Public
Sector
Committee

October 1994

Occasional Paper 1

Implementing Accrual Accounting in Government: The New Zealand Experience

ISSUED BY THE
INTERNATIONAL FEDERATION OF ACCOUNTANTS

ACKNOWLEDGMENT: The Public Sector Committee (PSC) of the International Federation of Accountants (IFAC) is indebted to Ken Warren of the New Zealand Treasury for allowing it to publish this case study as an Occasional Paper of the PSC. The views expressed in the Occasional Paper are those of the author and are not necessarily shared by the PSC or the IFAC.

Ken Warren is the Director, Financial Reporting in the New Zealand Treasury. In his role he has responsibility for the preparation of the financial statements of the Government of New Zealand, the data collection and consolidation processes supporting both the financial reports and the fiscal forecasts, accounting policy development and the central financial internal audit function.

Ken Warren is a member of the Institute of Chartered Accountants of New Zealand.

Copyright © 1996 by the International Federation of Accountants. All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without the prior written permission of the International Federation of Accountants.

ISBN 1-887464-21-2

PREFACE

The Public Sector Committee (PSC) is a standing committee of the Council of IFAC formed to address, on a coordinated worldwide basis, the needs of those involved in public sector financial reporting, accounting and auditing. In this regard, the term "public sector" refers to national governments, regional (e.g., state, provincial, territorial) governments, local (e.g., city, town) governments and related governmental entities (e.g., agencies, boards, commissions and enterprises).

PSC has been given the authority, on behalf of the Council, to issue standards, guidelines, studies and occasional papers on financial reporting, accounting and auditing in the public sector.

Occasional papers are intended to provide information that contributes to some segment of the body of public sector financial reporting, accounting and auditing knowledge. They are aimed at providing new information or fresh insights into public sector issues and generally result from research activities such as: literature searches, questionnaire surveys, interviews, experiments, case studies and analysis.

PSC believes that the issue of such occasional papers pronouncements will contribute to the development of public sector financial management and accountability throughout the world.

This first occasional paper examines the implementation of accrual accounting and financial reporting from the perspective of a central agency and from the perspective of a department. It includes a very brief outline of the context within which the development of accrual accounting took place in New Zealand.

Implementing Accrual Accounting in Government: The New Zealand Experience

TABLE OF CONTENTS

	Paragraphs
CHAPTER 1: THE NEW ZEALAND CONTEXT	
Introduction	.001 - .002
Background	.003 - .014
CHAPTER 2: IMPROVING FINANCIAL MANAGEMENT	
Commitment to the Changes	.015
Management of Risk	.016 - .018
The Implementation in Departments	.019 - .022
Accounting Staff	.023 - .024
Accounting Systems	.025 - .029
Opening Balance Sheets	.030 - .031
Charging for Capital	.032 - .033
Cost Allocations	.034 - .036
CHAPTER 3: IMPLEMENTING ACCRUAL-BASED FINANCIAL REPORTING	
Accrual Reporting by the Crown	.037 - .038
Crown Accounting Policies	.039
Reporting Entity	.040 - .041
Use of Equity Accounting	.042 - .043
Asset Valuations	.044 - .045
Power to Tax	.046 - .048
Recognition Criteria for Taxes	.049
Benefits, Grants and Subsidies	.050 - .051
Collection of the Information	.052 - .059
Consolidation of the Information	.060 - .061
Obtaining Assurance over the Information	.062 - .065
Commentary and Analysis	.066 - .069
Presentation and Publication Issues	.070 - .072
Communications and Marketing	.073 - .078
CHAPTER 4: LESSONS AND CONCLUSION	
Lessons from the Implementation	.079 - .082
Conclusion	.083 - .084

CHAPTER 1

THE NEW ZEALAND CONTEXT

Introduction

.001 The New Zealand public sector experienced major reform in the late 1980s and early 1990s. This reform changed public sector management from a system based on compliance with detailed and restrictive rules and budget cash limits to a performance and accountability-based regime. The successful implementation of these reforms demanded considerable effort at both strategic and operational levels and led to fundamental and extensive changes in both the management of public sector operations and also in the financial results of those operations. The New Zealand experience demonstrates that such change is not only possible but can also be highly successful.

.002 This paper focuses on the move ("migration" was the colloquialism) by New Zealand government departments from cash to accrual accounting, and the project to produce the first set of Financial Statements for the New Zealand Government. The paper also attempts to draw out the key management issues in the implementation of full accrual accounting in a national government. The paper is written from the viewpoint of the Treasury which played a central role in the change.

Background

.003 The financial situation, and dysfunctional nature of the management systems of the New Zealand Government in the mid-eighties have been well documented, as have the theoretical bases for the reforms.[1] The results of the reforms have also been positively assessed from the viewpoint of management efficacy.[2] The financial results are startling with a 20 year slide in Government debt being sharply reversed and a marked turnaround from deficits to surpluses in the last three years(1994 - 1996), with some evidence that this is more than a cyclical result. While this paper does not attempt to repeat this well-covered ground, a short background to the reforms is necessary to understand the implementation issues.

.004 In the early 1980s the management systems were dominated by centralized input controls, established though Treasury Instructions and the Public Service Manual, and the requirement to use centralized monopoly suppliers for accommodation, vehicles, computers, office services, etc. Much management, and audit, effort was directed towards ensuring that these controls were understood and complied with.

.005 All public money was required to be paid into a consolidated bank account, one of a suite of five "public" bank accounts managed and operated by the Treasury. In accordance with Treasury Instructions, departments submitted vouchers for payment to Treasury offices which then organized payment, and reported on the transactions in the "Public Accounts."

.006 Budgeting was in the main limited to a set of appropriations of cash payments for loosely defined purposes (programs). The appropriation could be expressed in terms of the recipient, the government activity, or the type of payment (e.g., a grant or a capital payment).

.007 Not only was this operating environment frustrating to officials, but Ministers were also unhappy with the system as it stood. As Sir Geoffrey Palmer who was Deputy Prime Minister, and subsequently Prime Minister, during much of the period when the reforms occurred, has commented:

---

1 See "Government Management" The post-election briefing provided by the Treasury to the returning Government in 1987.

2 "Logan Report" - review of State Sector Reforms, State Services Commission, Wellington, 29 November 1991.

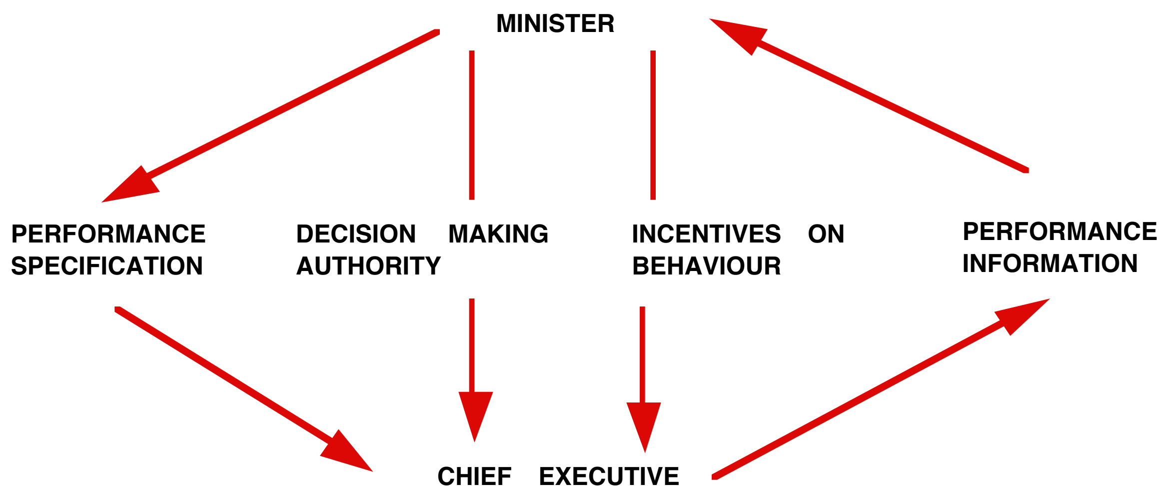
"I shall never forget the experience of being a new Minister of a reformist Government in 1984 when we were confronted with a whole range of economic problems which demonstrated the Government was not really in command of the public policy of the country at all. Expenditure was driven by forces beyond the Government's control. We were elected to be the Government. We thought we should be. We set about bringing about the conditions that allowed us to control the levels of Government expenditure and the priorities. The feeling I have just described had a great deal more to do with the reforms engaged in by the Fourth Labor Government than people have been prepared to admit. The State-Owned Enterprises Act 1986, the Public Finance Act 1989 and the State Sector Act 1988 were all driven by that imperative."

.008 From this beginning, the New Zealand Government has developed a comprehensive and integrated financial management system that:

- translates government strategy into decisions and action;
- informs government decision making;
- encourages the state sector to be responsive and efficient; and
- is constantly being enhanced.

.009 Cabinet Ministers are formally responsible for specifying performance requirements of the chief executives of departments. Chief executives are in turn responsible for service delivery and have the necessary managerial decision-making authority delegated to them. There are incentives to perform and requirements for performance information, as a basis for monitoring and assessment.

Table 1



.010 The main piece of financial legislation governing the new regime is the Public Finance Act 1989 which:

- removed many administrative controls;
- defines the appropriation process in terms of outputs;
- makes chief executives responsible for departmental financial management; and
- establishes departmental and Crown reporting requirements.

These provisions were all designed to clarify the accountabilities of the chief executive and remove their responsibilities for things over which they have no control.

.011 In chief executives' annual performance agreements, performance is defined in a way that distinguishes between, on the one hand, the Government's interests in the performance of a department as the purchaser of the services being provided either directly to the Government or to third parties, and as the owner of the department on the other.

.012 As purchasers, Ministers are looking for services that meet agreed specifications as to quantity, quality, timeliness and location at the best price.

.013 There are four dimensions to the owner's interest in departments; *strategic alignment* - ensuring that the Government's goals are fully and consistently shared, *integrity* - maintaining behavior that supports the reputation and credibility of Government, *future capability* - ensuring that departments have the capacity to deliver on expected future demands, and *cost-effectiveness over the long run*.

.014 Distinguishing these perspectives lends greater clarity to the specification of performance expectations. It follows from this owner/purchaser distinction that clear specification of the deliverables and a full accrual-based accounting of the resources consumed in their production is essential (e.g., to measure the maintenance of capital). The management need for accrual cost information and audited statements of service performance flows directly from the purchase interest. To satisfy the ownership interest, knowledge is needed of the capital invested, demanding 'balance sheet' type information.

CHAPTER 2

IMPROVING FINANCIAL MANAGEMENT

Commitment to the Changes

.015 Support from leaders in the public sector, both political and within the bureaucracy, was a key factor in the successful implementation of the migration to the new financial management regime. At a strategic level the components in the reforms were ordered in such a way as to generate early benefits to both the bureaucracy and Ministers, reflecting the different pay-offs associated with different elements of the reforms, and taking into account relationship issues between the Treasury and other public sector bodies. Early in the process, bureaucrats received (in exchange for increased accountability for outputs) the benefit of managing their departments without the need to comply with the extensive detailed procedural requirements that had been contained in Treasury Instructions and the Public Service Manual. Ministers saw the benefits through their capacity to manage better the fiscal situation they faced in preparing the 1991 Budget.

Management of Risk

.016 Any such implementation carries significant risk. Management of this risk was a key element of the implementation of the reforms. This was achieved partly through the ordering of the reforms. For example, centralized input controls were retained over departments until they moved to the new regime.

.017 Other elements of the risk management included an intensive communication strategy, comprising a booklet "Putting it Simply", a video "Setting a New Course", journal, magazine and newspaper articles and innumerable conferences, seminars and presentations. This communications effort was very successful in conveying a common understanding of the key principles of the reforms to a wide audience. Also, a central Financial Management Assurance function was established within the Treasury to provide a strategic internal audit role, and a consultancy service to departments during migration.

.018 The design of the legislation was a key element of the reforms as well. While avoiding the use of legislation to regulate detailed administrative processes, the State Sector Act 1988[3] and Public Finance Act 1989 provided powerful signals as to the Government's seriousness of intent, and therefore the likely permanence of the reforms. This removed any incentive to undertake changes slowly or in a manner that would facilitate easy reversion to the old system.

The Implementation in Departments

.019 Departments individually received approval to move onto the new system. For individual departments, all the key structural elements of the new system, including both the accrual budgeting and appropriation process, as well as the reporting process were changed at the same time. The migration involved:

- specification by each department (in consultation with Treasury) of its broad classes of outputs, which then became the basis for accrual based appropriations;

- each department developing an accrual based accounting system which provided the basis of monthly reporting to Ministers and the Treasury and annual reporting to Parliament (and the public). Monthly reporting included a full set of financial statements as well as statements of expenditure against appropriation;

---

[3] The State Sector Act sets out the roles and responsibilities of Ministers and chief executives and establishes the industrial relations framework for the state sector.

- development of cost allocation (including where necessary time-cost) systems to enable the allocation of all departmental input costs to outputs. The costs allocated include overhead costs, depreciation and the capital charge;

- development of a system of cash management, including the opening of departmental bank accounts; and

- departmental chief executives taking full responsibility for their financial management, including the integrity of the information they provide to Ministers and the Treasury.

.020 While these were the changes required of departments, the Treasury played a key role in this process. Key tasks carried out by the Treasury over this period included:

- the communication activities outlined previously;

- exercising quality control over the specification of output classes (prior to the reforms in New Zealand there were 56 separate binding appropriations, after moving to an output appropriation basis this had increased to 774 in 1991);

- setting up the central cash management system and letting the contract for the government's banking services (this tender was won by Westpac Banking Corporation - a major trading bank in New Zealand, who were able to provide state-of-the-art electronic banking services with low transaction costs as well as meeting the centralized cash and debt management demands of the Treasury);

- developing a set of accounting policy parameters, within which departmental accounting policies were constrained (this task was simplified enormously by the use of GAAP to provide a framework for the specific accounting policy parameters); and

- approving the readiness of departments to move on to the new system (this assurance was provided by the Financial Management Assurance function, referred to earlier).

.021 Treasury provided little in the way of advisory or training resources beyond the communications efforts described previously. Provision of such services would have hindered the "culture change" message, that chief executives of departments were now responsible for effecting the changes, but also it partly followed from the limitations on the resources of the central agency to provide those services as well as carrying out the higher priority functions listed above.

.022 As departments increasingly accepted the permanence of the reforms, and were educated as to what they meant, a momentum for the migration became established. Peer group pressure was able to be brought to bear. No department wanted to be seen to be slow in demonstrating that it had determined its outputs and established adequate financial management policies, procedures and controls required to be capable of operating in the new environment. In fact, while the legislation gave departments two years to develop their own accrual based systems, this was achieved by most in a year and by all departments within eighteen months.

Accounting Staff

.023 The Public Finance Act requires that the financial statements for the New Zealand Government and for each government department should be prepared in accordance with generally accepted accounting practice (GAAP). Use of GAAP greatly facilitated the implementation by allowing a flow of private sector talent and experience to resource the reforms. It became possible to make the best use of experienced people, software and systems.

.024 It was also helpful that New Zealand has one professional accounting body encompassing practicing accountants, corporate accountants and public sector accountants. The Institute of Chartered Accountants of New Zealand (the Institute)(then the New Zealand Society of Accountants) was interested in and supportive of the reform process, and energetic members gave much time to organizing conventions and otherwise making use of Institute forums in both encouraging and educational roles.

Accounting Systems

.025 A major activity during this stage of the reforms was the significant contracting between departments and accounting firms and software suppliers to provide financial management and information systems. A feature of the initial selection of accounting software systems was their short lives. While user requirements in terms of reporting to Ministers and the Treasury were relatively easy to specify, internally managers had no experience in the new regime and had difficulty in specifying their requirements in the terms demanded by the IT industry. Of the forty-five accounting systems implemented in 1990-91, few are still in use today.

.026 Unless the development of the initial accounting system occurred at the same time as restructuring activity, no new funds were provided for the development of the accounting systems. Rather the cost of the development was expected to be recouped from efficiency gains. While a number of departments complained that this led to money being diverted from worthy operational activity into corporate overhead, in general this was found to be manageable.

.027 Indeed, one of the advantages of accrual accounting systems is that activities such as commitments or purchase order systems, payroll, fixed assets, creditors and debtors are able to be integrated into one system, thereby reducing double processing and reconciliation problems associated with disparate systems. The time savings this brings about can be major.

.028 Despite these changes few government department finance functions grew in terms of total staff complements. There was however a significant upgrading in financial expertise as compliance officers were replaced with professional staff capable of negotiating budgets and marketing financial information. The Treasury was able to make reductions in staff responsible for routine accounting functions, from six large regional Treasury offices to a complement of just six staff.

.029 An implication of the new environment has been that the central accounting system was modularised into individual accounting systems. This has greatly assisted departmental flexibility as it ensures not only that accounting systems do not fall behind leading technology but that they can continue to meet changing needs as departmental activities change. One department can now take advantage of new system features of particular value to its organization without reference to the rest of the bureaucracy. Where a new system requires a capital injection by the owner (most in fact are funded from within the departments' own balance sheets) then the owner will seek to ensure that the development aligns with its and the department's objectives, and that the investment is appropriately managed to ensure cost effectiveness in the long run.

Opening Balance Sheets

.030 A major concern through the implementation was to ensure that the opening balance sheets were as complete and accurate as possible. Without the discipline of previous annual balances and audits reconciling asset records to any financial ledgers, the information on assets was discovered in some cases to be woefully inadequate. In some cases, the best starting point was for managers to carry out a stocktake and certify that the resulting list comprised all the assets under their control. This was an area in which the auditors were particularly helpful and constructive in assisting departments to put together auditable records and processes.

.031 Departments and auditors found it a particularly difficult task to ensure that all properties were reported, and to do so it became necessary to co-ordinate searches of Government Valuation records with the Land Transfer Office and individual departments. This work however had a most valuable spin-off in identifying surplus properties that were able to be sold.

Charging for Capital

.032 A common weakness in government financial management systems is the tendency towards budget maximization and the absence of checks against accumulating assets of low utility. To counter this the New Zealand Government instituted a system of charging departments for the capital they use. This capital charge is applied to the net assets in each department's balance sheet. Through this process, any reduction in its capital base that a department is able to offer the Government is rewarded in a reduction in the capital charge that is imposed (with appropriations being left unchanged).

.033 Cabinet established a capital charge task force with departmental representation, which oversaw the implementation of the new regime. The Government boosted the revenue departments received from the Government at the same time as the capital charge was introduced avoiding a serious diminution in resources available to departments. To some extent this had the effect of muting the incentive effect on departments. However, where the department was charging users for the service, the incentive was created for that department to either increase its price to reflect the full cost or to rationalize the capital structure associated with the output.

Cost Allocations

.034 A necessary requirement of focusing the financial management system on outputs is to build cost accounting systems which allocate costs to outputs. As these costs include the capital charge it is possible to compare them with similar costs that would be incurred by other suppliers both in the public and private sectors and, in time, with the same department's record in previous years.

.035 Initially the cost allocation systems developed were fairly basic, reflecting both the lack of experience and skill in this area, and the lack of demand by output managers for detailed cost information. Progress from this initial stage has been somewhat hampered by the importance placed on living within appropriation. The stress placed on ensuring appropriations are not breached has led to a demand that cost allocation systems produce a highly predictable amount rather than a result that is highly sensitive to changes in costing mixes.

.036 However, greater progress in this area is now emerging as some departments are identifying unit costs both for internal comparison purposes and for benchmarking with other organizations.

CHAPTER 3

IMPLEMENTING ACCRUAL-BASED FINANCIAL REPORTING

Accrual Reporting by the Crown

.037 Once departments had fully migrated onto the new financial management regime it became possible to focus on the aggregated financial reporting of the Government. Production of the new series of GAAP based Financial Statements of the Government was managed as a major project comprising seven elements:

- establishing the Crown Accounting Policies;
- collection of the information from departments, Crown entities and State-owned enterprises (SOEs);
- consolidation of the information;
- obtaining assurance over the information;
- commentary and analysis;
- presentation and publication issues; and
- communications and marketing.

.038 The usual elements of project management were put in place. A project steering committee kept an overview of the project. Individual sub-project teams were resourced, timetables established and critical paths determined. Throughout the project there was a shared vision of the final end-point; timely publication of a GAAP based set of Financial Statements for the Government, with the credibility of a clear audit opinion behind them.

Each of the sub-projects is described separately below.

Crown Accounting Policies

.039 As noted already, adopting GAAP simplified the accounting policy setting process enormously. In most areas the same approaches that the private sector takes could be used without difficulty. This approach however did not mean that there were not a number of contentious issues to be dealt with. Also, as the Crown accounting policies establish the methodology for preparing the financial statements of the Government and impact all the organizations within Government great care was taken over their development. They were subjected to extensive external review by accounting experts, issued as an exposure draft, briefing sessions were held for departmental chief financial officers and comments were sought from them.

Reporting Entity

.040 A critical issue in determining the accounting policies was establishing the reporting entity. This issue is of some consequence for a sovereign Government which will typically develop institutional arrangements to devolve authority and control and seek to distance the Executive centre from the other arms of Government. In New Zealand the problem of defining the reporting entity remained in effect unfinished business at the time of the original Public Finance Act when it was recognized that our thinking required further development. The original Financial Statements covered Ministers and core government departments only. The issue was resolved through an inquiry by a sub-committee of the Finance and Expenditure parliamentary select committee which established a set of criteria for deciding whether an organization should be included:

- that the Crown owns a majority of voting shares;
- that the Crown has the power to dismiss and replace the governing board or chief executive;
- that the Crown has a right to more than 50% of the assets on disestablishment;

- that the Crown assumes responsibility for any residual liabilities on disestablishment; or
- that Parliament deems the entity to be owned and that it should therefore be included.

.041 The committee recommended that to remove uncertainty, Crown entities should be defined by reference to a schedule in the Public Finance Act. Over a twelve month period, the Government reviewed all likely entities, measuring them against the select committee criteria, prior to introducing the necessary amendment to the Public Finance Act in 1992.

Use of Equity Accounting

.042 Governments have generally created Crown entities and State-owned enterprises with separate governance structures to establish some independence from the "core" government. Also, it was considered that financial reporting by the Government should reflect Government's financial performance. Separate financial reporting by Crown entities and SOEs reflects the managerial performance of their external boards. It was hypothesized that government accountability for these entities is confined to its monitoring role and compliance with undertakings to contain its involvement to agreed limits. Because of the different bases for accountability it would be inappropriate to fully consolidate the financial statements of the "core" government with those of SOEs and Crown entities. Therefore, the approach taken to accounting for these entities was an "equity accounting" method reflecting that "significant influence" rather than "day-to-day control of operating and financing activity" more appropriately describes the nature of their relationship to the Crown.

.043 Significant additional information is provided on these entities in the financial statements so that an overall view can be obtained of this segment's financial results and position. The current accounting standard on group combinations contains an exemption for the Government. This standard is however now being reviewed by the Institute and the future approach to combination of Crown entities and SOEs is at this time unresolved, but a move to the full consolidation of some or all of these entities is possible.

Asset Valuations

.044 One of the legacies of the previous cash accounting system was the unavailability of information on the historic cost of many assets. This was generally resolved by using a net current value approach to the valuation of assets. Where a net realizable value cannot be obtained or is otherwise inappropriate, as in the case of some infrastructure and "heritage type" assets, a depreciated replacement cost concept is used.

.045 This approach countered concerns expressed by some fiscal analysts and public sector economists that historical cost information is largely irrelevant to their needs. These users of the financial statements therefore derived some comfort that by adopting the net current value approach to the valuation of most assets, the balance sheet more fairly portrays the economic reality of the financial position. This approach has been more recently endorsed by the recent accounting framework developments in both Australia and New Zealand.

Power to Tax

.046 The power to tax and other regulatory rights are a feature of governments distinguishing them from the private sector. There was some debate on whether the power to tax should be reported as an asset in the financial statements. The conclusion was reached that the criteria for recognizing an asset were not properly satisfied, as the transaction or event giving rise to the benefit had not occurred (e.g., earning of taxable income), nor could its value be measured reliably.

.047 The power to tax was viewed as analogous to the powers that mutual or co-operative organizations have to levy their members. This is not treated as an asset as members want to know the financial position of the organization prior to the exercise of the power to levy. Further, it is impossible to value the power to tax "asset" with sufficient reliability and the attempt to do so would overwhelm the other information in the

balance sheet. Similarly, on the liabilities side, the value of future social welfare obligations is a very large item in respect of which the event giving rise to the liability was considered not to have occurred, over which the government has significant discretion, and which is very difficult to quantify.

.048 Non-recognition of the "power to tax" and welfare entitlements in the balance sheet does not imply that information on these powers and obligations is not important in determining the financial condition of a sovereign government. Currently this information need is met in New Zealand through the fiscal projections and outlooks included in the budget documentation, which provide projections for 10 years into the future.

Recognition Criteria for Taxes

.049 The appropriate recognition point for reporting taxes and other sovereign power revenue required considerable deliberation. While the most appropriate recognition point from an economic perspective is the time that the taxpayers obligation arises (e.g., when the taxable revenue is earned or the taxable consumption enjoyed by the taxpayer), sufficiently reliable information is often not available on a timely basis. Therefore, particularly in the case of long-run taxes, it was sometimes necessary to compromise on a later recognition point when more reliable information is available. For example, terminal income tax is recognized when the tax return is assessed, as sufficiently reliable information is not available earlier. Over time, developments in the tax accounting systems have yielded more useful information, enabling increasingly reliable estimates of tax obligations not yet payable to be made. As a result not only has the Government been able to move the tax recognition points closer to the point that the obligation arises, but it has also benefited from improvements in the forecasting of tax receipts from taxation.

Benefits, Grants and Subsidies

.050 The approach taken for benefit, grant and subsidy payments was that if the payment is discretionary until payment, then the expense is to be recognized when the payment is made. Otherwise the expense is to be recognized when the specific criteria have been fulfilled and notice has been given to the Government.

.051 This approach necessitated a change in treatment by some grant distribution bodies who had previously recognized grants when approved or committed by the governing board, regardless of whether the specified criteria had been met. However, at that stage, it is not possible to say that an obligation has been incurred, and there have been many recorded instances when the actual grant has not then been made. This is not to say that a commitments system is unnecessary or undesirable, but rather a clearer view of the financial position of the organization is obtained if its current obligations and commitments are reported separately.

Collection of the Information

.052 Provision of regular, accurate, timely financial information to Treasury was a requirement that was a critical element of the management framework. Nevertheless, as departments experienced some marginal costs in providing this information without perceiving any direct benefit, collecting the necessary information featured as a key issue in the preparation of the first set of financial statements of the New Zealand Government.

.053 From the viewpoint of Treasury, the implementation strategy was to ensure that departments had sufficient notice of the requirements to ensure that they were able to meet them, that only information necessary for the aggregate financial statements and for appropriations monitoring was demanded, and that departments and Crown entities were clear about the use to which the information was being put.

.054 As well as notifying departments of the reporting requirements by circular, several visits were made to each department, where individual issues were discussed and group seminars were held on the process. The initial timing for the provision of the first set of information was arrived at by agreement, with chief financial officers being aware of the statutory reporting timetable.

.055 Departments, however, were in the process of bedding down new information systems. In many cases this involved significant cultural change. For example, where the costing system required all staff to complete timesheets, a new and unwelcome activity for many bureaucrats, processing was often delayed creating considerable difficulty in meeting the deadlines. As processing fell behind, so too did key internal controls such as reconciliations to subsidiary records such as bank accounts, debtor and creditor ledgers, fixed asset registers and the costing system.

.056 A natural response in such circumstances was to attempt to reduce the burden of external reporting to Treasury. The incoming government in 1990, looking to examine the new system, was quickly made aware of departmental concerns and the examination of the compliance costs of reporting was included in the terms of reference for a major review of the new system.

.057 Gradually, however, as departments acclimatized to their new systems and the end-of-month procedures became a regular activity, the cost of meeting Treasury information requirements were perceived to be marginal and minimal. By the time the review addressed the issue, the concerns of departments were far more muted and focussed more on the disruption caused by changes to the reporting requirements.

.058 The departments that had the most difficulty meeting Treasury reporting requirements were those that needed to identify and value large property holdings and those that implemented decentralized accounting systems. In the case of the former, previous asset records were found to be of little value and significant resources were required to identify all the property holdings and obtain auditable valuations. Several departments initially implemented accounting systems where significant authority (for example to add ledger codes) was devolved to regional offices. These were quickly found to be cumbersome and were hurriedly recentralized.

.059 Initially the information collection process comprised of a set of hard copy schedules which departments completed. Treasury experienced major quality control problems with these schedules and they were replaced with a spreadsheet based system which obliged departments to meet a number of validation tests (e.g., that the balance sheet actually balanced). More recently a commercial collection and consolidation software package has been purchased which has streamlined the data collection process by allowing the information to be collected electronically and consolidated automatically. The New Zealand Government is now able to prepare a complete set of GAAP based financial statements on a monthly basis within 20 days, and this time lag is continuing to reduce.

Consolidation of the Information

.060 A clear understanding of the accounting policies by departments and their provision of reliable data on time, makes the consolidation process a conventional and relatively easily managed accounting exercise. Initially however difficulties in the collection process noted above led to great pressure on the team consolidating the financial statements.

.061 A general ledger was used rather than a spreadsheet to process the consolidation as this provided an audit trail for the many amendments that were received or required as part of the preparation of the financial statements. This ledger has recently been superseded by the consolidation package referred to previously.

Obtaining Assurance over the Information

.062 Assurance over the reliability of the information was derived from three sources. First, departmental chief executives and chief financial officers were required to sign a statement of responsibility with the consolidation schedules that to the best of their knowledge they were a fair reflection of their financial results. Second, the Financial Management Assurance team reviewed the consolidation schedules and draft financial statements with the resulting analysis providing some measure of comfort. Third, the full audit carried out by the Audit Office provided assurance through the opinion attached to the financial statements.

.063 The responsibilities of chief executives was emphasized in Treasury's communications on the reporting requirements. The provision of information by Treasury on the financial management of the departments at the time of the chief executive's performance assessment, proved useful, if controversial, tool where improvements in accounting systems and in the reliability and timeliness of the financial reports were needed.

.064 A vital role was played by the Financial Management Assurance team who were available as "troubleshooters" on material issues. As they had gained a knowledge of the departmental systems and intentions through the migration process, they were well placed to advise on areas that needed to be tackled and in some cases became involved in the preparation of information at department level. At the end of the process they were able to relieve the pressure on the consolidation process highlighted above and provided much of the analysis of the information for internal purposes as well as the externally published commentary.

.065 Throughout the process, the Audit Office were heavily involved, often providing representatives on the various task forces implementing aspects of the public sector management reforms. In particular, Treasury consulted heavily with the Audit Office in the development of the accounting policies and regular meetings between the two organizations ensured that major issues coming to either Treasury's or the Audit Office's attention were dealt within a timely manner. This constructive relationship was vital and at the end of the process the Audit Office saw the unqualified audit opinion as an achievement as much as the Treasury.

Commentary and Analysis

.066 The commentary accompanying the financial statements has evolved. Initially the commentary explained and justified the new reports. Now, a more detailed analysis of the financial information is produced, as trends and budget comparative information have become available.

.067 The first set of financial statements reported a significant negative net worth position, a financial position that clearly would not be tenable in a private sector organization. The commentary provided with the financial statements therefore initially concentrated on explaining and describing the financial information. The commentary highlighted the importance of interpreting the new accrual information with care, while still emphasizing the higher quality information provided about the financial consequences and long-term implications of government policies.

.068 Provision of full balance sheet information provided an opportunity for the Government to comment on the management of risks associated with holding the assets and liabilities reported on the balance sheet. Just as the reform process had led to greater attention being provided to asset management programs, the accountability of Crown entities and SOEs and the management of working capital; the reporting process also became an opportunity to market these results.

.069 More recently, trend analysis has become possible as the history of the financial statements has built up providing a new perspective on the information contained in them.

Presentation and Publication Issues

.070 Considerable effort went in to issues of presentation and marketing to ensure that the better quality financial information was appropriately presented in a better quality document. As with any document driven by a deadline, improvements were being made right up to the "OK to Print" sign-off being provided to the printers.

.071 This process demonstrated the usefulness of a style guide being prepared well ahead of time, so that debates about detailed presentation issues are not held in a frantic atmosphere at the end of the process, but rather are agreed and communicated well in advance.

.072 Liaison with the printers was critical as every minute available was utilized to polish the final product. At the end however, there was inevitably a list of improvements "for next time".

Communications and Marketing

.073 The communications and marketing effort that went in to the initial sets of financial statements turned the good output into a good outcome. The financial statements in New Zealand were marketed as a world first, providing in tandem with other economic information, new and better information on the Government's fiscal position and stewardship, informing and supporting the executive's base for decision making and enhancing the ability of Parliament and others to hold the Executive to account.

.074 The most significant area of risk was felt to relate to the overall negative net worth position and concerns that this would raise general public alarm and adverse effects on investor and rating agency perceptions. Care was therefore taken to ensure realistic expectations in the financial markets, and to present the result in such a way as to ensure it was not misinterpreted.

.075 A second concern was that while audited financial statements contain a significant amount of useful and reliable information about the financial performance of the Crown and its impact on the economy, they do not fully reflect economic concepts of wealth and income. The statements in themselves are unable to capture such economic assessments as measures of social capital, inter-generational equity, and wider fiscal risks etc.

.076 Key users of the financial statements were identified as being Parliament, economic and financial analysts, rating agencies, media and the public, and special interest groups such as environmental groups.

.077 A marketing strategy was adopted that emphasized that the new information, available from the financial statements enriched the development of the Government's economic and fiscal policy. The consultation process on the accounting policies and format of the Financial Statements provided an opportunity to market them, and this was followed up by presentations on the significance and interpretation of the first set of financial statements for Ministers, Members of Parliament, financial market analysts and the media. Finally a "lock-up" was held for analysts and media at the date of release of the financial statements, with Treasury personnel available to guide them through the figures.

.078 This strategy ensured the Financial Statements were well received and minimized any misinterpretations of the result. The immediate credibility of the financial statements and the positive international reaction obtained by the Government were of key importance in the decision to move all its fiscal reporting, including its whole-of-government budgeting on to a basis consistent with GAAP.

CHAPTER 4

LESSONS AND CONCLUSION

Lessons from the Implementation

.079 The implementation of accrual accounting in government is a major exercise, particularly if it is done in a way that will provide maximum benefit to decision making processes and accountability to external users. The New Zealand Government's experience provides so many lessons at both macro and micro levels that it is difficult to distinguish the most critical.

.080 However, probably the most important lesson is that it can be done. There is no fundamental theoretical barrier for a sovereign government which prevents the implementation of accrual accounting. Rather, there is much to recommend the development of accrual accounting in government when it is implemented in the context of a regime which encourages management performance.

.081 This leads to the second major lesson. Accounting is important and exciting when it generates information that is used by decision makers. Conversely, without decision-makers demanding and using accrual information then the implementation effort is far less likely to succeed. While the demand for accrual accounting information is likely to increase as public administration trends towards public management, development of accrual information should be seen as an integral element of this reform and not a stand-alone exercise.

.082 At an operational level a number of lessons can be highlighted:

- Commitment is critical. This requires a clear understanding that accrual accounting will not bring benefits as of itself but rather by providing richer information can bring benefits by improving the quality of decisions. The lesson is that commitment based on false expectations will not continue. Better the sceptic turned convert than the lapsed believer.

The net fiscal costs of operationalizing accrual accounting systems compared with cash systems are relatively trivial. Overly centralized accounting processes, with subsidiary elements that are more-or-less poorly integrated are surprisingly cumbersome and expensive when compared with the best private sector practices of centralized cash management, with streamlined financial management systems.

- Trade-offs will be necessary and therefore a shared understanding of key goals is required to make such trade-offs. An example is the Treasury decision not to engage in training for departmental financial managers despite one view that training was necessary to realize the benefits and reduce the risks associated with the new regime. In terms of the higher level objectives and other demands to achieve those objectives this was the right decision.

- Identify and respond to major risks. In the New Zealand setting these included the specification of the outputs of government, the identification of all the assets in the Crown estate, defining the Government reporting entity and eliminating the build-up of processing backlogs. In the final analysis none of these issues was allowed to derail the implementation.

- Achieve major gains from leveraging off private sector accounting. By making use of GAAP the best of private sector off-the-shelf accounting software could be used and the pool of skills and expertise available to the financial management reform was sufficiently widened to cope with the new demands and make benefit from the new opportunities.

Conclusion

.083 The implementation of the new financial management system is generally regarded as a success. At the start of the implementation there was general dissatisfaction with the status quo. Sustained political and senior management commitment encouraged most public sector managers to welcome the change. An emphasis on communications and a careful ordering of the process ensured that risks were well managed. Apprehensions about cost, accounting policy issues and concerns that the results would be misinterpreted, failed to materialize to any material extent. The following comments come from a recent survey of public sector managers:

> "The introduction of private sector methods of accounting rated more positives and fewer negatives than any other feature of public sector change . . .The financial changes were seen by one participant as necessary disciplines if the public sector is to make any claim to management professionalism . . . One person admitted to having been a sceptic turned convert, as the new system had clarified the cost of capital, the distinction between costs and cash, and the burden of overheads on operating units." [4]

.084 The implementation has ensured each of the elements of the New Zealand Government's Financial Management System reinforce the other elements to provide a comprehensive approach to implementing the governments strategy, facilitating high-quality decision making by management, and enabling effective scrutiny by Parliament.

---

4 Re-invented Government - the New Zealand Experience. Richard Norman, Victoria University of Wellington, 1994.