

INTEREST DURING CONSTRUCTION OF WORKS.

It is a well-established principle of accountancy that where works are constructed out of loan-money it is proper that the interest on the loan for the period during which the work is under construction—that is, until the work becomes revenue-earning—should be charged as a part of the capital cost of the work. A similar principle applies in the case of large additions to or extensions of works. In New Zealand it has not been customary to follow this principle in the case of public works constructed out of loan-moneys in the Public Works Fund, General Purposes Account. The result has been that not only has the interest during construction become a direct and final charge on the Ordinary Revenue Account of the Consolidated Fund, and the immediate burden on the taxpayer thus been directly increased, but the cost of each work as shown in the accounts has been considerably understated.

In the case of additions and improvements to the railways (but not in the case of new works) the interest during construction has since 1st April, 1925, been charged in the Railway Accounts, but is charged to revenue and not capitalized. In the case of large additions and improvements this sometimes results in a heavy charge against railway revenue before the relative expenditure becomes revenue-producing.

The importance of this matter may be most easily illustrated by an example. If a line of railway, costing, say, £100,000, takes five years to complete, and the rate of interest is 5 per cent., the cost, supposing the expenditure to be equally distributed over the period, would be as follows:—

Year.	Construction Cost per Year.	Total Construction Cost to End of Year.	Interest, 5 per Cent. per Year.*	Total Interest to End of Year.†	Total Cost, including Interest.
	£	£	£	£	£
First	20,000	20,000	500	500	20,500
Second	20,000	40,000	1,500	2,000	42,000
Third	20,000	60,000	2,500	4,500	64,500
Fourth	20,000	80,000	3,500	8,000	88,000
Fifth	20,000	100,000	4,500	12,500	112,500
Total	100,000	100,000	12,500	12,500	112,500

* Only half the interest has for obvious reasons been charged in respect of the year during which the expenditure was incurred.

† Interest on these amounts is not included in the total sum of £112,500.

It will be seen that though the direct expenditure on construction was £100,000 only, the actual cost of the railway during the period of construction was £112,500, an increase of 12½ per cent. Under the New Zealand system only £100,000 would be charged as the cost of the railway, the £12,500 being charged to the Consolidated Fund and met out of general taxation. Under the system usually followed in the case of undertakings run on commercial lines the whole £112,500 would be charged as capital cost of the railway, and the railway revenue would be expected to pay interest on this amount, and not on £100,000 only. A reference to the accounts of the South African railways, which are a Government undertaking, appears to indicate that the accepted commercial principles are applied, and that all interest charges incurred in connection with railway expenditure are brought into the railway accounts, and not met from general taxation. It is clear that unless these principles are applied the railway accounts do not show the full cost of the undertaking.

The foregoing remarks apply not only to railways, but to some other public works which are constructed from loan-money over a period of years.

SUGGESTIONS BY THE CONTROLLER AND AUDITOR-GENERAL.

Section 90, Public Revenues Act, 1926.

In accordance with the above section I would offer the following suggestions with reference to a better record of the details of expenditure under the annual votes, and with a view to facilitating the charging and audit of the vouchers for expenditure under such votes.

It is the present practice, in presenting the estimates to Parliament, to incorporate a statement showing the actual expenditure under the various items for the previous financial year. This statement is the only record of such itemized expenditure, and is thus a very valuable statement for purposes of record. It is the practice, however, when incorporating the estimates as passed by the House in the parliamentary papers B.-7 and B.-7A, to omit this information, so that no record of the itemized expenditure is preserved in the Appendix to the Journals of the House. As a result it is sometimes a matter of great difficulty to obtain such information relating to past years. The estimates alone are of little use after the expiration of the year to which they relate, but the expenditure made thereunder should be a matter of permanent record, and I would therefore suggest that the estimates as passed by the House, and recorded in B.-7 and B.-7A, should include the itemized statement of the previous year's expenditure.