The PFA Basics

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Context – 1980s New Zealand

Constitutional arrangements made for ease of action:

• No written constitution
• No states
• No Upper House of Parliament
• First past the post electoral system
Financial management and reporting reform in the wider contexts of:

- Microeconomic and sectoral reform
- Public sector management reform
  - State-Owned Enterprise Act 1986
  - State Sector Act 1988
  - Public Finance Act 1989, then:
  - Financial Reporting Act 1993, and
  - Fiscal Responsibility Act 1994
Financial Management Pre-reform

• Program budgeting
• Treasury-run accounting system (SIGMA)
• Cash-based budgeting, appropriations and accounting
• Fund accounting – Consolidated Revenue Fund et al
• Input oriented – people, dollars and materials
• Highly detailed rules – controls but not control
  – Treasury Instructions
  – (also Public Service Manual)
Implementation Timeline

1989  Passage of the Public Finance Act
      Departments move to accrual accounting, budgeting & appropriations

1992  First six-monthly and annual Crown Financial Statements (CFS) on
      accrual basis

1993  First full consolidation of CFS
      Financial Reporting Act

1994  Fiscal Responsibility Act
      First whole of government budget on accrual basis
      Monthly financial statements

1995  First CFS with full budget/actual comparison on accrual basis
The Key Concepts

- Accountability
- Integration of management system
- Performance definition
  - Ownership and purchase
  - Inputs, outputs and outcomes
  - Crown and department
Figure 2: State Sector Accountability Framework
Figure 1: Key Documents in the Financial Management Cycle
Performance: Ownership and Purchase

Purchase and Ownership Interests

The government has two different interests in the activities of departments and Crown entities – purchase and ownership interests. These purchase and ownership interests of the Government drive different approaches to managing performance.

The Government, as a purchaser of outputs (goods and services), is likely to require information along the lines of a private sector sales/services contract: provider, quantity, quality, time and place of delivery and cost.

To specify intended performance adequately, departments and Crown entities and other providers must be able to define (and report on) their outputs in terms of these performance indicators.

The Government ultimately owns the resources of departments and Crown entities. As owner, the Government wants to ensure that capital assets are used efficiently and that agencies maintain the capability to provide services efficiently and effectively in future years, in accordance with the Government’s objectives. As owner, the Government requires the same kind of financial reporting that constitutes generally accepted accounting practice in the private sector.
Ownership Performance

<table>
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<tr>
<th>Financial</th>
<th>Non-financial</th>
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<tr>
<td>• Maintenance of capital</td>
<td>• Governance</td>
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<td>• Financial performance</td>
<td>• Strategy</td>
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<td>• Asset and liability management</td>
<td>• Scope of business</td>
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<td>• Capital expenditure</td>
<td>• Risk management</td>
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<td>• Cash flows</td>
<td>• Human capital</td>
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<td>• Legal compliance</td>
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Performance: Inputs, Outputs, Outcomes

OUTCOMES

INTERVENTIONS
Mix of actions to achieve desired outcomes

Outputs  Regulations  Transfers  Taxation  Ownership
What Are Outcomes?

Outcomes are a state or condition of society, the economy or the environment, or a change in that state or condition. Outcomes, such as unemployment, can change without any action by the Government.
What Are Outputs?

Outputs are the goods and services commissioned by Ministers from public, non-governmental and private sector producers.

For the purpose of measuring and reporting performance, government agencies and other providers must be able to define their outputs in terms of quantity, quality, delivery time and cost.
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<th>NZDF Outputs</th>
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<th>Prepare</th>
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<th>Veterans’ Affairs</th>
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<tr>
<td>1</td>
<td>4</td>
<td>7</td>
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<tr>
<td>Navy Capabilities Prepared for Joint Operations</td>
<td>Operations to Protect New Zealand and New Zealanders</td>
<td>Supporting our Veterans</td>
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<tr>
<td>Army Capabilities Prepared for Joint Operations</td>
<td>Operations Contributing to New Zealand’s Security, Stability and Interests</td>
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<td>3</td>
<td>6</td>
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<tr>
<td>Air Force Capabilities Prepared for Joint Operations</td>
<td>Advice to the Government</td>
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**NZDF Outputs**

- **Prepare**
  - 1. Navy Capabilities Prepared for Joint Operations
  - 2. Army Capabilities Prepared for Joint Operations
  - 3. Air Force Capabilities Prepared for Joint Operations

- **Protect, Project and Inform**
  - 4. Operations to Protect New Zealand and New Zealanders
  - 5. Operations Contributing to New Zealand’s Security, Stability and Interests
  - 6. Advice to the Government

- **Veterans’ Affairs**
  - 7. Supporting our Veterans
How Military Capability is Defined

The term ‘military capability’ is broader than a ship, machine gun or aircraft. It is a complete combination of highly trained and skilled people, top-class equipment (such as vehicles, weapons and supplies), supporting infrastructure and the best leadership, research and development and information technology. The NZDF has a range of military capabilities within its three Services. For each mission, the best mix of capabilities is selected to create a tailored task force.

Readiness

Readiness is a critical part of being an effective combat force. NZDF’s core role in an increasingly violent and unstable world is to support a rules-based international order. It works both independently and in conjunction with security partners on a range of operations from humanitarian through to combat, that contribute to global peace and security. Outputs 1, 2 and 3 fund NZDF to maintain ‘readiness’ to deploy Naval, Army and Air Force units or formations.

The measurement of readiness is an assessment of the time it would take for a designated unit or formation to be ready to deploy, appropriately staffed, trained, equipped and supported, to meet the defined conditions and standards for the designated operation. A unit is deemed to be at readiness when it can demonstrate that it can be made ready to deploy within the timeframe agreed with Government. Units are kept at different levels of readiness depending on the notice the NZDF has between being directed to deploy and deploying.

Readiness is assessed by NZDF’s ability to:

- maintain personnel at the required strength and training levels to meet directed readiness levels;
- retain adequate levels of equipment for training, current operations and contingencies;
- complete stipulated training activities that enable force elements to operate effectively as a collective force to achieve the specified tasks; and
- maintain the ability to sustain the deployment as required.

High levels of readiness are resource intensive and levels of readiness vary. Therefore each year, the NZDF agrees with Government on readiness standards for each unit or formation based on how quickly they may be required.
Outcomes and Outputs

• Outputs a means of achieving outcomes
• Complexity of relationship
• Both are important
  – Outputs are how value is added
  – Outputs are not “widgets”
"Ownership" and "Purchase"

- Measured quite differently
  - Financial statements key to ownership performance
  - Service performance statements for purchase performance
- May be traded off against one another
- Purchase performance has more political significance
- Need accrual accounting to measure both
“Crown”/Department Distinction

Managing items on behalf of the Crown

• Assets e.g. Department of Conservation – national parks
• Liabilities e.g. Treasury – government debt
• Revenue e.g. Inland Revenue Department – tax revenues
• Expenses e.g. Ministry for Social Development – transfers
Concepts into Practice

• Performance expectations
  – Purchase
  – Ownership

• Budgets

• Appropriations

• Reporting
  – Monthly
  – Annual
  – Service Performance
Better financial information ought to make it harder for the New Zealand government to ignore the future consequences of short-sighted policies. Time will tell. It could be good news for tomorrow’s taxpayers. It is even better news for all the accountants whom the New Zealand government has had to hire.
Time will tell....

- Intergenerational dimension of PFA
- Financial performance
- Resilience
- Transparency is markedly improved
- Accrual accounting works in government
- But could do better...
Current Status

• Accrual accounting deeply embedded
• Multiple reviews – one currently in progress
• Multiple evolutionary changes
• Still struggling with Outcome (Wellbeing) management
• System maintenance needs attention
  • Conceptual clarity and understanding
  • Financial systems
  • Asset management
• Incentives remain critical
Some Things to Protect...

- Coherence of the system
- Conceptual clarity
- Accrual information base
- Monthly financial statements
- Enabling aspects of the PFA
- Independence of Standard Setting
- Independence of Treasury
- Capital charge