

**For discussion on 7 May 2001**

**LEGISLATIVE COUNCIL PANEL ON FINANCIAL AFFAIRS**

**REVIEW OF GOVERNMENT FINANCIAL REPORTING POLICY**

**INTRODUCTION**

The Financial Secretary announced in the 2001-02 Budget Speech that starting with the accounts for 2002-03 the Government would publish two separate sets of Annual Accounts, one under the existing cash accounting convention and the other prepared on the accrual basis. This paper informs Members of the background of the initiative and our plans for its implementation.

**BACKGROUND**

2. The Annual Accounts of the Government of the Hong Kong Special Administrative Region (HKSAR) are prepared by the Director of Accounting Services and audited by the Director of Audit. Currently, these Annual Accounts are prepared on the cash basis of accounting.

3. In recent years, some developed economies have introduced accrual-based accounting in publishing their governments' accounts. There have also been suggestions from the local accounting profession and some Legislative Council Members from time to time for the HKSAR Government to adopt the accrual basis of accounting. We therefore set up a Task Force under the chairmanship of the Secretary for the Treasury in April 1999 to review the Government's financial reporting, with reference to the experience of comparable jurisdictions and to international accounting standards on financial reporting by the public sector.

4. The Task Force has completed its review, and its report in the form of a consultation document is enclosed. In formulating its recommendations, the Task Force has taken into account views expressed by the Director of Audit in his Results of Value for Money Audits Report No. 33, and those of the accounting profession and the academics obtained through a symposium on this subject organised by the Treasury in March 2000.

## **FINDINGS**

5. The Task Force considers that the main objectives of government financial reporting should be to -

- (a) demonstrate budget compliance/stewardship;
- (b) report fairly on spending and revenue of the Government and its financial performance;
- (c) report fairly on assets and liabilities of the Government and its financial position;
- (d) induce informed decision making and enhance cost-control and cost-effectiveness; and
- (e) demonstrate the Government's accountability for resources employed in the delivery of public services.

6. While the existing cash-based accounts prepared by the Government can demonstrate budget compliance on funds appropriated by the Legislative Council, the Task Force finds that such accounts do not fully present the Government's financial performance, financial position or the resources employed to deliver public services, because some significant assets and liabilities are not reported in the accounts.

7. In order to improve on the existing cash-based accounts, the Task Force recommends that -

- (a) the existing cash-based Annual Accounts of the Government will continue to be prepared in order to demonstrate the Government's compliance with budget appropriations approved by the legislature and the stewardship of cash spending. There will also be no changes to the Government's existing budgeting practice as the budget will continue to be prepared on the cash basis;
- (b) an additional set of accrual-based consolidated financial

statements (comprising a Statement of Financial Position, a Statement of Financial Performance and a Cash Flow Statement), a Stewardship Statement and a Departmental Service Cost Statement will be prepared on an annual basis to provide a fair representation of the overall financial performance and financial position of the Government and to demonstrate the resources employed by the Government in the delivery of public services in the following manner -

- Major assets and liabilities (including fixed assets, loans, investments and pension liabilities) will be reported in a Statement of Financial Position and the related expenses such as depreciation and accrued pension benefits will also be reflected in a Statement of Financial Performance. Entities in which the Government has a major interest, such as the Exchange Fund, MTR Corporation Ltd., Kowloon-Canton Railway Corporation, the Hong Kong Housing Authority, etc. will be consolidated in these Statements;
- a Stewardship Statement will be prepared to provide non-financial information on major physical assets (i.e. land, buildings, roads, drains, etc.) employed by the Government for service delivery; and
- a Departmental Service Cost Statement will be prepared to report on the full cost of service delivery for each bureau and department. The costs to be reported include costs of services provided by other departments; staff fringe benefits paid under central Heads and Subheads; accruing costs such as pensions and depreciation; and notional accommodation cost.

8. The proposed future annual accounts of the Government will therefore consist of -

- (a) Volume I - containing the Accounts of the Government more or less as at present, but with the Departmental Service Cost Statement replacing the existing departmental analyses; and

- (b) Volume II - containing the consolidated accrual-based accounts, incorporating the interest that the Government has in other public sector organisations. In these accounts, there will be two analyses of expenditure, one by nature, the other by function. This Volume will also contain the Stewardship Statement of major physical assets employed by the Government, albeit not expressed as a financial value.

9. We believe that the above proposals will not only supplement the existing accounts and thus increase the Government's transparency and accountability, but will also facilitate the achievement of greater cost-effectiveness.

## **PROPOSED IMPLEMENTATION PLAN**

10. The Task Force will publish the enclosed report for public consultation from 7 May to 30 June 2001. Briefings and consultation will be made with interested parties, including Members of this Panel, the accounting profession and accountancy academics, before a final decision is made as regards the precise format and style of the future accrual-based annual accounts.

11. Copies of the report are available for collection by the public at the Treasury and the Government Publications Centre. Members of the public may also access the report through the websites of the Finance Bureau, the Treasury and the Government Information Centre and give their views on the report.

12. Given the scope and complexity of the work involved, the Task Force recommends a two-phased implementation plan. The Task Force's proposals will be implemented starting from the accounts for 2002-03, except for the reporting of fixed assets which will be implemented starting from the accounts for 2004-05 to allow adequate time for identification and valuation of the fixed assets. A post-implementation review is planned for 2006-07 to assess the results achieved and the need for further changes.

## **RESOURCE IMPLICATIONS**

13. A preliminary assessment of the resource implications is that :
- a one-off implementation cost of \$68 million will be incurred between 2002-03 and 2004-05 mainly for identification and valuation of fixed assets; and
  - an average annual recurrent cost of \$18 million will be incurred for 2002-03 to 2004-05.
14. The above estimates will be refined in consultation with bureaux and departments in the course of the detailed examination of their resource requirements.

**Finance Bureau and the Treasury**  
**April 2001**