PUBLIC FINANCE PIONEER

New Zealand's bold shift to accruals accounting was just the start of what has been a groundbreaking transformation

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Ian Ball,
Victoria University of Wellington

3%

ANNUAL GDP GROWTH IS THE SAME AS IN THE US, BUT NEW ZEALAND ENJOYS A STRONG BALANCE SHEET

By **Victor Smart**

Thirty years ago, the government of New Zealand became the first to shift from crude cash accounting to accruals accounting, the more rigorous approach that private firms must employ. Then, this May, the government introduced a much-vaunted wellbeing budget, making it one of the first countries in the world to measure the success of public financial management by its people's wellbeing.

In the period between, the New Zealand Treasury has devised a living standards framework, where financial outcomes jostle for attention with indicators on human, natural and social capital.

For a generation, New Zealand has been a pioneer in public financial management systems, trialling some of the most ambitious attempts to measure performance in a new, more meaningful way, which required an updated, broader role for accounting. Instead of fixating on a narrow range of financial data, the government's system now looks at a wide range of measures that affect this and future generations – from mental health to climate change.

The shift to accruals was at the heart of the landmark Public Finance Act 1989. No longer would the Treasury in Wellington measure budget deficits on when cash was received or paid out but when liabilities were incurred or assets acquired: future pension obligations would count as a liability, for example, and privatisation of a state-owned firm would no longer look as if it created an inflow of cash without an offsetting drop in the state's assets.

Ian Ball, emeritus chair of CIPFA International and professor of public financial management at Victoria University of Wellington, was one of the architects of the act. He comments: "New Zealand instituted a number of reforms in the 1980s and early 1990s that were radical by any international standards. Today they would be described as transformative. While they have by no means solved all of the problems New Zealand faces, they very largely achieved what they set out to do."

He cites former minister of finance Ruth Richardson's claim that the reforms gave her the ability to significantly restructure the government's expenditure in a surgical way, knowing clearly what services or transfers would be cut or changed. And, on one occasion, showing a proper set of financial statements to international rating agencies was instrumental in avoiding a double downgrade for the country.

To Ball, the most compelling evidence of the act's success is the increase in the government's net worth since the reforms, together with the resilience of the government's fiscal position following the financial crisis. When it switched to accruals, the government had negative net worth. Since then, this has become positive and is now equivalent to 45% of GDP.

"The resilience resulting from this strong balance sheet was demonstrated by the fact that net worth declined for only four years from the onset of the financial crisis, whereas most comparable countries – like Australia, Canada, the US and the UK – have both significant negative net worth and continuing decline in their fiscal positions," says Ball.

Oddly, New Zealand's efforts on deficits have come at a time when a view is emerging that we can worry less than we once did about government indebtedness. In the UK, opposition to the austerity policy introduced after the financial crash remains strong, with the outgoing prime minister claiming it has ended. The US is a special case because of the continued global role of the dollar, but its annual budget deficit is set to reach nearly $1trn this year. Over the next decade, the total amount owed by the US government is projected to balloon to 105% of GDP.

New Zealand's economy continues to perform well

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Even so, Ball insists: "Deficits and debt don't matter – until they matter. If I had to choose between the US and New Zealand positions, both with annual GDP growth of around 3%, but with the US incurring huge deficits and declining net worth, and the New Zealand position with surpluses and growing net worth, I know which I would choose." It is worth noting that New Zealand's economy continues to perform well, although it ▶

45%

OF GDP: EQUIVALENT NET WORTH OF THE NEW ZEALAND GOVERNMENT, COMPARED WITH SIGNIFICANT NEGATIVE NET WORTH IN COMPARABLE COUNTRIES SUCH AS AUSTRALIA, CANADA, THE US AND THE UK

New Zealand's emphasis on information means prime minister Jacinda Ardern's government has much more insight into the impact of its reforms

▶ WELLBEING

Living standards framework

Almost a decade ago, the New Zealand Treasury began work on a living standards framework and has now augmented this with an official dashboard to track changes in wellbeing outcomes, including a measure of intergenerational wellbeing.

This aims "to capture a comprehensive, balanced range of wellbeing outcome indicators. It is not prescriptive about whether or how governments should intervene to promote wellbeing – it helps support advice about prioritisation".

To promote higher living standards, four stocks of capital are considered – human, social, natural and financial/physical. There are also 12 domains of wellbeing, including subjective wellbeing, income and consumption, jobs and earnings, housing, knowledge and skills, and cultural identity.

In May, New Zealand introduced a much-vaunted wellbeing budget, measuring success by its people's welfare

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is no longer widely seen as a 'rock star' economy and the OECD says long-term investment in infrastructure is poor.

The bold shift from cash to accruals accounting 30 years ago can be viewed as part of a much broader shift in New Zealand. The emphasis in government circles has been to provide information for politicians (and those that hold them to account) that is insightful and ranges far more widely than financial figures offering a limited rearview-mirror perspective. Hence the inclusion of new measures, such as environmental sustainability, plus an intergenerational dimension. Arguably, this promotes long-term thinking among politicians and both encourages and enables them to make better decisions. Though politicians ultimately make their own decisions, the approach may tend to favour higher spending on public services since these tackle wellbeing issues such as mental health or child welfare.

Other countries are moving in a similar direction. Almost two-thirds of governments around the world will shift to accrual-based accounting within the next five years, CIPFA and the International Federation of Accountants have predicted.

The UK, for example, has made some changes to public financial management similar to those in New Zealand. But Ball believes it has not moved far enough to reap the benefits. "The tragedy of the UK reform process is that it has gone to a great effort to put in place better accounting systems, but then does not use the information those systems produce in its fiscal decision-making.

"If it were serious about actually using this information, it would not take over a year to produce its financial statements, the budget documents would contain forecast financial statements and parliament's appropriations – the legal authority to spend – would reflect all resource consumption, not just cashflows."

Meanwhile, the authorities in New Zealand face the challenge of making a reality of the shift from financial to wellbeing metrics. The general approach has much in common with integrated reporting, which also measures outcomes against a variety of capital resources, including human capital (such as skills) and natural capital (such as fish stocks). While this has to be superior in principle, is there a danger that narrow but hard metrics could be replaced by nebulous, ill-conceived ones?

Ball comments: "There is a devil in the detail of how this is done. Determining the set of wellbeing indicators is a very challenging task indeed, especially if the aim were to be comprehensive, covering all-important areas of wellbeing. Ideally, it would be done in a way that reinforces the current act, rather than undermining any of its key features." ●

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