The financial provisions of the Fire Service Act 1975 are outdated, over-prescriptive and inconsistent with current public sector financial practices. The provisions are typical of the financial environment that existed in the public sector 25 years ago – cash-based fund accounting with mechanistic approval regimes.

The Fire Service Act does not provide a framework for sound financial governance. It sits uneasily with the provisions of the Public Finance Act 1989 and, in certain respects, is at odds with generally accepted accounting practice.

We recommend that the Fire Service Act be amended to remedy these inadequacies.

Introduction

4.1 We carried out a detailed review of the financial provisions of the Fire Service Act 1975 (the Act) and posed the questions:

- Are the financial provisions of the Act a sound basis for financial management of the New Zealand Fire Service (the Fire Service) by the New Zealand Fire Service Commission (the Commission)?
- Are the financial provisions of the Act consistent with generally accepted accounting practice (GAAP)?
- If the financial provisions do not provide a basis for sound financial management or are inconsistent with GAAP, how has the Commission coped in practice?

4.2 We did not at this time review other aspects of financial management. These aspects might include:

- treasury management;
- long-term planning of borrowing; and
- long-term forecasting of revenue, expenditure and capital requirements.

4.3 We consider that a review of these aspects should be carried out at a later date, when the Commission has better developed physical asset management plans and procurement plans. Such plans will form a large part of future expenditure forecasting and, until they are prepared, longer-term financial planning will not be as soundly based as it ought to be.

4.4 We also do not comment on known issues and problems in relation to the basis for and collection of the Fire Service levy. We reported to Parliament in 1998 on the difficulties being experienced in levy collection arrangements.[1] That report identified difficulties and uncertainties over the base for calculating levies and the range of techniques used to minimise or avoid fire service levies. We are not aware of any change, since issuing that report, in the circumstances giving rise to it.

Statutory Framework for Financial Management

4.5 Part IV of the Act sets out the statutory provisions for the Commission's financial management. There are also references in the Act that bring into application other legislation such as the Trustee Act 1956, the Fees and Travelling Allowances Act 1951, and the Public Finance Act 1989. However, the Act provides the bulk of the financial framework within which the Commission must operate.

4.6 When the Act was enacted in 1975, the public sector financial regimes in place were characterised by cash accounting, an emphasis on separate fund accounts, and micro-management of approvals and authorisations. Such characteristics are evident in the Act's provisions. Many of the financial provisions are similar to the statutory provisions which then applied to local government financial management. This was to be expected, as the Act brought under the umbrella of the Commission the separate local fire authorities which had previously been part of local government.

1 *New Zealand Fire Service Commission: Adequacy of the Arrangements to Ensure that the Fire Service Levy is Properly and Fully Paid*, ISBN 0 477 02855 1, July 1998.

4.7 Since 1975 there have been several significant amendments to the financial provisions of the Act:

- In 1990 amendments were made to incorporate financial aspects of rural fire activities which had been outside the control of the Commission;
- In 1994 an amendment introduced a Restructuring Fund (which had only a temporary status); and
- In 1998 amendments were made to borrowing powers and to the process of reviewing the rate of fire service levy.

How Sound is the Framework?

4.8 On a number of counts, it is apparent that Part IV of the Act is not consistent with current public sector financial management practice. If the Commission approached financial management purely from the perspective of the Act, it is unlikely that it would be effective or efficient. Problems can be grouped as:

- overly prescriptive provisions;
- clouded governance arrangements;
- a deficient approval mechanism;
- uncertainty of terms;
- unnecessary fund accounts; and
- varying treatment of income.

Overly Prescriptive Provisions

4.9 There is elaborate and prescriptive detail in a number of the provisions of the Act, which places significant constraints on the Commission's financial management. For example:

- *Section 44* – which provides authority to spend money both on the general functions and duties of the Commission, and on a number of specific purposes which are listed.

The specific authorisations appear unnecessary and could have the effect of calling into question items of expenditure which are not specifically authorised, but which are likely to be consistent with the overall functions and duties of the Commission.

In addition, section 44 allows the Commission to spend an aggregate of $12,000 each year *out of its ordinary funds for purposes not authorised by any Act or law*. Such expenditure is commonly referred to as "unauthorised expenditure". This is similar to a provision in the Local Government Act 1974 in relation to expenditure of local authorities. The intention of such provisions is to act as a back-stop to catch minor expenditure which does not cleanly fit into the normal functions and duties of a public entity. However, such provisions are now seen as anachronistic, and somewhat impractical to apply. Any expenditure of public entities should be consistent with the purposes and tasks they are mandated to perform.

- *Section 46* – which requires the Commission (i.e. the governing body) to appoint the bank accounts to be used. While a provision of this type was typical of legislation passed at the time, modern practice is to confer these powers on a Chief Executive.

Clouded Governance Arrangements

4.10 The financial provisions of the Act also give agencies external to the Commission micro-management roles in relation to Fire Service matters. Those roles could be at odds with the primary role of the agencies concerned.

4.11 One example is section 46(2), which requires the Commission – if it wishes to open a separate bank account for any special purpose – to obtain Audit Office consent. Such a provision was not uncommon at the time the Act was passed, particularly in legislation applying to local government. Legislative provisions concerning such administrative details have since been largely removed from the governing legislation of public entities.

4.12 Another example is in section 58, under which expenditure from the Reserve Fund for purchase of land (where that expenditure was not provided for in the approved estimates) can be made only with the approval of the Secretary for Internal Affairs.

4.13 Until recently, the Secretary for Internal Affairs was a member of the Commission, and the Department of Internal Affairs is the Crown's monitoring agency for the Fire Service. The Department therefore had three potentially conflicting roles – being part of a management process (albeit of a minor nature); exercising governance at the highest level (as a commissioner); and reporting to the Minister on Fire Service matters (the Crown's monitoring agency).

Deficient Approval Mechanism

4.14 We have described in paragraph 4.9 some legislative provisions that are very prescriptive in nature. Normally, the more prescriptive a provision, the greater the clarity it would be expected to provide. That does not always appear to be the case in the financial provisions of the Act.

4.15 Section 45 provides an example. Subsection (3) requires the Commission to prepare estimates of expenditure for the next financial year and submit these to the Minister by 30 April. These estimates become the *Approved estimated expenditure* when approved by the Minister under subsection (4).

4.16 What is missing from section 45 is legislative provision as to the timing of the Minister's approval. The Commission's financial year begins on 1 July, so there is a two-month period from the latest date the Commission must provide its estimates to the Minister until the start of the year to which the estimates apply. In practice, the date of the Minister's approval has been much later than this, as shown on the next page.

Financial Year	Estimates Submission Date	Estimates Approval Date
1998-99	30 April 1998	4 June 1999
1999-2000	30 April 1999	14 October 1999
2000-01	5 May 2000	3 October 2000
2001-02	30 April 2001	27 June 2001

4.17 For the 1998-99 estimates, the approval was given in the final month of the financial year to which the estimates related. For the 1999-2000 estimates, the approval was given just over 3 months into the year, and the 2000-01 estimates were also approved after 3 months of the year had passed.

4.18 It is not for us to question why the Minister approved the estimates on the dates shown. Our concern is instead with the uncertain status of the Commission's expenditure up to the time of the approval of estimates. It could be argued that there was no authority for any expenditure by the Commission in each financial year until the approval for that year was obtained.

Uncertainty of Terms

4.19 There is also uncertainty as to what is meant by the term *expenditure* in section 45. Is it intended to be net of revenue or gross? And is it to be calculated on a *cash* or on an *accrual basis*? Other sections of the Act appear to give subtly different meanings to income and expenditure. In the absence of any definitions, the practice of the Commission has been to prepare the estimates on an accrual basis with both expenditure and revenue shown in gross terms. This is a pragmatic approach, but the uncertainty in the Act is not helpful.

4.20 Section 47 also contains an unusual mechanism. The general intent of the section is to regulate the setting of income. Where the Levy income exceeds or falls short of net expenditure, the excess or shortfall must be taken into account when next reviewing the levy rate. However, section 47(4) states:

> *The uncommitted surplus (if any) or the amount of the deficit (if any) of the Commission for any financial year must be taken into account in calculating the income and expenditure of the Commission for the next succeeding year.*

4.21 The legislation does not define what is meant by *uncommitted surplus* or *deficit*, or how the surplus might be regarded as uncommitted. The intent of other financial provisions of the Act is to equate the yearly income with yearly expenditure, thus providing no *surplus* or *deficit* on Fire Service operations. The financial statements of the Commission show that any surpluses or deficits for the year are only brought about by the net movements in special funds of the Commission.

Unnecessary Fund Accounts

4.22 The Act makes provision for the following funds to be established:

- Rural Fire Fighting Fund (sections 46A-46L)
- Gratuities Fund (section 57)
- Reserve Fund (section 58)
- Special funds for authorised purposes (section 58A).

Rural Fire Fighting Fund

4.23 The Rural Fire Fighting Fund was introduced into the Act when the Rural Fire Service was brought under the control of the Commission in 1990. The Fund is financed by a first charge against the proceeds of the Fire Service levy and a Crown grant through the Department of Conservation. Money from the Fund is applied towards meeting costs of fire authorities in the control, restriction, suppression or extinction of fires.

4.24 There is legal opinion that the status of the Rural Fire Fighting Fund is a trust fund. The Fund's income and expenditure is shown as part of the Commission's income and expenditure, and the Fund's net surplus or deficit of the year is incorporated in the Commission's surplus or deficit. The Fund's balance at 30 June 2001 was $3.8 million, and is 'ring-fenced' within the amount of equity.

Gratuities Fund

4.25 The Commission has not seen the need to establish a Gratuities Fund. A more modern legislative provision would have been merely to permit the payment of gratuities in given circumstances.

Reserve Fund

4.26 The Reserve Fund is used for capital expenditure which has been allowed for in the approved estimates, and for purchase of land where this has not been allowed for in the approved estimates. The nature of the Reserve Fund is somewhat impractical and cumbersome. Section 58 of the Act appears to contemplate a cash basis of accounting with a separate capital fund account. The Reserve Fund has not been used by the Commission in recent times.

Special Funds

4.27 Section 58A makes it possible for any number of special funds to be created. However, maintaining and accounting for numerous separate funds complicates the financial statements.

4.28 The Commission has established four special funds in terms of section 58A of the Act. The funds and their balances at 30 June 2001 are:

	$000
ACC Partnership Fluctuation Fund	2,044
Contestable Research Fund	626
Loss of Medical (Residual) Fund	169
Volunteer Needs Fund	303
	3,142

4.29 While there may be sound reasons for the Commission establishing a separate financial identity for an aspect of the Commission's activity, the prescriptive wording of section 58A makes practical administration of special funds difficult. The funds are to be separately banked or invested and tight restrictions are placed on investment avenues.

4.30 While the Commission can establish funds, it does not have an unfettered right to wind up a special fund. Furthermore, there is some doubt as to whether the special funds should form part of the Commission's financial statements. However, the Commission has acted prudently in disclosing the balances and movements of the special funds in its financial statements.

Varying Treatment of Income

4.31 The Act makes distinctions between various types of income:

- levy income;
- other income earned by the Commission (e.g. interest, fire alarm revenue);
- revenue of statutorily established Funds (e.g. Rural Fire Fighting Fund, Reserve Fund); and
- special fund income.

4.32 For each type of revenue, the Act has rules as to how it should be treated. The distinctions appear to be somewhat artificial and do not assist in the overall financial management of the Commission.

Inconsistencies between the Act's Financial Provisions and Generally Accepted Accounting Practice

4.33 The Public Finance Act (section 41) provides that all Crown entities are to prepare annual financial statements in accordance with generally accepted accounting practice (GAAP). GAAP is defined (in summary) as approved financial reporting standards or, where there are no approved standards, as accounting policies that are appropriate to the entity and have authoritative support within the accounting profession in New Zealand.

4.34 As a Crown entity, the Commission is subject to the Public Finance Act. But it is also subject to the provisions of the Fire Service Act. There are financial provisions in the Fire Service Act which do not sit comfortably with GAAP.

Recognition of Fire Service Levy Income

4.35 Section 48(12) of the Act states:

> *all money received by the Commission in respect of the levy under this section shall be deemed to be income of the Commission in the financial year in which it is received ….*

4.36 Under GAAP, levy income should be recognised on an accrual basis. This means that the levy should be recognised as income in the Commission's Statement of Financial Performance in the financial year to which the levy relates, rather than in the year when the levy is actually received by the Commission.

4.37 The Act also states, in section 47(2) and (3):

> *Where in any financial year the levy income of the Commission under this section exceeds (is less than) the actual net expenditure of the Commission, that excess (shortfall) is deemed to be an advance (shortfall) in the payment of the levy …*

Based on this wording, any excess or shortfall in levy collection above or below the requirements is accounted for as revenue in advance or in arrears. This accounting treatment effectively ensures that any levy revenue recorded in the Commission's Statement of Financial Performance is equal to the net expenditure of the Commission. However, this accounting treatment, brought about by sections 47(2) and (3) and 48(12), is inconsistent with the principles of GAAP.

4.38 Some accounting consequences are:

- actual levies received may include levies assessed beyond the financial year of the Commission.
- delays in remitting levies to the Commission from one financial year to the next could mean levies are not recognised in the correct financial year;
- any arrears of levies are not recognised in the financial statements, as they are not generally known by the Commission; and
- in situations where the Commission is aware of arrears (e.g. a dispute over the way levies were calculated), the revenue is still not recognised in the financial statements, and nor are the arrears recorded as debts due to the Commission.

Presentation of Financial Results

4.39 Section 47 of the Act specifies the procedures to reconcile levy income with the Commission's expenditure. Subsections (1) to (3) state:

> ***Income of Commission*** *– (1) In each financial year there must be paid to the Commission such income from the proceeds of the levy (other than the portion of the proceeds required for the Rural Fire Fighting Fund) as is required to meet the actual net expenditure of the Commission.*
>
> *(2) Where in any financial year the levy income of the Commission under this section exceeds the actual net expenditure of the Commission, that excess is to be deemed to be an advance in the payment of the levy and is to be taken into account when the rate of the levy is next reviewed.*
>
> *(3) Where in any financial year the levy income of the Commission under this section is less than the actual net expenditure of the Commission, that shortfall is to be deemed to be a shortfall in the payment of the levy and must be taken into account when the rate of the levy is next reviewed.*

4.40 For accounting purposes, the *excess* referred to in section 47(2) – representing the excess of levy income over actual net expenditure – has been treated as a liability called "Levy in advance" in the financial statements. In the opposite case – where actual net expenditure exceeds the levy income – the shortfall has been treated as an asset and included in debtors.

4.41 This means that the financial performance of the Commission is not readily discernible by reading the Statement of Financial Performance in the Annual Report. The deficit or surplus of the Commission, as measured in the Statement of Financial Performance, represents only the net movement of its special funds. Disregarding these movements, the Commission's approach to applying section 47 results in a break-even position each year.

4.42 More information is found in the Note to the Financial Statements which shows the movements in the Levy in Advance or the Levy in Arrears account as shown on the next page.

	2001 $000	2000 $000	1999 $000	1998 $000
Levy in advance/ (shortfall) at beginning of year	(7,410)	33,804	67,226	67,934
Levy contribution collected	190,097	144,209	132,900	171,922
Levy contribution available for operations	**182,687**	**178,013**	**200,126**	**239,856**
Funding of net operating expenditure	195,974	183,423	165,072	171,130
Funding of Rural Fire Fighting Fund	1,000	2,000	1,250	1,500
	196,974	**185,423**	**166,322**	**172,630**
Levy in advance/ (shortfall) at end of year	**(14,287)**	**(7,410)**	**33,804**	**67,226**

4.43 However, a portrayal of the Commission's financial performance that would more closely accord with GAAP could be shown by setting off the actual operating expenditure shown in the Statement of Service Performance against the actual levy contribution collected (albeit cash-based) shown in the Note to the Financial Statements, as follows on the next page.

	2001 *$000*	2000 *$000*	1999 *$000*	1998 *$000*
Levy contribution collected	190,097	144,209	132,900	171,922
Interest	-	833	2,530	6,832
Other revenue	9,488	8,242	7,235	9,834
	199,585	153,284	142,665	188,588
Total operating expenditure	202,859	192,969	175,543	203,596
Funding of Rural Fire Fighting Fund	1,000	2,000	1,250	1,500
	203,859	194,969	176,793	205,096
"Surplus"/ "(Deficit)"	**(4,274)**	**(41,685)**	**(34,128)**	**(16,508)**

Levy Asset/Liability

4.44 At 30 June 1999 the levy in advance liability was $33.8 million compared to $67.2 million the previous year. This then changed to a shortfall asset of $7.4 million at 30 June 2000 which increased to $14.3 million at 30 June 2001.

4.45 In a normal business situation, it would be expected that, if there is a revenue in advance liability, the entity would know to whom the liability is owed and the circumstances in which it arose. That is not possible with the Commission's levy in advance liability.

4.46 The levy shortfall is treated as a current asset in the financial statements. It is regarded as an asset as it is a first call on the next year's levy receipts; that is, it represents anticipated income. However, the extent to which it can be treated as an asset in this case is problematic, because it assumes a future flow of levy income.

Treatment of Funds and Trusts

4.47 We have earlier commented on trusts and funds that are either statutorily required or able to be established by the Commission.

4.48 With the exception of the Rural Fire Fighting Fund, the provisions of the Act suggest that a cash basis of accounting is contemplated, rather than an accrual regime. This results in the same conflict with GAAP for these accounts as was referred to in paragraph 4.37 on page 87.

Conclusions

4.49 The financial provisions of the Fire Service Act 1975 are outdated, over-prescriptive, and inconsistent with current public sector financial practice. The provisions reflect the type of financial environment that existed in the public sector twenty-five years ago – cash based fund accounting with mechanistic approval regimes.

4.50 The Act does not provide a framework for sound financial governance. It sits uneasily with the provisions of the Public Finance Act and, in certain respects, at odds with generally accepted accounting practice.

4.51 Mooted changes to financial arrangements, as part of Crown entity reform considerations, would have aided the Commission in putting its financial governance on a sounder footing. However, this would not have been sufficient without simultaneous amendments to the Fire Service Act.

4.52 Significant changes are required to the Fire Service Act in order to:

- clarify financial accountabilities, particularly the mechanism for budget approval;
- remove constraints on decision-making; especially the approval of petty matters by external agencies;
- remove the legal requirements for specific funds;
- clarify the status of the Rural Fire Fighting Fund; and
- remove provisions which are inconsistent with generally accepted accounting practice.