

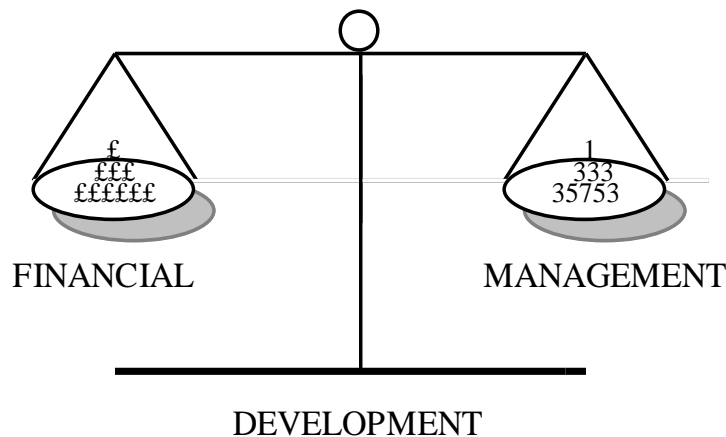
FINANCIAL MANAGEMENT DEVELOPMENT

Financial Accounting

Common Problem Areas

NO 147

GOVERNMENT ACCOUNTING



ONE OF A SERIES OF GUIDES FOR
FINANCIAL MANAGEMENT DEVELOPMENT

FROM

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This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

GOVERNMENT ACCOUNTING

This note sets out a brief overview of the key areas in which Government Accounting differs from the more usual form of "Accruals Accounting" adopted by commercial organisations. It is designed to be no more than an introduction to the issues and, in particular, to the changes taking place as Government Accounting increasingly adopts the practices of accruals accounting. The Government promised to introduce "Resource Accounting" in the "near future" in 1996. In 2012 it is slowly becoming a reality. The Treasury website states: "Resource Accounting is the application of accruals accounting for reporting on the expenditure of central government and a framework for analysing expenditure by departmental aim and objectives, relating these to outputs where possible." Since a Franciscan monk, Luca Pacioli wrote the principles in 1494 and every sensible commercial organisation has been using them for decades, the use of the words "where possible" is slightly worrying.

THE ISSUES

Government activities take a variety of forms. They include -

- (a) Commercial Activities in competition with the Private Sector
- (b) Commercial Activities in a monopoly situation
- (c) Non-Commercial Activities

The difficulties of containing costs, measuring performance and gaining value for money have caused the Government to try to privatise many activities, thus leaving it to market forces to sort out. For the activities that remain Government controlled, there is a move towards greater accountability. However, some key areas of difficulty remain.

1. Definition of Success

In a commercial organisation the rate of return is measured, as the only objective (for investors) is maximising return on investment. In the Public Sector the concept is difficult to apply. There is a tendency to measure -

"Inputs" - Hours Worked/Money Spent

or

"Intermediate Outputs" - Patients Seen/Meals Delivered/Criminals caught.

In many instances the outputs are difficult to quantify - particularly in Health and Social services. The valuation of pain and distress is influenced by individual experience. The external reporting consists of activity levels not profits. Very often these measures are compared with the past or with similar organisations. The definition of success may be no more than being average and can also be politically defined and constrained, with very short timescales. They can be manipulated if managers circumvent the spirit of the target whilst complying with the rules. Thus "all patients must be seen within six weeks" is a target that can be met by seeing the patient for five seconds and saying "come back in a year".

2. Use of Cash

The difficulty of defining success has led to the use of cash limits as a basis for control. However, this leads to "respectable ways" of remaining within the limit - recruitment freeze, delays in starting new projects, delays in re-ordering, transfers from capital to revenue (virement) and "less respectable ways" - delaying payments to suppliers, creating Private Finance Initiatives (disguised sale and leaseback arrangements), retaining privatisation proceeds to meet current expenditure (disguised asset stripping) or the Student Loan system (blatant transfer of debt from the published Government debt figures - i.e. money owed by the taxpayers as a group, to individual debt - money owed by the taxpayer as individuals).

Since 60-80% of Government expenditure is "fixed" such manipulation to meet year end targets has a disproportionate effect on the variable/discretionary costs. Thus the cumulative effect of these manipulations over decades has hidden past overspends so that the correction - the reduction in expenditure (including debt repayment) to below income - is dramatic and will take decades to correct.

The problem is compounded because for all centrally funded activities any surplus has to be returned to the Treasury. Since there is often a belief in an "unmet need", the generation of a surplus is seen as a failure! Since future allocations are based on past spending there is every incentive to overspend, or at least spend all the budget.

3. Capital Expenditure

Any expenditure on an asset with a life of over one year is deemed to be capital and does not qualify as revenue expenditure. Since most Government Bodies have no depreciation charge in their accounts there is no real costing mechanism for charging for the use of capital assets - roads, hospitals, Government buildings, airfields, etc. There is a tendency to run down the asset base when expenditure is constrained - which is what ruined British Coal, British Docks, British Leyland, British Steel, British Rail, etc

4. Maintenance

Following on logically from the above the maintenance of assets is an area where reducing revenue spend, may result in a loss of value but may not be reflected in accounts. The upkeep of Stonehenge, the waterway system, the roads, fields and other tangible fixed assets costs money. If it is not spent the results may not be immediately identifiable in monetary terms. However it is considerably easier than identifying the impact of a failure to maintain the health of the nation (by cutting back on the health service) or the future earning capacity of the workforce (by cutting back on education) and whilst an accountant might attempt to value the impact of these, there remain some areas of vital expenditure which defy "rational" valuation - the care of the mentally or physically incapacitated, the care of the dying. Morals do have a value, but it is not easily quantified.

5. Budgets

Budgets are normally set on a line by line basis based on the previous year. Very few attempts are made to evaluate the potential for efficiency savings from new technology or new methods of working. Instead global "Efficiency Savings Targets" are set (but widely ignored.) Inflation is normally ignored at local level and provided for centrally. Attempts to manage by input/output budgeting, Programme budgeting and Zero-Based Budgeting have been tried, with limited success. Currently the vogue is for Service Level Agreements at an agreed cost level. Some services have been outsourced in an attempt to avoid the problem altogether.

6. Ownership and Accountability

Public bodies have no share capital, pay no dividends and are not expected to make a profit. They have a complex system of targets with various stakeholders whose needs may not be coherently or consistently expressed. Many inputs are provided by different organisations and many outputs are complex, with multiple competing objectives.

THE OBJECTIVES

The objectives of financial management in Government have not been fully defined but include -

- Consistent Planning
- Clear Objective Setting
- Adequate Record Keeping
- Review of Performance

At last there is now a tendency away from Cash Accounting to Income and Expenditure Accounts (Cash adjusted for Stock, Debtor and Creditor movement) with the ultimate goal of full accrual accounting (proper recognition of Assets and Liabilities). It is difficult to value items like Stonehenge (original cost?), the atom bomb (replacement cost?), etc. However, these are the exception rather than the rule and the private sector has 500 years of experience to draw on to help.

One stumbling block is that proper recognition of the public sector underfunded pension liability is so vast that no one dare quantify it. In February 2010 a Minister was reported as having said in answer to the question "What is the pension deficit in the public sector?" "Off the top of my head £600 Billion." When faced with accounting deficiencies of this magnitude, mere accountants can only revert to cataloguing the History of the situation.

THE HISTORY

FMI (Fair Market Initiative) 1982 had key aims -

- Develop Corporate Planning for Department Heads
- Devolve Budgets and financial control to Line Managers

All managers were to be made aware of their objectives to make best use of resources by scrutinising outputs and obtaining value for money. To do so they were to be given information on costs and on the achievement of their objectives, training and access to expert advice.

GPI (Government Purchasing Initiative) 1984 - aimed to improve VFM (Value for Money) by promulgating best practice

MDRA (Multi-Departmental Review of Accounting) 1986 - exhorted top management to set out priorities, manage resources and review performance.

NSI (Next Steps Initiative) 1988 - aimed to "deliver services more effectively and efficiently within available resources for the benefit of customers, taxpayers and staff". The White Paper (Competing for Quality) - emphasised this. "Accruals Based accounts provide the essential information needed to run the business in the most economical and effective way" (NSI). "It has become apparent that both cash and accruals accounting information are needed for management purposes and for planning, control and reporting purposes", Sir Alan Hardcastle HOTGAS (when Head of the Government Accounting Service).

FMI has been described as VFM plus 3E's

- | | | |
|---------------|---|-------------------------------|
| Economy | - | of Inputs |
| Efficiency | - | of Outputs compared to Inputs |
| Effectiveness | - | of Outputs |

Clear Line of Sight Project (CLOs) July 2007 took the process forward and now a serious attempt is now being made to introduce proper accounting and accountability, although the approach is bedevilled by acronyms. Here are just a few:

RDEL and CDEL Resource and Capital Departmental Expenditure Limits

SoFP Statement of Financial Position

SOCNE Statement of Comprehensive Net Expenditure (Operating Cost Statement).

AME Annually Managed Expenditure

There is perhaps a need to realise that as St Paul pointed out to some people in Corinth 2,000 years ago "The letter of the law kills, the spirit brings life"(2Cor 3:6). The acronym to use is ACS (Applied Common Sense).

As the pressure increases there will be an increasing need for:

- Better Quality
- More Timely
- Financial and
- Other Management Information

and that can only be good for owners (the nation) and management.

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David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development and has been an Ordained as a Deacon in the Catholic Church.

He has worked as a Financial Controller and Company Secretary in the Finance industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over forty major organisations including Arla Foods, Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, Royal Mail, Unilever and Zeneca. He also runs programmes for the Leadership Foundation and the management teams at a number of Universities. International training experience includes work in Belgium and Holland for CSC, in Denmark, Kenya and the Czech Republic for Unilever, in Holland and the US for Zeneca, in Dubai for Al Atheer, in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. In addition he has run courses in acquisition evaluation (The Economist, Eversheds, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). All training is specifically tailored to the needs of the organisation with the emphasis on practical applications to enhance profitability and cashflow. He has developed material for delivery by in-house personnel (Royal Mail, Lloyds Bowmaker and Conoco), computer based training packages (The Post Office, Unilever and BP), and post course reinforcement self-study workbooks (CSC and Zeneca). He has also produced a training video on Cashflow Management.

He is a prolific writer of case studies, role plays and course material. He has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants, the need for taxation awareness training for general managers, evangelisation and Christian business ethics.

Many of his generic documents are freely available on his website:

FinancialManagementDevelopment.com including papers on Charity Management.

In addition to his Diaconal work in the Church, he has held a number of voluntary positions including University, College and School Governor, Hospice Treasurer and Trustee of various charitable institutions. He continues to provide ad hoc commercial advice to several other charitable organisations. He has been married for over 35 years and has one daughter and three granddaughters.

This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared (Matthew 10:8).