

## **Executive Summary**

### **The Review**

In early 1999, a Task Force was set up by the Secretary for the Treasury to review the financial reporting of the Hong Kong Special Administrative Region (HKSAR) Government taking into account the present basis of reporting and the latest developments in other countries and international accounting standards and to subsequently consider the costs and benefits of adopting a different form of financial reporting. This Report is the result of its deliberations which have taken into account the responses received from the public consultation conducted on this subject.

2. The approach taken by the Task Force in the review was to first identify the background to the existing financial reporting regime and the objectives of government financial reporting, then to evaluate the strengths and deficiencies of the existing financial reporting practices against the identified objectives and finally to recommend appropriate measures to address the deficiencies accordingly. The conclusion of the review was that the existing Government Accounts are considered effective in demonstrating budget compliance but do not reflect fairly the Government's financial performance, its financial position and resources that it employs to deliver public services. To address these deficiencies, a number of recommendations were made by the Task Force which included, in the main, that a set of consolidated accounts prepared on the accrual basis, a Stewardship Statement and a Departmental Service Cost Statement should be published in addition to the existing cash-based accounts. The Task Force also recommended that compliance with the International Public Sector Accounting Standards (IPSASs) issued by the International Federation of Accountants (IFAC) should be moderated, where appropriate, to accommodate the particular circumstances of the HKSAR Government.

### **Public Consultation**

3. In May 2001, the Task Force published for public consultation until June 30 its review results and recommendations. A number of comments have been received from different sectors of the community and they all welcome the Government's initiative in introducing accrual accounting. In general, respondents consider that the proposals of the Task Force will improve the Government's cost-effectiveness, decision making, stewardship and accountability of resources, and facilitate better understanding of the

Government's financial performance and position. Some respondents are supportive of the Government's pragmatic approach in formulating, where justified, its own financial reporting policies even though they are not entirely in compliance with IPSASs. Some respondents, while accepting it may not be practicable at this stage to comply with generally accepted accounting principles (gaaps) in general and IPSASs in particular, consider that the goal should be to move towards harmonisation with IPSASs and their compliance within a definite timeframe. Some commentators suggest there should be a single system unifying the cash-based and the accrual-based accounts or only the accrual-based accounts should be prepared. A few urge that the Government's budget should also be prepared on the accrual basis.

4. The Task Force agrees that it should be the HKSAR Government's longer term aim to produce a set of annual accounts on the accrual basis conforming as far as is practicable with international accounting standards and gaaps. The Task Force believes that the production of such accounts will assist legislators and commentators to better assess the status and performance of the HKSAR Government and will also provide the basis for Controlling Officers to better understand and manage the resources being used to deliver the services for which they are responsible.

5. The proposals which are being made are the HKSAR Government's first steps towards these longer term goals and represent a pragmatic approach to obtain as much benefit as possible within a reasonable timeframe and at a reasonable cost. A post-implementation review will be made in 2006-07 to re-assess the costs and benefits of the implementation of the current proposals and take a view on the way to proceed thereafter.

6. The Task Force believes that, at least initially, it is necessary for both cash-based and accrual-based accounts to be provided. The cash-based accounts will demonstrate the Government's stewardship of the sums appropriated each year by the Legislative Council (LegCo) for the delivery of government services, while the accrual-based accounts will tend to focus attention on the costs of those services being provided.

7. The Task Force is aware of the dangers of confusion when presenting two sets of accounts but has undertaken to ensure that reconciliation statements and explanations will be provided to minimise the difficulties which may be experienced by readers.

## Recommendations

8. The Task Force recommends that, starting from the financial year for 2002-03, the Government Accounts will consist of two volumes –

(1) Volume I

- The accounts cover the core Government only (i.e. the General Revenue Account and the Funds created under section 29 of the Public Finance Ordinance (PFO)).
- The accounts are prepared primarily on the cash basis to demonstrate budget compliance, i.e. the same as the existing Government Accounts.
- The existing Statement of Expenditure Analysis by Head and Subhead will be re-titled as Departmental Service Cost Statement and expanded to report on the full cost of service delivery by individual departments and bureaux through the inclusion of major accrued costs (i.e. depreciation, untaken leave, earned pension benefits and contract gratuities) and the costs of services provided by other departments. Pending the completion of the identification and valuation of fixed assets, depreciation will not be reported until the accounts for 2004-05.

(2) Volume II

- The accounts cover the core Government and the entities consolidated according to the principles discussed in paragraphs 4.25 - 4.28 of this Report.
- Subject to the following, the accounts are prepared primarily on the accrual basis to report on the Government's overall financial performance and position –
  - Pending a review on the practicality of accruing revenue and expenses after the introduction of the new Government Financial Management Information Systems (GFMIS), no accrual will be made for revenue receivable and expenses payable except accrued pension benefits, untaken leave and contract gratuities.
  - Government land will not be reported as fixed assets because of (i) the lack of an objective reference (e.g. market value) upon which valuation can be based to

reflect the specialised use of the land concerned (e.g. land occupied by fire stations, roads and sewers, etc.); and (ii) even for those pieces of land which can be sold, valuing them all at estimated market value will require constant updating given the volatility of the property market. It is also an imprudent basis as this would be tantamount to including future revenue in the Statement of Financial Position.

- Infrastructure assets (such as roads and drainage systems) which do not have a significant part of their costs recovered from users will not be reported as fixed assets. Capitalisation of these assets is tantamount to deferring the recognition of expenditure which will not generate any revenue but in fact requires ongoing maintenance. It is also impracticable to value and include all infrastructure assets in the Statement of Financial Position.
- A Stewardship Statement will be prepared to demonstrate the Government's accountability for the resources employed in service delivery. This statement will provide non-financial information on major infrastructure assets (i.e. roads and drainage systems), land and buildings used by the Government and land allocated for public housing development.

### Implementation Timetable

9. All of the recommendations will be implemented in the accounts for 2002-03 except –

- the reporting of fixed assets and depreciation – pending the completion of the identification and valuation of fixed assets in 2004-05; and
- the Stewardship Statement – pending the collection of the required non-financial information also to be completed in 2004-05.

### Implementation Costs

10. The estimated one-off implementation costs are about \$49 million to be incurred between 2002-03 and 2004-05 while the average recurrent costs

for these three years are expected to be around \$9 million per annum.

### **Post-implementation Review**

11. A post-implementation review will be conducted in 2006-07 to assess the results achieved and the need for further changes particularly –

- the usefulness and acceptance of the accrual-based accounts;
- the areas for further compliance with gaaps especially IPSASs that can be implemented;
- the desirability and practicality of accrual budgeting; and
- the need for legislative amendments.