Rate of Interest on Loan Capital of Government Accounts.

In my report on the accounts for the year ended 31st March, 1929 (B.-1 [Part II], 1929, page xix), I drew attention to the importance of charging interest on loan capital borrowed by one Government account from another on a uniform system and at a rate bearing a reasonable relationship to the current rate offered to the public on Government loans.

I find that under the English system it is a rule that the rate of interest to be charged on capital in the case of Government trading services is the current rate of interest fixed for local loans. There is a further rule, based on a recommendation of the Public Accounts Committee of the House of Commons, that a note should be attached to each trading account showing the rate of interest charged on capital advanced to the account.

These rules support Audit views as expressed with regard to the necessity for charging interest on capital at a rate commensurate with the current rate, and the importance of the rate of interest as a factor bearing on the accuracy of the accounts, and, in my opinion, a similar practice to that obtaining in England could with advantage be adopted in New Zealand.

The practice obtaining in New Zealand of fixing a rate of interest considerably below the ruling rate, and of failing to adopt a uniform method of fixing the rate payable between different Government accounts, has the effect of rendering some of the departmental profit and loss accounts and balance-sheets unreliable. As an example, I would refer to an actual transaction which took place during the year. Early in the year the Electric Supply Account borrowed moneys in London at a cost of approximately 5¼ per cent. after allowing for expenses. Portion of this money was subsequently lent to other accounts at 4 per cent., £100,000 being so lent to the Education Loans Account.

Had this £100,000, instead of being lent at 4 per cent., been lent at the same rate as the Electric Supply Account was paying in London—5¼ per cent.—the Electric Supply Account would have benefited to the extent of £621 9s. 8d., and if it had been lent at the then ruling rate offered by the Treasury to the public in New Zealand—5½ per cent.—the account would have benefited to the extent of £757 8s. 5d., whilst the account which borrowed at 4 per cent. has had a corresponding advantage. It is estimated that, taking other similar transactions into consideration, and the current rate of interest at 5½ per cent., the loss to the Electric Supply Account during the year from this cause exceeded £5,500.

A somewhat similar position arises as a result of the use of Post Office Savings-bank moneys by trading and quasi-trading accounts at less than the current rate payable on Government loans. Large amounts of Savings-bank moneys are invested in securities issued in respect of Treasury loan accounts, the usual rate of interest being only 4 per cent. As a result the revenue accounts and balance-sheets of the accounts receiving the use of this cheap money appear in a much more favourable light than those of the accounts which are forced to borrow at the ruling rate for Government loans. This advantage is in some cases more than sufficient to turn an actual loss into an apparent profit, with misleading effects.

Another result is that the profits of the Post Office Savings-bank, which by law belong to the Consolidated Fund, are not as great as they might be, and the Consolidated Fund loses thereby. The lending of the Savings-bank moneys to Treasury accounts at less than the current loan rate has the effect of making an undisclosed subsidy from the Consolidated Fund to the account by which the money is borrowed. Instead of the full potential earnings of the Post Office Savings-bank being applied in reduction of taxation, as is apparently intended by section 95 (*c*) of the Post and Telegraph Act, 1928, a portion is used in effect to reduce the losses or increase the profits of the separate accounts which borrow the money.

To illustrate the importance of this factor from an accounting point of view I append a statement of the Post Office Savings-bank investments in New Zealand Government securities as at the 31st March, 1931, showing the rates of interest and the accounts in respect of which the securities were issued. With the exception of the 3½ and 3¾ per-cents. and the Westport Harbour loan, which were all long-term loans, nearly the whole of these securities have been issued (either for new loans or for renewal of loans) since the 1st April, 1925. Since this date the rates offered by the Government for local loans have been as follows:—

	Per Cent.
1st April, 1925	5¼
8th October, 1925	5½
1st September, 1926	5¼
15th February, 1929	5⅜
9th January, 1930	5½

It will be seen, however, from the following statement that some £34,000,000 has been issued by the Post Office Savings-bank during this period at 4 per cent., a rate over 1 per cent. below the ruling rate.

An illustration of the effect on departmental profit and loss accounts is offered in the case of the Land for Settlements Account, which borrowed £6,162,626 at 4 per cent. from the Post Office. Had the securities for this amount been issued at 5 per cent. instead of 4 per cent., an increased charge in the Land for Settlements Revenue Account of over £61,000 per annum would have been involved, and a corresponding increase would have been realized in the Post Office Savings-bank profits to be credited to the Consolidated Fund in terms of the Post and Telegraph Act, 1928, section 95 (*c*). There might be a partial set-off against the increased amount so credited to the Consolidated Fund should the Land for Settlements Account prove unable to recoup to the Consolidated Fund the full amount of interest on loans chargeable against it, but the Consolidated Fund would certainly gain to some extent, and, what is possibly of as much importance, the various accounts concerned would disclose with greater accuracy the results of the various undertakings.