SECTION 6 IMPROVING THE MANAGEMENT OF FINANCE

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6.1 Strengthening internal audit systems

The effect of public sector reform in New Zealand has been to place increased accountability on management for organisational performance. Internal audit is one of the management systems used in the public sector to promote the efficient and effective use of resources. While internal audit is not new, its traditional role has been in ensuring that departments comply with various administrative and financial rules and requirements. It has now developed into a comprehensive tool for improving organisational performance in the New Zealand public sector.

The context for change

The New Zealand Institute of Internal Auditors uses the following definition and explanation of internal auditing:

> "Internal auditing is an independent appraisal function established within an organisation to examine and evaluate its activities as a service to the organisation. The objective of internal auditing is to assist members of the organisation in the effective discharge of their responsibilities. To this end, internal auditing furnishes them with analyses, appraisals, recommendations, counsel and information concerning the activities reviewed.
>
> The members of the organisation assisted by internal auditing include management and the public sector equivalent of directors. Internal auditors inform them about the adequacy and effectiveness of the organisation's system of internal controls and the quality of performance."

In contrast, external audit is carried out for Parliament and is concerned with ensuring departments meet legislative requirements.

Comprehensive auditing assesses departmental performance from three inter-related, but distinct, perspectives:

(i) *Financial statement auditing* – proper accountability depends on assurance that management assertions in the financial statements are true.

(ii) *Compliance auditing* – in the public sector it is important to have assurance of the probity and legality of departmental activity.

(iii) *Value-for-money auditing* – meaningful accountability requires that there be an assessment of whether departmental outputs are being delivered economically and efficiently and whether they are effectively contributing to the achievement of outcomes.

In recent years there has been a significant expansion of the number of internal audit units in the New Zealand public sector. Most of the larger government departments now have an internal audit unit. In 1990, the Auditor-General reported that there were internal audit units in 13 of the 43 departments.

The growth in the internal audit function is attributable to a number of factors:

- Internal audit reports serve objectives which are consistent with public sector reform – clarifying objectives, providing greater accountability and demonstrating the effectiveness of resource use.

- Public sector reform in New Zealand increased delegations and decentralised decision-making. For managers the *quid pro quo* for this autonomy was greater accountability. In this environment managers have a strong incentive to support internal auditing.

- The audit process can highlight where economies can be made. This is an important function in departments with static or falling levels of resources.

Internal auditors in New Zealand are in the business of advising management as to the efficiency, economy and effectiveness of internal controls and practices in a systematic and independent way. It should be seen as complementary to the following approaches:

- programme evaluation;

- total quality management;

- specialist review units/management consulting teams;

- corporate planning/performance management systems.

To be effective, internal audit must be treated as part of a wider planning and monitoring process.

Implementing change

The support of the chief executive is critical to the success of any internal audit unit. This support is required to ensure the unit is adequately resourced and also has the necessary authority to conduct the audit process. Chief executive support is also necessary to ensure recommendations are acted upon.

Credibility is a major element of a successful internal audit team. Without credibility anything the unit reports will tend to be dismissed or discounted no matter how objectively correct or compelling its findings on an issue. This means the unit needs staff with the appropriate mix of expertise and seniority to be able to deal with all levels of management.

When an audit unit is established, a directive, circulated to all staff, setting out the authority and responsibility of the internal audit unit, can act as the unit's charter which establishes its independence and its right of access to all information and staff.

A number of public sector organisations in New Zealand have established Audit Review Committees comprising senior management to endorse the internal audit unit's work programme and, of equal importance, to ensure that audit reports do not go unheeded.

Many of the departmental staff who work in an internal audit role initially acquired their skills from courses run by the New Zealand Institute of Internal Auditors.

There are a variety of internal audit methodologies followed in New Zealand but a common practice is to encompass the broad stages of:

- overview
- preliminary survey
- identification of the issues
- evidence gathering
- report writing.

Respecting confidentiality is the basic principle for ensuring a free flow of information.

Independence of all operations and management which it is to review is another requirement of an internal audit unit.

The planning of an audit programme is a major task. This will set out the scope, objectives and resource requirements of each audit planned in the period ahead.

The selection of topics for detailed internal audit scrutiny will depend on a number of factors. Generally projects are undertaken because of a combination of significance in terms of money spent or collected, the risks associated with them, and by the social or economic impact of the activity.

In summary, if internal audit reports are to be of value they must:

- address areas of concern to management;
- focus on risks;
- assist management decision-making;
- lead to improvement;
- be clear and concise.

Supporting material

(i) The Challenge of Performance Audit in a Policy Department, *Public Sector*, Vol 12, No 1, Mansfield, M. 1989, Wellington

(ii) Audit, Evaluation and Review in the Public Sector, *Public Sector*, Vol 15, No 3, Matheson, A. 1992, Wellington

(iii) *The Changing Role of Internal Audit*, Provost, L. 1992, Institute for International Research, Internal Audit Conference, Wellington

(iv) *Internal Audit in the Public Service*, Management Leaflet No 14, State Services Commission, 1986, Wellington

6.2 Achieving an output orientation

The New Zealand public service has undertaken major financial management reforms in recent years. A core concept of these changes has been to shift department Estimates from an input to an output basis. This entry looks at the introduction of output-based budgeting and the role it plays in the public sector's resource allocation process.

The context for change

Under the 1989 Public Finance Act all departments are required to specify their activities in terms of outputs when preparing annual Estimates.

Definition: An output is an identifiable good or service supplied outside an organisation. In the case of government departments, outputs include goods and services for ministers, other departments, the public and the private sector. Possible types of output include policy advice, the administration of regulations, the provision of services, the production of goods and the administration of grants and benefits. It is important that departments are able to define their outputs in terms of quality, quantity, cost and time.

The degree of precision in the specification of outputs varies according to the use to which the information is to be put. The uses of output information are:

- parliamentary accountability;
- ministerial decision-making concerning output purchasing;
- internal management decision-making.

In terms of parliamentary scrutiny (and in accordance with the Public Finance Act) appropriations are approved for broad classes of outputs. These classes are more aggregated than is generally useful for internal management purposes.

Ministers are responsible for choosing the quality and quantity of outputs purchased annually from departments. They may also make decisions on whether or not they wish to purchase the outputs at all.

New Zealand adopted an output-based financial management system for a variety of reasons including:

- To improve Parliament's capacity to scrutinise departmental expenditure. Specification of outputs represents a significant improvement in the standard of information available to Parliament.

- To improve managerial performance. Associated with the introduction of outputs was a removal of many of the former detailed input controls. This gave chief executives and other managers greater freedom to make decisions on the mix of inputs necessary to ensure resources were used to best effect.

- To enhance departmental accountability, allowing a much clearer statement of what is expected than was previously possible. It allows for ministers to make more meaningful decisions about what they wish to purchase. It is also much easier to judge the efficiency and effectiveness of departmental activity and make meaningful comparisons of performance between departments and the private sector.

In summary, the rationale for an output focus is that it allows a more effective acceptability relationship between minister and department. Chief executives can be held accountable for performance in the delivery of services at an output level whereas they cannot be held accountable for the ultimate consequences of government programmes, i.e. the outcome level.

Financial management reform in the New Zealand state sector has been wide-ranging. The intention is that each of the key elements of financial management reform, such as the output focus, accrual accounting, capital charge and corporate planning, will reinforce each other in improving state sector performance.

Implementing change

The basic preconditions for introducing output-based Estimates are:

- departmental accounting systems able to operate the new procedures;

- the outputs must be capable of being defined;

- key stakeholders such as ministers and chief executives must be involved.

In New Zealand the Treasury played a pivotal role in the shift to an output focus. In outline, departments developed their initial set of departmental outputs through the following steps:

(i) The department would meet with Treasury to work through some of the basic issues.

(ii) Detailed discussions involving the department and Treasury.

(iii) The department would establish a small working group reporting to senior management. Discussions would continue until Treasury and the department concurred on an output specification.

(iv) The agreed specification would be vetted by a quality control panel of senior central agency officials. The purpose of this group was to oversee all outputs and develop a consistent specification approach across all departments.

(v) If cleared by the senior officials, the department would seek endorsement from their minister, and Treasury would submit a recommendation to the Minister of Finance that the outputs be used for inclusion in the department's annual Estimates.

The introduction of a formal public service management system based on outputs was done in a series of stages. Because it was not realistic to convert all departments to an output regime simultaneously, it was necessary to distinguish different types of financial appropriation. The principal categories were:

Mode A: Departments in this category continued to be funded on a traditional input basis. The function of this category was to allow departments time to convert the way they were managed. From the passing of the Public Finance Act on 1 July 1989, departments had until 1 July 1991 to move from Mode A status.

Mode B is split into two groups:

Mode B (Net): Departments who receive revenue from third parties as part of their activities, as well as receiving direct funding from government. This may include proceeds from the sale of goods and/or services (e.g. charges for passport licences). This additional funding may be used to cover operating costs and other costs of output production. The additional revenue is counted as part of the department's total appropriation.

Mode B (Gross): Any third party revenue received, other than direct funding from government, is directed to the consolidated fund.

Mode C: Departments in this group also focused on inputs but were in competition with other suppliers. Like Mode B departments, these organisations had to provide information on the price and the quality of their outputs, but because their prices could be compared with competitors, they were also to develop a capital structure and pay notional interest, tax and dividends.

Mode A, the transitional device to allow departments to convert to an output basis, was in place for two years.

The initial set of outputs that departments developed were rarely definitive. As expected, the specification of outputs continues to be refined in a joint process between departments and Treasury. In effect, Treasury provides the quality control for the specification of output classes across the public service. Changes in government policies and priorities are also reflected in adjustments to outputs in an on-going way.

As experience has been gained in defining outputs it has become apparent that there is need to specify outputs, and associated costs, with progressively greater precision. For this purpose the output classes appropriated by Parliament are too broad for management purposes. Departments are now required to produce annually a formal *purchase agreement* with their minister that sets out in considerable detail the exact composition of each output.

The trend toward output budgeting as a means of enhancing accountability is widespread. We are not aware of any other country that has adopted as comprehensive a set of financial management reforms as New Zealand.

In summary, from New Zealand experience, the following general criteria for defining outputs appeared to be the most important:

- outputs have to be goods and services;
- the goods and services have to be supplied outside the organisation;
- outputs do not include either the ultimate effects on the community, or goods and services consumed in the department itself;
- the production process has to be under the control of the department in order that the chief executive can be held responsible for their production;
- the output should be significant either because of the expenditure involved or for other reasons such as its importance constitutionally;

- the set of all outputs should be complete and should include all goods and services produced by the department.

Common problems encountered in the New Zealand context include:

- a tendency to want to specify outcomes rather than outputs;

- a temptation to aggregate inputs together in the belief that this would give management greater flexibility;

- initially some departments included as outputs goods and services which did not go outside the department;

- a tendency to think that outputs have to reflect the existing organisational structure.

Thus three key lessons emerge from the New Zealand experience:

- the need for strong support from senior management;

- the need to concentrate on goods and services that leave the department;

- the need to think beyond current organisational structures.

Supporting material

(i) *Putting it Simply – An Explanatory Guide to Financial Management Reform*, The Treasury, 1989, Wellington

(ii) *Specifying Organisational Outputs*, Bushell, P. 1989, New Zealand Society of Accountants Conference, 1989

6.3 Improving output costing

There is an increasing demand for better management information in the public service. In New Zealand, departmental financial reporting is based on the outputs it delivers (outputs being discrete services delivered or policy advice rendered). This is achieved by directly assigning as many direct costs as possible to outputs and indirectly assigning the balance of costs on the basis of various assumptions. The aim of an output-based approach is that ministers and departmental managers should be clear about the quantity and quality of the services that government is purchasing from departments.

This entry covers a number of ideas connected with improving output costing. In particular, it draws on guidance recently published by the Treasury to assist operational and financial mangers to improve the quality of cost information and costing systems.

The context for change

Cost accounting systems fill two objectives:

- They facilitate external reporting by providing information on the costs of departmental estimates. This information appears in the department's main Estimates, monthly monitoring reports and in annual financial statements.

- They are used internally to help departmental managers plan and control departmental expenditure. Cost accounting data can also be used in non-routine decision-making situations.

The 1994 Treasury booklet entitled, *Improving Output Costing – Guidelines and Examples*, has two parts:

Part 1 covers the role output costing plays in the public service and identifies ways of improving costing systems;

Part 2 sets out an example of an internal costing system report in a hypothetical department.

The specific topics covered in the booklet include:

- indicators of effective and out-dated systems;

- areas for internal system review;
- definition of cost objects;
- cost classification;
- assigning direct and indirect costs;
- costing system development;
- documenting cost systems;
- disclosure of cost accounting systems.

Output costing has been crucial to public service reform because:

- Public service organisations are now accountable for the delivery of pre-specified outputs and government is interested in receiving value for money from these purchase decisions.
- Apart from its interests as a purchaser of services, government also has an ownership interest in the performance of a department.
- Many public service organisations and departments have to recover all or part of the costs of producing their outputs.

Improving the quality of cost information can enhance the ability of decision-makers to:

- control and allocate resources within the organisation;
- assess the cost-effectiveness of outputs;
- determining the merits of new spending opportunities and the consequence of terminating activities;
- pricing, planning and forecasting outputs;
- contracting for the delivery of outputs.

The ability to cost well-defined outputs with a reasonable degree of accuracy lies at the heart of New Zealand's public sector financial management reforms. This entry should therefore be read in conjunction with the entry on *achieving an output* *orientation* which describes how New Zealand moved to an output-based regime as part of its financial management reforms.

Implementing change

New Zealand experience suggests that the three main steps to be followed in designing or developing a costing system are:

- analysing the system;
- developing the system;
- implementing the system.

The following factors must be taken into account in the design of a system:

- the level of information required by users;
- the complexity and diversity of cost objects;
- the frequency of cost allocation;
- the reporting structure within the department;
- the costs of maintaining and operating the system.

A checklist for ascertaining whether the costing system is reporting accurate information or needs improving could be:

Penetration: a good costing system will routinely facilitate decision-making and be accessible at all levels of the department.

Accuracy: the closer the costing system tracks actual consumption of resources the more effective it is. A problem that public service organisations share with service organisations in the private sector is that joint or common cost attribution tends to account for a large proportion of total cost. As a general rule the larger the proportion of total costs to outputs that the costing system can assign the more successful it will be.

Flexibility: government departments are now frequently subject to changing structures, technology and activities. The costing system should be able to adapt to this changing environment.

Timing: it is important that the information from the costing system is available when required. Management decisions often require real time information.

Automation: the value of automation is in reducing personnel costs and the risk of human error. The aim should be to minimise the human intervention in the interfaces between components of the costing system (i.e. the input and output modules).

The symptoms of an out-dated costing system include:

- wide variations between actual and budgeted cost information;
- lack of usefulness of information for internal decision-making;
- managers running independent information systems because of a lack of confidence in the department's system;
- operational managers not taking ownership of costs;
- the need for frequent and manual adjustment to results and reports.

Supporting material

Improving Output Costing – Guidelines and Examples, The Treasury, 1994, Wellington

6.4 Introducing capital charging

Capital charging has been widely used in the private sector in order to take account of the full cost of capital in decisions involving capital investment. Similarly, in the public sector, the capital charge is a charge levied on departments which represents the cost of the capital government has invested in them. This entry explains the use of the charge in the New Zealand public sector, its rationale and method of calculation.

The context for change

New Zealand has an investment of over $10 billion in the net assets of government departments. Much of this investment is in the form of physical assets. These assets have been purchased with tax-payer funds: funds which would otherwise be available for purposes such as new programmes. The capital charge makes the cost of capital tied up in government's investment explicit. This, in turn, enables the real cost of different activities and spending decisions to be determined. With such information, the full financial implications of decisions can be made and more efficient asset management achieved.

A primary reason for the capital charge is to enable a true comparison of costs to be made. Taxes impose a burden on the community and the government, therefore, has to continually assess the merits of competing claims for spending. In order to do this effectively, it is important to know the true cost of activities. If the cost of capital is not made explicit, it is possible that departmental activities requiring capital would be favoured because such investment would appear to have lower on-going costs and to be better value in terms of their contribution to government objectives than is really the case.

Departmental managers should be aware of the full cost of the decisions they make. Managers have the responsibility of producing, in the most cost-effective way, the services government requires. If they do not have to account for the cost of the capital used, this is likely to bias decisions in favour of greater use of capital. This arises from the difficulty in making a fair comparison between activities that incur a cost of capital and those that do not.

Many departments sell goods and services. By including a capital charge, all the production costs of output are included and there is no hidden subsidy to purchasers. A choice in favour of subsidised production is still possible but use of the capital enables the extent of the subsidy to be known.

Another major reason for adopting a capital charge is to encourage efficient asset management. In the past, capital was, in effect, a "free good" to New Zealand public service managers and they had little incentive to use it in the most economical fashion. Now that capital carries a cost, departments have a strong imperative to think about their use of investment capital and dispose of assets that are not contributing effectively to outputs.

Finally, the charge indicates the return government expects to receive from its investment in departments. The charge allows a comparison to be made between similar investments in the private and the public sector. In this way the charge permits a government to measure the full cost of public sector activities against the benefits that are generated.

In recent years New Zealand has adopted a wide range of reforms aimed at improving financial management performance in the public sector. Overall, these measures are designed to clarify what government departments produce and at what cost. The capital charge regime is an integral part of this reform process.

Implementing change

From 1 July 1991 all New Zealand government departments were subjected to a charge for the level of capital employed in their operations. This reflects the opportunity cost to tax-payers of the funds employed. At the end of each half-year the charge is included in the department's costs at a particular rate for each dollar of capital employed. Since its inception the application of the capital charge regime has been progressively extended to include not only government departments but also other public sector organisations.

In 1991, the first year that the capital charge was introduced, departments were funded in a manner that was largely fiscally neutral. Departments received full compensation for the annual capital charge. This resulted, in effect, in a rise in the sale price of outputs. Where departments sold goods and services to customers other than the government, they were expected to recover the costs of capital by increasing prices or lowering overall costs. It was recognised that this could not be achieved immediately.

Initially, all departments paid a standard rate of 13 per cent. This rate was derived from a consideration of the rates of return required for debt and equity in the private sector.

Further development and refinement will enable more individual rates to be set taking into account each department's particular business. The aim is to establish the cost of capital associated with particular activities.

From the 1993/94 financial year a pilot group of departments was selected to test the use of departmental specific charge rates. An officials group has been established to oversee the introduction of the capital charge and its future development.

Since its initial introduction, the capital charge regime has been progressively refined and its application broadened. With effect from 1 July 1994, all Crown entities (other than tertiary institutions) are now required to include a capital charge in their accounts.

The capital charge is calculated by multiplying a department's capital base by the capital charge rate.

CAPITAL CHARGE = CHARGE RATE X CAPITAL BASE

Capital base
The capital base of a department represents the Crown's investment in a department. In the New Zealand context the department's capital base is the Net Tax-Payers Funds reported in their published financial statements.

The figure for Net Tax-Payers Funds tends to be understated. This is because reported asset values are likely to be lower than economic values and because some important assets, such as human resources, are not included. Nevertheless this accounting framework is widely used in the private sector and is the best measure currently available.

The valuation of assets often poses particularly complex issues in the public sector where no readily available market for the assets exists (for example, in the case of types of military equipment). Often a considerable number of assumptions and judgements have to be made. The issue of valuing public sector assets is on-going and a number of valuation methodologies are being explored and developed.

Capital charge rate
The capital charge rate is set at approximately the rate that the government could expect as a return in a given year if its capital were invested in a business or organisation comparable to the department. Like other costs incurred in a particular period, the capital charge is matched to revenues earned in the same period.

In a sense it is akin to the annual cash returns received by investors in the private sector.

Supporting material

(i) *The Capital Charge Regime*, McCulloch, B., New Zealand Accountants Journal, Oct. 1991, Wellington

(ii) *New Zealand's Capital Charge Regime*, Lally, M., Victoria Economic Commentaries, March 1992, Wellington

6.5 Introducing accruals-based accounting

New Zealand has become a world leader in the extent to which its government accounts include a balance sheet of its assets and liabilities and an accrual-based operating statement of income and expenses. This entry looks at the adoption of accrual accounting in the New Zealand public sector.

The context for change

Governments have traditionally used a cash-based method of accounting to measure budget deficits, revenue and expenditure which are recorded when cash is received or paid out. (The New Zealand Government adopted cash-based accounting during the second world war.) In contrast to cash accounting, accrual accounting records spending and taxes when they are incurred, regardless of when the money changes hands.

Cash-based accounting has some major limitations:

- It can give a misleading picture about the sustainability of government policies and programmes. It fails to distinguish between current and capital expenditure and does not take account of the future cost of existing policies (for example the pension liability which accrues for as long as an employee is a member of a state superannuation scheme).

- It does not keep track of the changing value of assets and liabilities. Capital investment should be depreciated over the life of the asset rather than all being written off in the years the money is spent, as is the case with cash accounting.

Until the introduction of accrual accounting, departments only recorded the cash that was actually spent so budgets always equalled estimated spending. Capital items were handled in the same manner as say, personnel expenditure, with no recognition of the benefits for future years.

Accrual accounting enables the cost of resources consumed in the production of goods and services to be aligned with the revenues of the services produced.

Accrual accounting enables the economic and financial impact of policies to be seen more clearly and the government's net worth to be determined. The New Zealand Government has adopted accrual accounting because it believes that the new reporting system will give a more realistic picture of which government policies are sustainable over the long-term and what is happening to the country's asset base.

In the New Zealand context, accrual accounting should be seen as part of a wide-ranging initiative to make the public sector more efficient.

Accrual accounting is one element of the wide-ranging financial management reforms that have been introduced to the public sector in recent years. In total, these changes are designed to improve the quality of information available on how government uses the nation's resources. For example, now that departmental balance sheets are in place, departments depreciate capital and pay a capital charge calculated as a rate of return times the value of net departmental assets.

The accounting reforms have not occurred in isolation from other fundamental changes in the management and organisation of the public sector, such as the State Sector Act 1988 which introduced a new accountability regime between Ministers and departments.

Implementing change

In moving to accrual accounting in New Zealand, two fundamental issues had to be addressed:

- The establishment of an opening balance sheet, through a register of capital assets, that required valuing many major assets and liabilities. Assets include items as varied as military equipment, national parks and the roading system. An example of a major liability was the entitlement of public servants to state-funded pensions.

- Methods of combining all the diverse types of Crown-owned agencies such as State Owned Enterprises.

Following the passing of the Public Finance Act on 1 July 1989, New Zealand was able to move all departments to an accrual basis within 18 months. Within accrual accounting, multiple alternatives practices are possible. Therefore one aspect of the strategy to introduce accrual accounting was the use of generally accepted accounting practice (GAAP) of the New Zealand Society of Accountants, as the basis of reporting by departments and the Government as a whole. Use of an existing accounting standard conferred a number of benefits:

- It avoided the Treasury having to lay down a set of precise accrual accounting rules – a process that would be both time-consuming and a duplication of existing standards.

- It enabled private sector resources to be used in the implementation phase. Following conversion of the core departments to accrual accounting, a step by step approach was adopted to widening the coverage to all Crown Entities.

- In the longer term it meant that essentially the same accounting practices would be followed in the public and the private sector. This would facilitate understanding of governmental financial information, and, in a small society such as New Zealand, permit interchange of accounting staff between private and public sectors.

- In the transition to accrual accounting, the Treasury played a key role. A part of its role was to provide some advisory and training services. These functions were consistent with the principle that chief executive officers had primary responsibility for managing the transition.

The Public Finance Act 1989 required all departments to have an accrual accounting system put in place within a two-year time frame. Although departments had to be ready for the financial year beginning on 1 July 1991, this objective was, in fact, achieved by 1 January 1991.

The 1994/5 Budget Estimates were the first that required all Crown entities to submit accounts on an accrual basis.

New Zealand experience suggests that when public sector organisations are preparing to adopt accrual accounting, a series of key questions and issues have to be addressed:

(a) Is the accounting system ready for accrual accounting?

This broad issue can be divided into a number of subsidiary questions:

- Has an adequate time frame been established to convert the accounting system from a cash-based to an accrual accounting system?

- Has the Chart of Accounts been revised for accrual accounting?

- Is the fixed asset information available for accrual accounting?

- Have overhead allocation policies been established for the reporting on each significant activity?

- Are the administrative procedures for operating the accounting system defined and efficient?

- Is the existing accounting software likely to present any difficulties in adopting accrual accounting?

(b) Do the users understand accrual accounting?

- Has an education programme been established to improve the understanding of accrual accounting statements?

- Are the objectives of introducing accrual accounting clearly established?

- Which groups within the organisation should be included in the education programme?

(c) How is accrual accounting information to be presented and used?

- Will accrual accounting be used for monthly internal management reporting as well as periodic external reporting?

- Will budgeting and management planning use accrual accounting?

The introduction of accrual accounting requires good project planning that addresses the conceptual, technical and educational issues involved. A project timetable and regular monitoring is required, as well as the active involvement of senior staff. Without this involvement they will neither understand nor use the financial statement prepared on an accruals basis.

Supporting material

(i) *Accounting and Management Reform in the New Zealand Government*, McCulloch, B., 1993, Pan-Commonwealth Working Group, Kuala Lumpur, Commonwealth Secretariat, London

(ii) *Preparing Accrual Based Financial Statements*, McNally, G. 1989, New Zealand Society of Accountants, Public Sector Convention 1989, Wellington

(iii) *Financial Management Reform in the New Zealand Government*, Scott, G. & Ball, I., The Treasury, Wellington

(iv) The Treasury, 1989, *Putting It Simply – An Explanatory Guide to Financial Management Reform*, The Treasury 1989, Wellington

6.6 A particular initiative in improving procurement procedures: published guidance for suppliers and purchasers

Public sector agencies are large-scale purchasers of a broad range of goods and services. The New Zealand Government has taken a number of initiatives to ensure that public sector organisations give domestic industry full and fair opportunity to compete for this business. This entry looks at:

- the guidance issued by the New Zealand Ministry of Commerce to the suppliers of goods and services to the public sector;
- the policy guidance that public sector purchasers should follow.

In 1994 the Ministry of Commerce issued two booklets which are complementary and which should be read in conjunction with each other:

i) A policy guide, *Government Purchasing in New Zealand – Policy Guide for Purchasers*, is for use by departments, statutory authorities and other publicly funded organisations to help them understand government purchasing policy. It contains a checklist on implementing the policy and which is intended to be suitable for copying and inserting into any manuals held by purchasing officers. Emphasis is placed on a number of issues including the use of the New Zealand Industrial Supplies Office, multi-stage procurement processes or calling for alternative proposals to encourage innovation and new products.

ii) A further booklet entitled *Government Purchasing – Guide for Suppliers*, is intended to help suppliers understand and operate in the government purchasing environment. This booklet includes information on:

   - how and where suppliers can obtain assistance on government purchasing policy;
   - purchasing contacts in New Zealand departments and other State sector agencies with an indication of the goods and services they require;
   - the role of the New Zealand Industrial Supplies Office;

- background to the state sector reforms (suppliers to the sector must take account of the comprehensive changes that have occurred).

In the New Zealand government purchasing context, "domestic" or "local" refers to products or services which are wholly or partly produced in New Zealand and/or Australia. This is because New Zealand and Australia have made a commitment under the Australia-New Zealand Closer Economic Relations agreement (ANZCER) and the Government Procurement Agreement to give each other's products and services equal access and opportunity to compete in their government's purchasing markets on the basis of value for money. This does not imply that it is the New Zealand Government's policy to discriminate against foreign suppliers. Government agencies must be fair buyers who expect high standards and who support internationally competitive local producers only where they offer value for money to the tax-payer.

The basic purpose of the two booklets on procurement is to improve communication and understanding between public sector buyers and domestic industry to their mutual benefit. The booklets provide an opportunity to state the advantages of purchasing locally.

Government purchasing is substantial. New Zealand departments alone currently spend about $3 billion annually on purchasing goods and services. Other areas of the state sector also spend large amounts. Government wants to ensure that local producers get full and fair opportunity to cater to this market.

Government procurement policy helps to ensure that taxpayers receive value for money from the expenditure of departments and other state sector agencies. Because of the scale and diversity of expenditure, government purchasing practices can have a significant impact on the domestic economy and employment.

New Zealand has undertaken a widespread decentralisation and deregulation of government purchasing as well as removal of most import controls. After a long period of strict regulation and control this may have led some state sector agencies to favour unduly imported over locally produced goods.

There has been a significant move to greater autonomy in the purchasing activities of government departments (part of the trend towards decentralisation and devolution). No longer are detailed rules set down for government procurement activity. In this climate it is important that both suppliers and purchasers are aware of the key government policies and guidelines.

The purchase of locally made goods, whenever justified on a competitive and cost-effectiveness basis, can assist the development of local industry that is innovative and internationally competitive.

Within the Ministry of Commerce there is a unit known as the New Zealand Industrial Supplies Office (NZISO). The NZISO was established to give practical support to the Government's purchasing policy by facilitating contact between public sector buyers and suppliers about purchasing requirements and domestic industry capabilities. Public sector purchasers can take advantage of the free and confidential information and advisory services (and the very extensive and detailed NZ industry capability database) as an aid to cost-effective market research and purchasing.

One particular aspect of procurement policy is offset and industrial participation. The New Zealand Government seeks opportunities for New Zealand industry arising out of major purchases from overseas by government departments and other public sector agencies. For example, the ANZAC frigate project, a major collaborative project to build frigates for the Australian and New Zealand Navies, has involved large-scale participation by New Zealand industry as part of the agreed contract.

There is a private sector initiative known as the "Buy New Zealand Made Campaign". This campaign is sponsored by the New Zealand Manufacturers' Federation and the New Zealand Council of Trade Unions. The campaign is aimed at the buying public in general in order to promote consumer awareness and selection of New Zealand made products.

Institutional and policy change in New Zealand has been rapid in recent years. In order to keep up with changes in the procurement environment, any official guidance requires regular revision. The publications issued in 1994 for purchasers and suppliers replace guidelines issued in 1991 and 1992 respectively to these two groups. New sections have been added to cover issues such as the environment, quality assurance and energy efficiency.

The policy guidance for purchasers provides explanations on the following topics relevant to giving full and fair opportunity to local producers:

- preparation and planning;
- defining requirements;
- environmental and energy efficiency considerations;
- researching the market;

- dealing with unfamiliar products (risk aversion);
- buying patterns;
- purchasing methods;
- evaluation/negotiation/debriefing;
- post-contract relationships;
- purchasing consultants and agents;
- role of the Ministry of Commerce.

Supporting material

(i) *Government Purchasing in New Zealand – Guideline for Suppliers*, Ministry of Commerce, March 1994, Wellington

(ii) *Government Purchasing in New Zealand – Guideline for Purchasers*, Ministry of Commerce, March 1994, Wellington

6.7 A particular initiative in improving fiscal responsibility: the Fiscal Responsibility Act (1994)

In 1994, the Fiscal Responsibility Act was passed wihich sought to enhance the transparency with which the Government manages public funds and to improve overall fiscal management.

The four main elements of the Act are:

- a requirement for regular and explicit fiscal reporting;
- a set of benchmarks against which fiscal policies can be assessed;
- a move to a more open and transparent Budget process; and
- a requirement for select committee review and Parliamentary debate of fiscal reports.

The requirement to articulate fiscal objectives and to demonstrate progress towards achieving them will encourage government to place fiscal management within a longer-term perspective. The Act also encourages Government to ensure consistency between its policy stance and its stated fiscal objectives.

The Act requires government to:

- produce annual progress reports, with three-year economic and fiscal projections;
- prepare Crown financial reports in accordance with generally accepted accounting practice;
- publish a budget policy statement of the Government's long-term fiscal objectives and intentions for the next two financial years, three months before the start of each financial year.

Although the Act requires government to be explicit about its fiscal stance, it leaves it to government to decide what that stance is.

Since the Act was passed, the Estimates have been separated into two documents, reporting details of appropriations and information on departmental activities. The Estimates are now easier to understand and ministerial objectives and departmental performance are now clearer. This facilitates more effective scrutiny and performance monitoring of government departments and other agencies.

Supporting material

Fiscal Responsibility Act: brief overview, Treasury Briefing Note (1994), New Zealand Treasury