



**INTRODUCING PUBLIC SECTOR
FINANCIAL MANAGEMENT**

The purpose of New Zealand's public sector financial management system and the structures within which it operates.

The Purpose of Public Sector Financial Management

The New Zealand public sector financial management system aims to:

- assist the Government to translate its strategy into action
- promote informed decision-making and accountability
- encourage a responsive and efficient public sector.

The system achieves these aims through the planning, decision-making and scrutiny processes that culminate in the passing of the Government’s Budget, the incentives for managing efficiently, and the reporting and feedback processes. Chapters Three, Five and Seven respectively, describe these features.

Understanding the financial management system requires a knowledge of the constitutional environment within which it operates. The Government is accountable to Parliament. The public sector financial management system supports this constitutional structure. It provides accountability, in particular through the appropriation system and through parliamentary scrutiny of the Government’s performance. Chapters Four and Eight outline how these work.

The public sector comprises more than just government departments. Some types of government operation are better suited to alternative organisational structures such as companies. Chapter Six explains financial decision-making and accountability structures employed for organisations forming part of the wider public sector. However, this booklet does not cover local government.

This and the next chapter introduce the key concepts underlining the system. Firstly the environment in which the system operates is looked at.

Public sector financial management operates in the context of New Zealand’s constitutional and administrative structures.



The public sector financial management system focuses on Government’s accountability for its financial performance in the public sector (i.e., through its government departments, State-owned enterprises, Crown entities and other organisations).

Key Documents generated by the Public Sector Financial Management System



What is the Constitutional Structure of the Public Sector?

Public sector financial management operates in the context of New Zealand's constitutional and administrative structures.

New Zealand is a monarchy. It is a parliamentary democracy. New Zealand's constitution increasingly reflects the fact that the Treaty of Waitangi is regarded as a founding document of government in New Zealand¹.

The Constitution Act 1986 recognises that the Queen is the Head of State of New Zealand and that the Governor-General is appointed as her representative in New Zealand.

Section 2 of the Public Finance Act 1989 defines the "Crown" to mean:
Her Majesty the Queen in right of New Zealand; and includes all Ministers of the Crown and all departments, but does not include:

- an Office of Parliament
- a Crown entity
- a State-owned enterprise.

Parliament controls the public finances.

Parliament (the legislature) is the supreme law-making authority in New Zealand. It consists of the elected House of Representatives and the Governor-General as representative of the Head of State.

Parliament has full power to make laws and a Bill passed by the House of Representatives becomes law when the Sovereign or the Governor-General assents to it. Parliament controls the public finances. The Crown may not levy taxes, raise loans, or spend public money except by or under an Act of Parliament.

Each Parliament has a term of three years, unless it is dissolved earlier. The Governor-General has the power to summon and dissolve Parliament. After each general election Parliament meets within six weeks of the date fixed for the return of the writs.

The **House of Representatives** (the House) consists of elected Members of Parliament who represent the people of New Zealand.

The leader of the party or coalition with the confidence of the House is Prime Minister and head of the **Government**.

The **Executive Council** is the institution through which the Government formally advises the Governor-General. Members are appointed by the Governor-General on the advice of the Prime Minister. All Ministers of the Crown are members of the Executive Council. The Executive has a parliamentary character as only Members of Parliament may be appointed as Ministers of the Crown.

Cabinet is the collective of Ministers, chaired by the Prime Minister, that makes Government policy decisions. Cabinet decisions are implemented by Ministers through departments or other agencies for which they are responsible.

In a broad sense, it is the Ministers or government of the day that govern. Ministers as a whole must have the support of the House and take collective and individual responsibility for their joint decisions, decisions that are taken in their name, and measures that they propose.

New Zealand is a monarchy, it has a parliamentary system of government and it is a democracy. The Governor-General is the Queen's representative in New Zealand.

Parliament is elected every three years, and controls the public finances and the law-making process. All laws must be assented to by the Queen or the Governor-General.

Cabinet makes Government policy decisions, which are then implemented by Ministers and their departments.

¹ "On the Constitution of New Zealand: An Introduction to the Foundations of the Current Form of Government", Sir Kenneth Keith, July 1990.

Select committees are groups of Members of Parliament appointed by the House of Representatives to consider and report on specific issues. The *Finance and Expenditure Committee (FEC)* and the *Government Administration Committee* are the committees most directly involved in the public sector financial management system.

The FEC scrutinises the forecast and year-end financial statements of the Government as a whole, monitoring performance on behalf of the House. The FEC and other select committees do the same for:

- departments
- State-owned enterprises
- Crown entities
- Offices of Parliament
- organisations deemed by the House to be public organisations, for example, the Reserve Bank of New Zealand.

The *Audit Office* is an *Office of Parliament* (in terms of the Public Finance Act) and carries out its functions under the authority of, and for the benefit of, Parliament. The Auditor-General reports to the House and to select committees on whether departments have conducted their business in accordance with the intention and authority of Parliament. The role of the Audit Office is essentially to provide Parliament with an assurance that all expenditure of public money has been properly authorised and accounted for, and that the information presented to Parliament is fair and correct.

Three central agencies are concerned with co-ordinating and monitoring public sector performance. They are the Department of the Prime Minister and Cabinet, the State Services Commission and the Treasury.

The *Department of the Prime Minister and Cabinet*:

- provides advice to the Prime Minister on policy, administrative and constitutional issues
- provides executive support to Cabinet
- contributes to co-ordination of the work of the Government across departments.

The *State Services Commission* is the Government's principal adviser on public sector organisational form and strategic human resources management. Its functions include:

- advising on performance management and organisational structures
- recommending departmental chief executive appointments
- reviewing chief executive performance.

Parliament's Finance and Expenditure Committee (FEC) is the main select committee scrutinising public sector financial management.

The Audit Office checks government departments' financial reports and assures Parliament that these reports are complete and accurate, and that public money has been spent for the purposes that Parliament authorised.

The Department of Prime Minister and Cabinet, the State Services Commission and the Treasury provide advice to Government on public sector management.

The Auditor-General reports to the House and to select committees on whether departments have conducted their business in accordance with the intention and authority of Parliament.

The *Treasury* is the principal economic and financial adviser to the Government. It:

- reports on expenditure proposals submitted to the Government
- manages the public debt
- has a significant role in tax policy advice
- participates in reviews of significant policy issues that affect resources.

The Treasury advises on the content of the Government's annual Budget, and prepares Budget documents and the Financial Statements of the Government of New Zealand. These financial statements show how public resources have been used, and, in particular, report:

- Crown assets and liabilities
- Crown revenue and expenses
- Crown cash flows, borrowings, contingent liabilities and commitments.

The *Crown Company Monitoring Advisory Unit* is an independent unit administered by the Treasury that provides advice to the Ministers for Crown Health Enterprises, Crown

Research Institutes, State-owned Enterprises and other shareholding Ministers in Crown companies, on the Government's ownership interest in Crown companies. The Unit advises on ownership issues such as financial performance, strategic direction, fiscal risks, appointments to boards, restructurings and divestments. It also monitors policy and asset/liability management.

Government departments provide goods and services to Ministers and to the public. Each government department is led by a chief executive appointed by

Cabinet on the recommendation of the State Services Commissioner.

Other government providers of goods and services are *Crown entities* and *State-owned enterprises*. Individual governing boards are responsible for these organisations which, unlike departments, have a separate legal identity from the Crown.

What is the Legislative Structure for the Financial Management System?

Four major statutes establish the legislative framework for the public sector financial management system.

State Sector Act 1988

The State Sector Act establishes the accountability relationship between departmental chief executives and their Ministers. Chief executives are appointed for a fixed term. They are responsible for employing their own staff under similar conditions to those applying in the private sector.

The Act devolves responsibility to chief executives for running their departments and for managing the resources allocated to those departments, with minimal central input control.

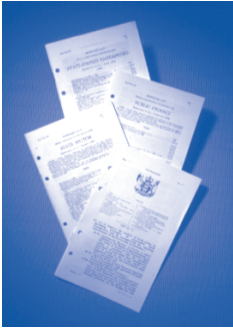
Public Finance Act 1989

The Public Finance Act 1989 requires an appropriation by Act of Parliament for all expenditure of public money. The Act determines the way Parliament votes appropriations to Ministers and specifies how the Crown, government departments and Crown entities report to the House on their intentions and results. Reporting specified by the Act includes both financial and non-financial information. The Public Finance Act also makes provision for banking, investing and borrowing arrangements.



The Treasury is the main economic and financial adviser to the Government. It is also responsible for preparing the Government's annual Budget and Financial Statements.

Four major statutes establish the legislative framework for the public sector financial management system.



Four main Acts govern the public sector financial management system: the State Sector Act 1988 includes definitions of the roles of Chief Executives of government departments, and gives them the authority to manage their departments; the Public Finance Act 1989 governs the use of public money; the State-Owned Enterprises Act 1986 allows Government to conduct some of its commercial activities like private sector businesses; and the Fiscal Responsibility Act 1994 charges Government with declaring its short- and long-term financial intentions.

State-Owned Enterprises Act 1986

Where government services may be managed as commercial operations, the State-Owned Enterprises Act allows the Government to provide these services through a similar organisational form as private sector enterprises. State-owned enterprises (SOEs) have been established as Crown companies charged with achieving a commercial return on the Government's equity investment.

Fiscal Responsibility Act 1994

The Fiscal Responsibility Act 1994 establishes the principles for formulating fiscal policy in New Zealand, and requires the Government to publish regularly its short-term and long-term fiscal intentions. It deals with financial aggregates rather than individual items of expenditure or revenue.

The Act requires publication of fiscal strategy reports and economic and fiscal updates. Minimum disclosure requirements for these reports are set out in the Act.

The Fiscal Responsibility Act establishes five principles of responsible financial management:

- reducing Crown debt to a prudent level
- maintaining Crown debt at a prudent level
- achieving and maintaining Crown net worth at a level that provides a buffer against adverse future events
- prudent management of fiscal risk
- reasonably predictable tax rates.

The Government is required to disclose any departures from these principles.

The Act does not define a “prudent level” of debt. Each Government must determine what it regards as “prudent”. The legislation does not specify objectives for fiscal policy. However, the Act does require a Government to disclose publicly its overall approach, and the financial impact of its decisions.

The Fiscal Responsibility Act:

- requires the Government to be explicit about its objectives and to explain any changes to them
- ensures the provision of comprehensive financial information for informed and focused debate about fiscal policy
- requires the Government to specify its intentions for fiscal management beyond the next 12 months.

Conclusion

This chapter outlined the purpose of the New Zealand public sector financial management system, the context in which it operates and its legislative framework. Chapter Two explains some of the key concepts that underlie the system.