

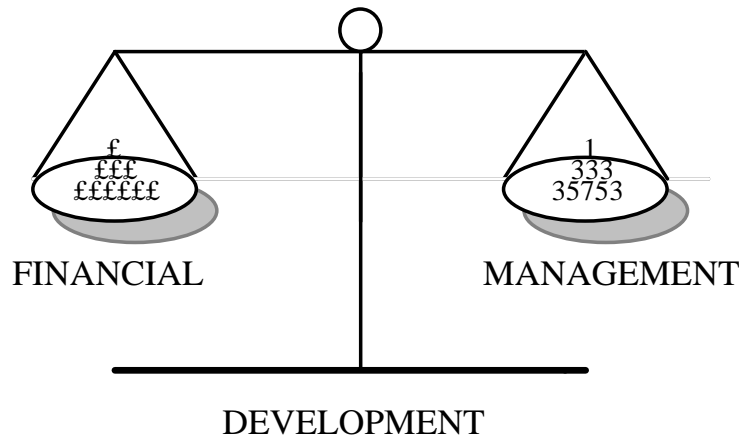
FINANCIAL MANAGEMENT DEVELOPMENT

Financial Accounting

Common Problem Areas

NO 147

GOVERNMENT ACCOUNTING



ONE OF A SERIES OF GUIDES FOR
FINANCIAL MANAGEMENT DEVELOPMENT

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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 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 has been an increasing trend towards greater accountability. However, key areas of difficulty remain. These are -

1. Definition of Success

In a commercial organisation the rate of return is measured. In the Public Sector the concept is difficult to supply. There is a tendency to measure -

"Inputs" - Hours Worked/Money Spent

"Intermediate Outputs" - Patients Seen/Meals Delivered.

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.

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 start up, delays in re-ordering transfers from capital to revenue (virement) and "less respectable ways" - delaying payments to suppliers.

Since 60-80% of expenditure is "fixed" such manipulation to meet a year end target has a disproportionate effect on the variable/discretionary costs.

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 etc.

4 Budgets

Budgets are normally set on a line by line basis based on the previous year. Inflation is normally ignored 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.

5. 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

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.

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 (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

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

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

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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.

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 thirty major organisations including Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, The Post Office, Rothmans and Zeneca. International training experience includes work in Denmark, Kenya and the Czech Republic for Unilever, in Dubai for Al Atheer, in Holland and the U.S. for Avecia and Zeneca and in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. A key output from the training is demonstrable use of the knowledge and skills acquired to enhance corporate profitability. In addition he has run courses in acquisition evaluation (The Economist, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). He has also developed material for delivery by in house personnel (Royal Mail, Lloyds Bowmaker and Conoco) and computer based training packages (The Post Office, Unilever and BP).

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 and the need for taxation awareness training for general managers.

He is married with one grown up daughter and his outside interests include being The Treasurer of the Hospice of St. Francis (Berkhamsted), and a member of the Catholic Alpha Training Team (Promoting the Alpha course on Basic Christianity). He was a Governor of Luton University for nine years and a school Governor for four years.

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).