

**Information Note for
Legislative Council Panel on Financial Affairs**

**Accrual-Based Consolidated Financial Statements
of the Government**

Purpose

This paper informs Members of Government's plan to publish the first set of accrual-based accounts on 5 January 2004 and the broad directions for refining these accounts for subsequent years.

Publication of first set of accrual-based accounts

2. We have completed the compilation of the accrual-based consolidated accounts for the year ended 31 March 2003, our first attempt at preparing such accounts. In drawing up these accounts, we have followed the recommendations of the Task Force on Review of Government Financial Reporting Policy¹ ("Task Force") with suitable modifications to reflect the latest situation and improve on the presentation. We shall present these accounts to Members at the Panel meeting on 5 January 2004 before publishing them later on that day.

Significance

3. The accrual-based Government annual accounts enhance the Government's financial transparency by complementing the existing cash-based Government annual accounts in the following key aspects -

¹ In the light of the move in recent years of some developed economies towards adopting the accrual basis in publishing government accounts and of the suggestions expressed by our local accounting profession and Members of the Legislative Council for the Government to make a similar move, an internal Task Force chaired by the then Secretary for the Treasury was set up in April 1999 to review the Government's financial reporting.

Purposes

- (a) The existing cash-based accounts serve mainly to demonstrate compliance with the cash-based budgets whereas the accrual-based accounts focus on the financial performance and position of the Government and Government-owned entities as a whole.

Scope of Coverage

- (b) The existing cash-based accounts cover the General Revenue Account and the Funds established under Section 29 of the Public Finance Ordinance (Cap. 2). To give an overview of the Government's financial performance and position, the accrual-based accounts expand the coverage to include -
 - (i) other funds established by the Government for specific purposes with their funding coming mainly from the Government, e.g. Quality Education Fund;
 - (ii) the Hong Kong Housing Authority;
 - (iii) government business enterprises (i.e. Trading Funds, and business enterprises in which the Government has an investment holding of not less than 20 per cent and of which the Government shares the net earnings. Examples include Kowloon-Canton Railway Corporation and MTR Corporation Limited); and
 - (iv) the Exchange Fund.

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- (c) The cash-based accounts consist of a Statement of Assets and Liabilities, a Statement of Receipts and Payments and Notes to the Accounts. In comparison, the accrual-based accounts consist of a Statement of Financial Performance (consisting of two parts, one analysing operating expenses by nature and the other by function), a Statement of Financial Position, a Cash Flow Statement, a statement reconciling the accrual-based General Reserve with the cash-based Fiscal Reserves, another statement reconciling the accrual-based surplus/deficit with that of the cash-

based, and Notes to the Accounts.

Steps ahead

4. We are adopting an incremental approach to refine the accrual-based accounts for future years. We aim to include Government-owned fixed assets and depreciation in the financial statements starting with the accounts for the financial year 2004-05, and to publish a stewardship statement describing in terms of physical measurements the major resources such as land, buildings and infrastructure assets held by the Government in the delivery of public services at the same time. In addition, we will conduct a post-implementation review in 2006-07.

5. We had intended to compile and publish, for the accrual-based accounts for 2002-03, Departmental Service Cost Statements (DSCSs), albeit on a limited basis to reflect the costs of the internal services of 11 departments only (e.g. Audit Commission, Treasury, Information Services Department). These are the departments which had already been doing annual costing for their services provided to other departments and bureaux.

6. In the course of compiling the DSCSs for 2002-03, we found that publishing the DSCSs with partial costing of the internal services would not present fairly the true costs of individual bureaux and departments. To avoid possible misinterpretation, we will revisit the form and contents of the DSCS to be published, particularly in relation to the costing of inter-departmental services.

Background

7. At the meeting on 7 May 2001, we briefed Members on the Government's initiative to publish two separate sets of annual accounts, one under the existing cash accounting convention and the other on the accrual basis as recommended by the Task Force, as from the year 2002-03. We then published the recommendations by the Task Force for public consultation. In June 2002, we informed Members of the public comments which were generally supportive of the initiative, and our proposed way forward on the Government's financial reporting policy. We also published the Task Force's

report “Review of Government Financial Reporting Policy” (the whole report can be accessed at www.info.gov.hk/fstb/tb). The key proposals on the way forward as set out in the report are -

- (a) We will continue to prepare and publish the existing cash-based annual accounts to comply with the existing statutory requirements and to demonstrate compliance with the budget which is prepared on the cash basis.
- (b) In addition, we will start publishing annually the following statements by two phases -
 - (i) Phase 1 – for financial year 2002-03 – publish the first set of accrual-based consolidated financial statements to report on the overall financial performance and position of the Government, and a Departmental Service Cost Statement for each government bureau and department to report on the full costs, including the costs of internal services provided by one bureau/department to another, of service delivery. For the accrual-based consolidated financial statements for 2002-03 and 2003-04, the fixed assets to be shown in these statements will only cover those owned by the Hong Kong Housing Authority as it takes time to identify and value the Government’s own fixed assets and the depreciation; and
 - (ii) Phase 2 – for financial years 2004-05 and thereafter – include the Government’s own fixed assets and depreciation in the accrual-based consolidated financial statements, and publish a Stewardship Statement to report on the major resources (mainly land, buildings and infrastructure assets) under the Government’s stewardship responsibility. The resources in the statement will be reported in terms of physical measurements such as areas and lengths rather than in financial terms as the latter are costly to obtain and inherently arbitrary in nature (e.g. valuing the land under roads and streets).

- (c) We shall conduct a post-implementation review in 2006-07 to take stock and assess the scope for further improvement.

Financial Services and the Treasury Bureau
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