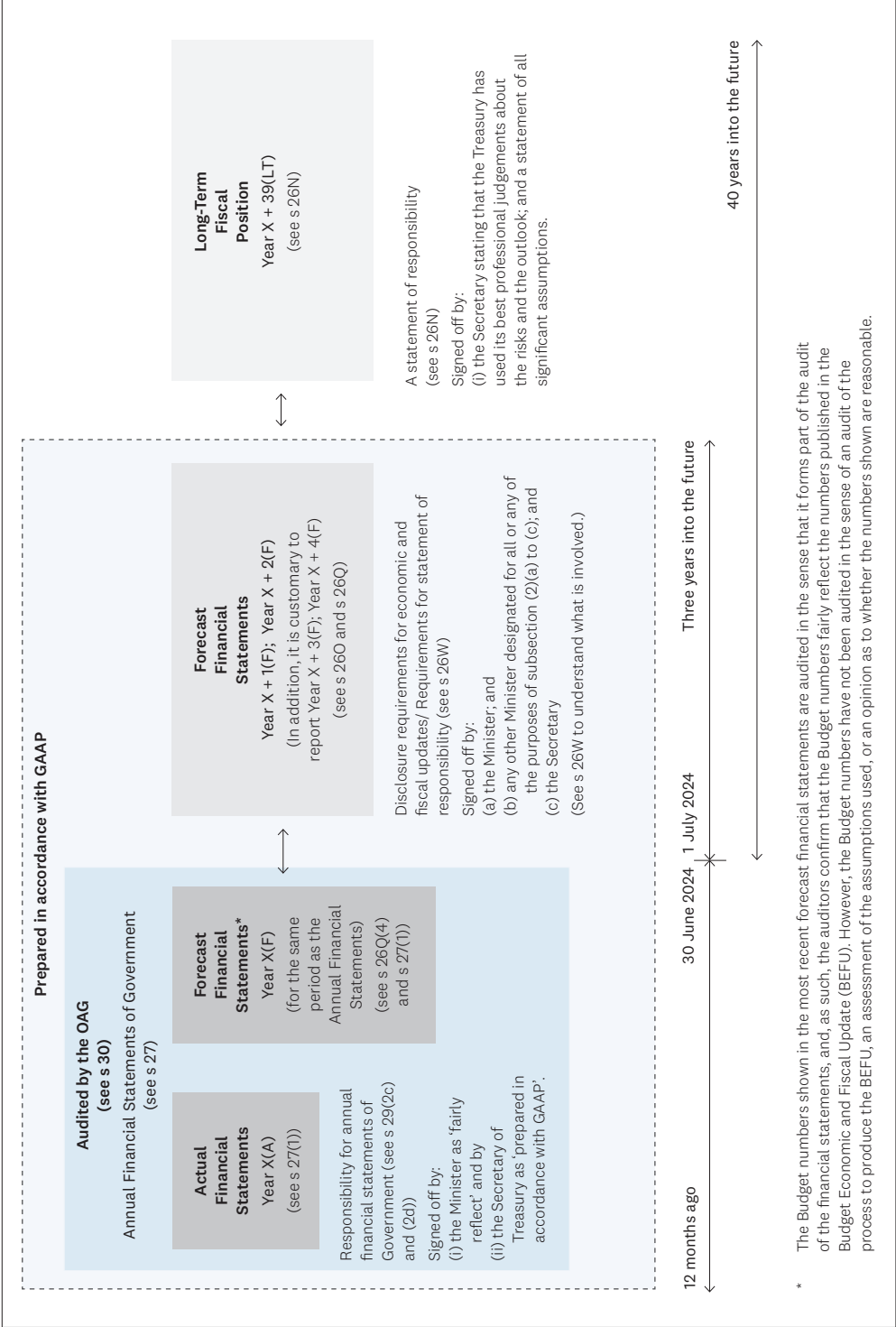
- (c) include, in addition to those financial statements required by generally accepted accounting practice,—
  - (i) a statement of borrowings that reflects the borrowing activities for that year, including budgeted figures for that year and comparative actual figures for the previous financial year;
  - (ii) a statement of unappropriated expenses and capital expenditure and unauthorised capital injections (excluding any capital injection to an intelligence and security department);
  - (iii) a statement of emergency expenses and capital expenditure incurred under section 25 and emergency capital injections (excluding any capital injection to an intelligence and security department) made under section 25A;
  - (iv) a statement of trust money administered by departments and Offices of Parliament;
  - (v) any additional information and explanations needed to fairly reflect the consolidated financial operations of the Government reporting entity for the financial year and its consolidated financial position at the end of that year. [bold added]

#### Section 29 Responsibility for annual financial statements of Government

- (1) Every annual financial statement shall be accompanied by a statement of responsibility signed by the Minister, any other Minister designated by the Prime Minister for either or both of the purposes of paragraphs (a) and (d) of subsection (2), and the Secretary.
- (2) The statement of responsibility shall comprise—
  - (a) a statement of the responsibility of the Minister, and of any other Minister designated by the Prime Minister for the purpose of this paragraph, for the integrity of the financial statements; and
  - (b) a statement of the Treasury's responsibility for establishing and maintaining a system of internal control designed to provide reasonable assurance that the transactions recorded are within statutory authority and properly record the use of all public financial resources by the Government reporting entity; and
  - (c) a statement by the Secretary that the Treasury has prepared the financial statements in accordance with generally accepted accounting practice; and
  - (d) a statement that, in the opinion of the Minister, and of any other Minister designated by the Prime Minister for the purpose of this paragraph, the financial statements fairly reflect the consolidated financial position and operations of the Government reporting entity for the reporting period. [bold added]

# 3.0 Illustration of the Government’s financial reporting system

Figure 1: Illustration of the Government’s financial reporting system



**Notes:**

1. X means the same financial year, and X+ means the next financial year, etc.
2. Year X(A) means Actual financial statements.
3. Year X(F) means Forecast financial statements.
4. Year X(F) is actually forecast three times: (i) in May before the year starts; (ii) in December for the HYEFU; and (iii) again in May when the year is almost complete as part of the following Budget. There is also a fourth update in election years with the Pre-election Economic and Fiscal Update 2023 (PREFU).

## Endnotes

- 1 See The Treasury. (November 2023). *A Guide to the Public Finance Act* (pp. 33–34). Retrieved 2 May 2024 from [www.treasury.govt.nz/sites/default/files/2023-11/guide-pfa-nov23.pdf](http://www.treasury.govt.nz/sites/default/files/2023-11/guide-pfa-nov23.pdf)
- 2 See The Treasury. (November 2023). *A Guide to the Public Finance Act* (p. 37). Retrieved 2 May 2024 from [www.treasury.govt.nz/sites/default/files/2023-11/guide-pfa-nov23.pdf](http://www.treasury.govt.nz/sites/default/files/2023-11/guide-pfa-nov23.pdf)
- 3 See The Treasury. (November 2023). *A Guide to the Public Finance Act* (p. 51). Retrieved 2 May 2024 from [www.treasury.govt.nz/sites/default/files/2023-11/guide-pfa-nov23.pdf](http://www.treasury.govt.nz/sites/default/files/2023-11/guide-pfa-nov23.pdf)



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