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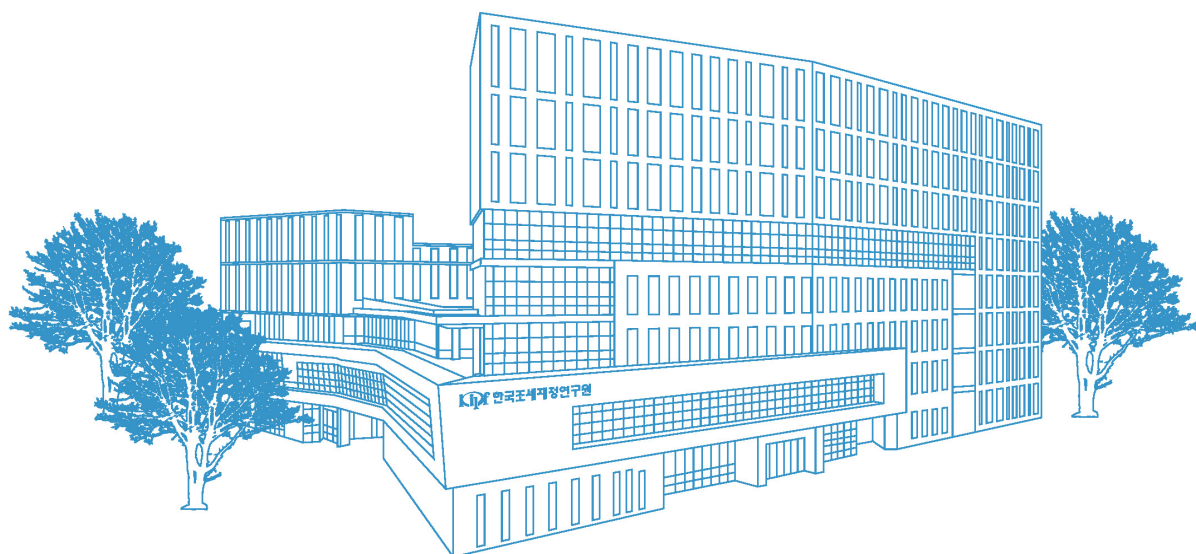
United Kingdom

Use of Accrual Information

Focusing on Fiscal Risk Identification and Assets and
Liabilities Management in the UK

2021

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Statement of Submission

The research was undertaken by the agreement for the research project “USE OF ACCRUAL INFORMATION: Focusing on Fiscal Risk Identification and Assets and Liabilities Management” between the Korea Institute of Public Finance (KIPF) and the Kalar Consulting.

Hence, this publication, *‘USE OF ACCRUAL INFORMATION FOCUSING ON FISCAL RISK IDENTIFICATION AND ASSETS AND LIABILITIES MANAGEMENT IN THE UK’,* is a result from the agreement proposed by KIPF with the purpose to conduct an in-depth study on the use of accrual information in UK.

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List of Abbreviations

Abbreviation	Name
BSR	Balance Sheet Review
CIPFA	Chartered Institute of Public Finance and Accountancy
CLCC	Contingent Liabilities Central Capability
DHSC	Department for Health and Social Care
EUEL	Estimated Useful Economic Life
FRR	Fiscal Risk Report
FSR	Fiscal Sustainability Report
GAD	Government Actuary's Department
GFS	Government Financial Statistics
GRAA	Government Resources and Accounts Act
HMT	HM Treasury
IFAC	International Federation of Accountants
IFG	Institute for Government
IFRS	International Financial Reporting Standards
IFS	Institute of Fiscal Studies
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
KIPF	Korean Institute of Public Finance
NAO	National Audit Office
NHS	National Health Service

OBR	Office for Budget Responsibility
OECD	Organisation for Economic Co-operation and Development
PAC	Public Accounts Committee
PACAC	Public Administration and Constitutional Affairs Committee
PFI	Public Finance Initiative
UK GAAP	UK Generally Accepted Accounting Practice
UKGI	UK Government Investments
WGA	Whole of Government Accounts



Executive Summary

The UK government only relatively recently implemented accrual accounting; it was not until 2001 when central government departments published the first financial statements on an accrual basis adopting UK Generally Accepted Accounting Practice (UK GAAP). Since then, there have been several milestones such as the adoption of International Financial Reporting Standards (IFRS) and the publication of the Whole of Government Accounts (WGA) for the year ended 31 March 2010. The WGA was one of the most comprehensive accounts covering the public sector, bringing together accounts from central government, local government, health, public corporations. The breadth of coverage reflects the highly centralized nature of UK government.

The new accounts offered data and insight across general government not previously seen, enabling scrutiny of long term liabilities such as those incurred under the Private Finance Initiative (PFI) and the number, value, and management of government assets.

The UK has begun to turn this promise into reality. For example, the national asset register offered insights to the strategic management of government property which supported the aims to reduce the size of the government estate¹⁾. This strategy resulted in a 30% reduction in the size of the estate since 2010, and £2.1bn additional revenue to the taxpayer²⁾. Furthermore, in 2017 the Chancellor of the Exchequer commissioned a review of the government balance sheet in the Budget and the team provided an update at the next Budget 2018³⁾ and a comprehensive Balance Sheet Review (BSR) Report 2020⁴⁾.

Since the creation of HM Treasury's (Treasury) Balance Sheet Management Team in 2017 there has been a dedicated focus on deriving better value from managing

1) <https://www.gov.uk/government/publications/government-estate-strategy-2018>

2) State of the Estate 2018-19 Report

<https://www.gov.uk/government/publications/government-estate-strategy-2018>

3) <https://www.gov.uk/government/publications/budget-2018-documents>

4) <https://www.gov.uk/government/publications/the-balance-sheet-review-report-improving-public-sector-balance-sheet-management>

government assets and liabilities. This has grown since then and has delivered considerable insight both within government, combined with scrutiny from PACAC⁵⁾ and NAO⁶⁾, to inform decision makers and resulted in significant change in policy such as the end of the Public Finance Initiative (PFI) scheme or new initiatives to better manage obstetrics in a bid to reduce the increasing clinical negligence cases across NHS Trusts that threatens long term sustainability of health finances. This is not only morally the right thing i.e. to change the focus to prioritizing prevention which is better for individual health outcomes; it is better for the taxpayer so that they would not have to pay for lifelong ongoing support at significant cost. This is supported by a newly created dedicated Contingent Liability Central Capability⁷⁾ (CLCC) team to work with the Department of Health and Social Care (DHSC) and develop strategies.

A dedicated Balance Sheet approach was developed to look at government assets and liabilities splitting these into core and non-core to activities and therefore determine what was best for the government balance sheet. The BSR provided a framework, based on international best practice, analyzing into three portfolios: policy portfolio, financial portfolio, and commercial portfolio.

The introduction of the UK Whole of Government Accounts has, most noticeably, been used by the independent Office for Budget Responsibility (OBR) in the evaluation and reporting of fiscal risks⁸⁾ and fiscal sustainability published in the Fiscal Risks Report (FRR) and the Fiscal Sustainability Report (FSR) respectively. The OBR, established in 2010, is required under its Charter (2015) to publish the fiscal risk report at least every two years and the government is formally required to respond to the findings. It is not OBR's role to manage the risks identified, that falls within Treasury's remit.

The first FRR was published in 2017 identified 57 different fiscal risks covering medium to long term risks. This was completed after consultation⁹⁾ with the IMF and reviewing

5) <https://publications.parliament.uk/pa/cm201719/cmselect/cmpublicadm/748/74803.htm>

6) <https://www.nao.org.uk/report/pfi-and-pf2/>

7) <https://www.ukgi.org.uk/2021/07/21/uk-government-investments-annual-report-and-accounts-2020-21/>

8) FRR 2021 does not refer to WGA data but the previous iterations did.

9) <https://obr.uk/frr/fiscal-risks-report-october-2016/>

international exemplars to assess which basis of preparation, methodology and presentation would be of most value to the UK context.

Treasury provided a detailed response to the risks identified in the July 2018 Managing Fiscal Risks Report¹⁰). This outlined the 5-stage approach to risk management: identify, disclose, mitigate, provision, and accommodate. In addition, it led to revisions to the Orange Book¹¹) and other changes.

The 2019 FRR considered the prevailing fiscal risks at the time as well as observations on Treasury's response to the risks identified in the 2017 report. Such a comprehensive assessment of risk has resulted in a substantial document over 300 pages.

The 2021 FRR¹²) marked a new approach. The aim was to make the FRR relevant to the current global environment and less repetitive by exploring risk from a thematic perspective focusing on three catastrophic risks in depth: the pandemic, climate change and the cost of public debt. The report is a thorough examination of risk in terms of magnitude i.e. the rarer, larger and often difficult to assess risks, not simply focused on probability.

Indeed, there is increasing evidence that the information in the WGA is being used in other areas too such as the geospatial survey which is a whole of government approach to the management of assets rather than looking at these individually. However, there is more to do to encourage others to make greater use of the information available.

This paper examines how the BSR team has had a transformational impact on the use of the information in the government balance sheet, supporting other teams across government to drive better management of government assets and liabilities. It also showcases the impact on policy development and implementation with case studies.

10) <https://www.gov.uk/government/publications/managing-fiscal-risks-government-response-to-the-2017-fiscal-risks-report>

11) <https://www.gov.uk/government/publications/orange-book>

12) <https://obr.uk/frr/fiscal-risks-report-july-2021/>

The NAO, SAI for the UK have also contributed significantly to the use of the WGA and published several reports identifying trends and challenges to long term sustainability of public finances on public sector pensions, government borrowing, contingent liabilities, and financial assets. Treasury have used these to inform their insight and recommendations to address these areas. These are explored in further detail in role of the NAO

The BSR team are not resting on their laurels. They are building on all that has been achieved. Plans already on track and some that extend beyond the financial statements such as leveraging the value of intangible assets and strengthened risk management. The impact has been across government through collaboration with other government departments to develop new policies, processes, capability and increasing professionalisation as demonstrated by the launch of the CLCC.

But there is more to do, and the final chapter offers ideas as to what more can be done to fully achieve benefits of using the accrual accounting information. There are several areas that need to be further enhanced that will have a marked improvement on the use of the government balance sheet. For instance, the usefulness of the WGA is limited due to the lack of timeliness of the information. Accessibility of the information in an easy to download manner would also broaden the use of the data and encourage independent think tanks to make greater use of the information. This will enhance transparency and accountability to the taxpayer as recommended in Accounting for Democracy reports by PACAC¹³).

To fully realizing the benefits of the balance sheet is to ensure the accrual budgeting is adopted. Benefits of accrual budgeting include better matching of revenue and expenses to accurately determine cost of government operations; greater visibility of decisions and their impact on long term sustainability of public finances; improvement in the management of assets and liabilities¹⁴). By separating the budgeting and

13) <https://publications.parliament.uk/pa/cm201719/cmselect/cmpublicadm/1197/1197.pdf>

14) Accrual Budgeting: The Pitfalls presentation by GERT VAN DER LINDE LEAD PFM SPECIALIST PULSAR / FINCOP JULY 10, 2018
https://cfr.worldbank.org/sites/default/files/2020-10/PULSAR_Accrual%20Budgeting%20Pitfalls_Gvd%20Linde_eng.pdf

reporting removes the link from budgeting to reporting and reduces accountability by the decision maker. This was the experience in the UK between 2001 and 2004 when budgeting was on a cash basis and financial reporting on an accrual basis. Many countries such as Korea, follow cash budgeting and will need to prepare reconciliations between the cash budgets and accrual reporting to maintain the link between accrual reporting and cash budgeting to ensure the PFM benefits of implementing accrual accounting are fully realized.

The UK is seen as a global exemplar in the use of accrual accounting information in both the use of assets and liabilities and in the identification, reporting and management of fiscal risk. There are many factors that have been pivotal to this achievement: the quality and availability of accrual accounting information in the WGA; the significant improvements to the data through challenge and insight from the NAO; champions for promoting the use of the information; greater desire for transparency and accountability for government spending by Parliament and importantly political commitment to using the information by the Chancellor of the Exchequer in 2017.

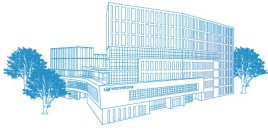
Use of Accrual Information Focusing on Fiscal Risk Identification and Assets and Liabilities Management in the UK

Introduction

The Government Accounting and Finance Statistics Center (GAFSC) of the Korea Institute of Public Finance (KIPF) is undertaking an in-depth study on the use of accrual information. This is a follow up to the 2017 “A Study and Analysis on the Global Utilization of Accrual Financial Information” research project conducted in collaboration with Organisation for Economic Co-operation and Development (OECD). The report indicated that many of the 25 OECD countries that participated in the survey were using the accrual information to help: identify fiscal risks, manage assets and liabilities, cost policing, and improving financial reporting.

This research project builds on the earlier research, taking it a step further from the identified usage of accrual information to focus on the identification of fiscal risks, and assets and liabilities management. There were seven countries identified as either best practice exemplars or provide a variety of practices and this section is devoted to the UK experience. The other six countries (New Zealand, Australia, Canada, and France, Austria and Switzerland are covered in their respective sections). The report is specifically focused on its effects, status of operation, level of recognition and acceptance on the usage. Moreover, it considers the experience and expertise in incorporating accrual information in the interests of sound public finance and financial management in the UK.

The aim of the report is to showcase what has been achieved and how by looking at the organisation and structure, resourcing requirements such as the skills and disciplines of the staff. It covers the evolution of the approach for fiscal risks identification, the management of government assets and liabilities and how this is progressing beyond the traditional accounting view presented in the balance sheet.



The report examines the current methodological approach adopted in the UK for the identification of fiscal risk, developed following consultation with IMF and by examining other countries approaches. It is important to note that this is an evolving process, and the third iteration of the Fiscal Risk Report published in July 2021 changed to a thematic assessment of risk and focused on three sources of risk in greater detail: the pandemic; climate change and public debt¹⁵⁾.

Medium term risks are identified in the Economic and Fiscal Outlook reports that examine five-year forecasts for the UK economy and public finances and an assessment of whether the Government is likely to achieve its fiscal targets¹⁶⁾.

The identification of long-term risks draws on several sources of information including the Whole of Government Accounts (WGA) that is prepared by Treasury. The WGA brings together audited data from across the general government sector by incorporating 9,000 individual entities in 2019¹⁷⁾. The expansive coverage of the WGA reflects the highly centralized function of government in the UK. The WGA is then independently audited by the National Audit Office (NAO), the Supreme Audit Institution (SAI) for UK. The WGA has evolved considerably since first publication in 2011 for the 2009–10 financial year. Originally consolidating over 3,000 entities it has grown considerably and has developed to include many government entities included in the National Accounts and addressed many qualifications raised by the NAO over the years.

The value of the WGA has grown over the period as it shows both a moment in time with the Balance Sheet¹⁸⁾ for each year and enables a comparison between the current year and previous years. The Balance Sheet has highlighted issues that were previously ‘hidden’ across many individual entity accounts. For example, it brought the significant long-term commitment to service the Private Finance Initiative (PFI)¹⁹⁾ to the fore as

15) Fiscal risks report 2021, <https://obr.uk/frr/fiscal-risks-report-july-2021/>

16) OBR Forecast Evaluation Report <https://obr.uk/fer/forecast-evaluation-report-january-2021/>

17) Whole of Government Accounts 2018-19

<https://www.gov.uk/government/publications/whole-of-government-accounts-2018-2019>

18) Now referred to as the Statement of Financial Position

19) Also called the Public Private Partnerships (PPPs) and PF2 in the UK

noted by the then Chair of the PAC²⁰) Trend data has been important to highlight concerns with increasing liabilities questioning their long-term affordability and the sustainability of public finances. This is also the case with public sector pension liabilities.

In the 2017 Budget, the Chancellor of the Exchequer commissioned a review of the information in the government balance sheet which led to the creation of the Balance Sheet Review²¹). This report examines the how the team have made a significant impact in a relatively short period of time since the review and there are ambitious plans for the short to medium term as highlighted in the Balance Sheet Review Report²²).

However, there has been limited engagement at best, with the WGA by Parliamentarians independent think tanks, and citizens, with little evidence of the data being used. This report also touches the main reasons for this and offers solutions to prevent similar instances elsewhere. As more countries move to implementing accrual accounting (as evidenced in the IFAC CIPFA financial accountability index)²³) it is important that the full benefits are realized. Otherwise, there is a risk that accrual implementation becomes only an accounting/ financial reporting exercise. It also examines future opportunities to further enhance transparency, accountability and deliver better management of the public finances.

The report was completed following desk research and meetings with key personnel from across various UK government entities including HM Treasury (Treasury), the National Audit Office (NAO), the Office for Budget Responsibility (OBR), UK Parliamentary Scrutiny Unit, the Institute for Government (IfG) and other academics. The author would like to thank all those who provided invaluable support and advice. Any errors or omissions are the author's. (Annex 1)

20) <https://publications.parliament.uk/pa/cm201012/cmselect/cmpubacc/1696/11120501.htm>

21) Balance Sheet Review 2017

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/937804/The_Balance_Sheet_Review_report____.pdf

22) Balance Sheet Review Report November 2020

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/937804/The_Balance_Sheet_Review_report____.pdf

23) <https://www.ifac.org/knowledge-gateway/supporting-international-standards/discussion/international-public-sector-financial-accountability-index>



Background

The 2008 global financial crisis and the subsequent sovereign debt crisis brought government indebtedness into sharp focus raising fears as to long term fiscal sustainability of the public sector. Therefore, it is unsurprising to see that more countries have committed to implementing accrual accounting. The IFAC CIPFA International Public Sector Financial Accountability Index 2020 provides an update on 2018 index²⁴⁾ which analyzed information from 150 jurisdictions across the globe to understand the bases and frameworks used in public sector financial reporting. The 2020 update includes information on 165 jurisdictions and the number reporting on accrual basis was 30% up 6% since 2018 and is projected to rise to 50% by 2025 and the greatest areas of accrual reform were projected to be Africa, Asia and Latin America and the Caribbean²⁵⁾.

Accrual accounting, where the economic substance of the transaction is recorded rather than when the cash payment is made, presents a comprehensive picture of the entity's finances by identifying assets and liabilities especially long-term commitments.

The claimed benefits of investing in enhanced public sector financial reporting are many:

- **Greater transparency and accountability** of the financial decisions made by jurisdictions for donors, citizens, and investors. Maintaining trust in the government is important for maintaining democracy. The recent global corruption perception index 2020 found that Korea had improved compared to other countries and is now ranked 33 out of 180 countries.

24) IFAC CIPFA Financial Accountability Index 2018 (published November 5, 2018) was the first such analysis that examined the results of 150 jurisdictions to assess their financial reporting bases and intentions <https://www.ifac.org/knowledge-gateway/supporting-international-standards/discussion/international-public-sector-financial-accountability-index>

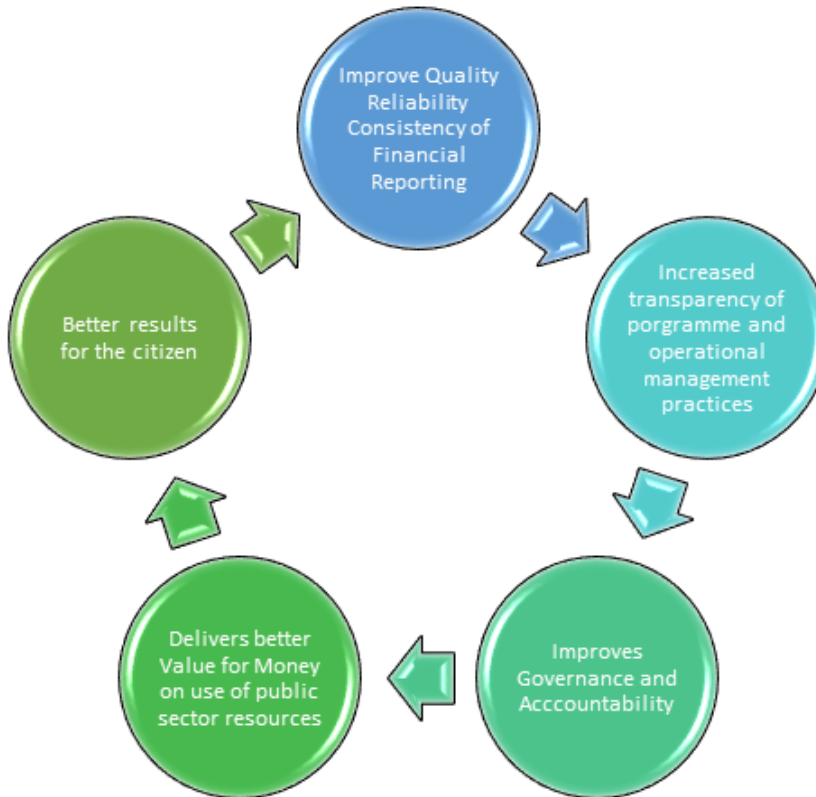
25) IFAC CIPFA Financial Accountability Index 2020 (published June 16, 2021) <https://www.ifac.org/knowledge-gateway/supporting-international-standards/discussion/international-public-sector-financial-accountability-index-2020>

- Complete information to **aid better decision making**, for example, through a better understanding of all assets and liabilities is invaluable in effective medium-term financial planning and therefore **more effective use of public funds** to deliver **improved outcomes for citizens**.
- Having a complete inventory of assets and stocks enables entities to assess whether these are being used **effectively, efficiently, and economically** to deliver public services. All government entities within a jurisdiction following the same accounting framework allows for comparisons and identification of best practice that can be replicated across other government entities as well as waste which can be eliminated.
- The quality of the government reporting framework is an important factor in the **assessment of a country's financial stability** and **attractiveness for investment**. According to Brian Quinn, director at the World Bank, "Research has shown that more transparent countries have better credit ratings, better fiscal discipline, and lower borrowing costs²⁶." By using an internationally recognised reporting framework the government's accruals based financial statements will support fairer and more accurate credit ratings and encourage foreign direct investment.
- **Governance** of public finances will be enhanced through greater transparency and accountability required by the disclosure of government assets and in particular liabilities. This additional scrutiny will drive a more informed debate on the sustainability of public finances and how best to use limited finances to deliver the best outcomes for the citizen.

26) World Health Organisation: IPSAS Benefits to WHO, 2013



Figure 1 Virtuous Circle of Improved Public Sector Financial Reporting



UK: Implementing Accrual Accounting

The adoption of accrual accounting in the UK was first discussed in the 1995 White Paper Resource Accounting and Budgeting in Government. This was mainly driven by the need for more efficient public financial management and by the need to enhance Parliamentary accountability by departments²⁷⁾.

27) ISSN 1608-7143, OECD JOURNAL ON BUDGETING, Volume 5 - No. 2 Lessons from Australian and British Reforms in Results oriented Financial Management by Bram Scheers, Miekatrien Sterck and Geert Bouckaert <https://www.oecd.org/gov/budgeting/43480984.pdf>

Financial reporting across the public sector was fragmented with different sectors adopting various approaches. For instance, local government was partial and then full accrual, public corporations followed commercial (accrual) financial reporting requirements, Health (NHS providers) were accrual from inception. This left UK central government sector as the largest and last to implement accrual accounting in 2001 following the enactment of the legislation – the Government Resources and Accounts Act (GRAA²⁸) 2000.

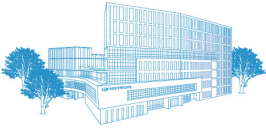
The use of the new resource accounts²⁹) was limited as it was initially perceived as an accounting exercise as the budgets were still prepared on a cash basis. It was only in 2005 once there was greater confidence in the data that accrual budgeting was introduced. There is less complexity if the budgets and accounts are prepared on the same basis, and it incentivizes the ‘right behaviour’. Linking budgeting to the financial reporting is an important pre-requisite to ensure value is derived from the balance sheet. In countries that have not yet implemented accrual budgeting, it is much harder to understand the effect of decisions on the balance sheet than it is to do so when budgeting reflects the long term cost of each decision. In these cases, additional reconciliations will be required to ensure there is a clear link between the budget to the medium to long term impacts of the decisions that are reflected in the financial reports.

The UK adopted a staggered approach using ‘dry-run exercises’ to develop processes, systems, capacity and capability. This approach provided valuable opportunities to resolve issues as these arose before the ‘real’ accounts were prepared and published. This planned approach secured buy-in from stakeholders, opportunities to celebrate successes and built confidence in the outputs before ‘go-live’.

The next milestone was the adoption of International Financial Reporting Standards (IFRS) in 2009–10 replacing UK Generally Accepted Accounting Practice (UK GAAP). It was also the first reporting year the Whole of Government Accounts were published in November

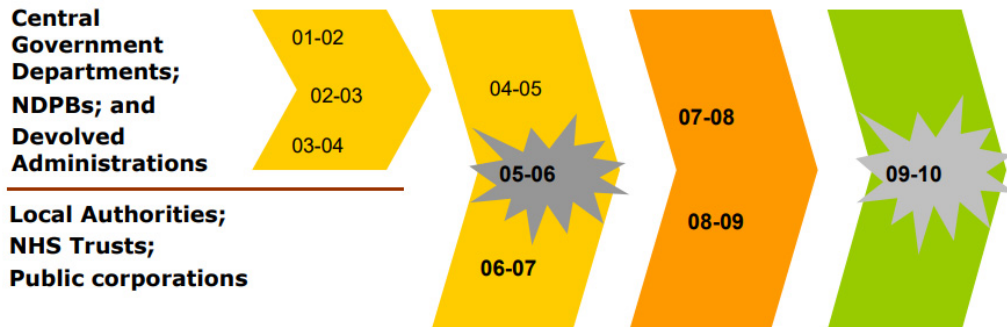
28) <https://www.legislation.gov.uk/ukpga/2000/20/contents>

29) In the UK the accrual accounts were referred to as Resource Accounts as these showcased the resources consumed rather than the cash spent.



2011. This follows several years dry-run exercises that gradually extended to incorporate the whole of the general government sector (Fig 2 shows the WGA project timeline)

Figure 2 Building WGA coverage across UK general government sector



Source: Presentation by Ian Carruthers, Chair IPSASB and Karen Sanderson, (then) Deputy Director, Government Financial Reporting³⁰⁾

There are now 10 years of WGA data to interrogate and identify trends in government assets and liabilities therefore informed government policy making. More about this in section Management of Government assets.

³⁰⁾ <https://ec.europa.eu/eurostat/documents/1001617/1012817/session3-I-Carruthers-and-K-Sanderson-UK.pdf>

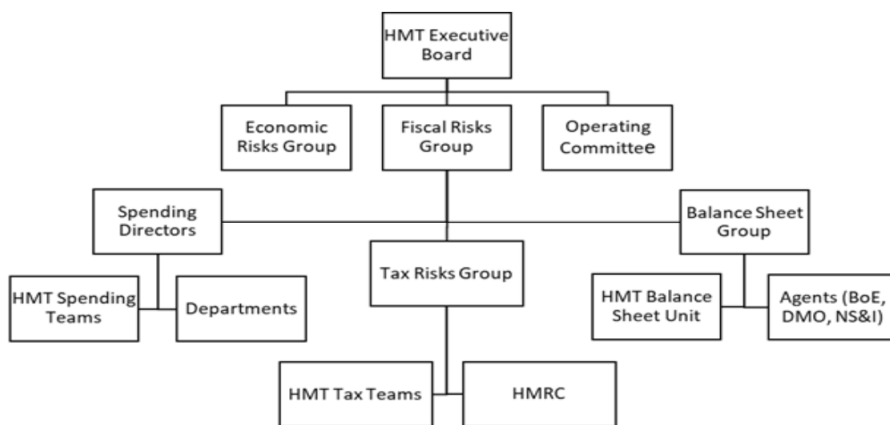
Fiscal Risk Management in the UK

The responsibility for the management of fiscal risk lies with Treasury, but uniquely the UK, in 2010, outsourced the reporting of fiscal risk to an independent entity, the Office for Budget Responsibility (OBR) to ensure transparency and build trust in the process. The OBR have embedded a culture of independence and are readily accepted as purveyors of independent economic forecasts.

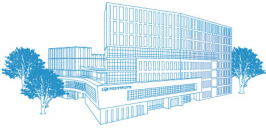
The Fiscal Risk Group was created in Treasury in mid 2000s to identify and assess risks related to government’s fiscal objectives.

Treasury’s Executive Management Board oversee three groups to identify and oversee economic, fiscal, and operational risk. The Fiscal Risk Group has responsibility for scanning possible sources of risk, identifying fiscal risks; assesses their likelihood and potential impact; and proposes mitigation strategies. These include risks to tax, spending, the balance sheet, the economy and long-term fiscal sustainability. The Economic Risks Group considers the wider economic impacts of risk and feeds into the Fiscal Risks Group if there is a fiscal impact³¹⁾.

Figure 3 HM Treasury Organisational Chart



31) OBR FRR 2017 Chapter 2: How does Government Manage Fiscal Risk?

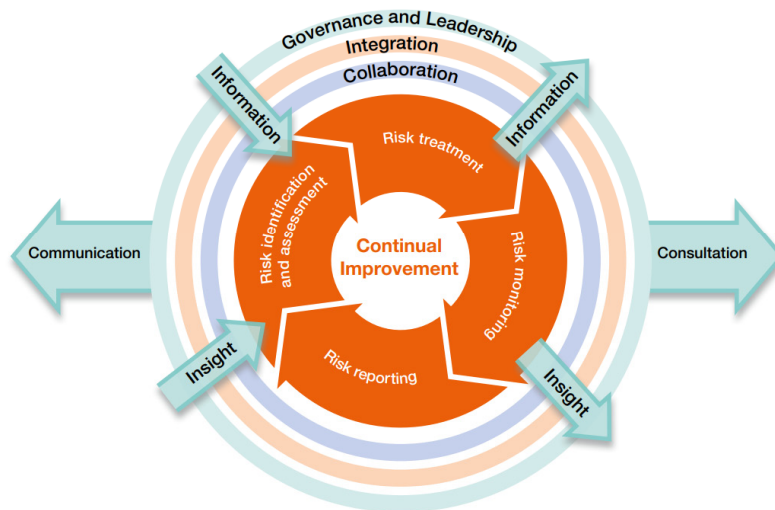


The Fiscal Risk Group meets monthly to collect the analysis of separate Treasury’s risk management groups on sector-specific risks, and then reports to the Executive Management Board with quarterly reports. A new Balance Sheet Group was established in 2016 to report to the Fiscal Risk Group on risks to the government’s holding of assets and liabilities.

The management of operational risk is set out in the government orange book (HM Government 2020). This sets out the principles, concepts, application of existing guidance and governance structures, and the questions to ask to improve risk management across individual government entities. The risk management framework is set out in figure 4. The framework sets out the ‘what’ and ‘why’ to design operate and maintain an effective risk management framework. The principles should inform an entity’s approach to operational risk management and its own policies, processes, and procedures – i.e. the “how”³²).

Figure 4 Risk Management Framework

Risk Management Framework



32) Orange Book

The Orange book requires the management of operational risk needs to be:

- Part of governance and leadership
- An integral part of organisational activity
- Collaborative and informed
- Structured i.e. risk identification and assessment, risk treatment options, risk monitoring and timely risk reporting.
- Continuously improved.

The management of risk is the responsibility of the lead officials for each government departments and the Arms' Length bodies. The Orange book states it is the effective management of risk, including optimizing opportunity rather than seeking to eliminate it.

Fiscal Risk Reporting

The creation of the independent Office for Budget Responsibility (OBR) in 2010 was a major reform to the fiscal framework. Prior to the OBR there was a perception that the economic forecasts developed by Treasury were not independent and subject to influence by Ministers. The OBR have worked hard to be and to be seen independent of any influence. This has been achieved through building a culture of independence and not taking a moral stance or provide comment on whether a policy is good or bad but to resolutely focus on reporting debt and deficit through a wide range of data and expert research and support by renowned academics.

The OBR has achieved its aim to increase credibility of economic and fiscal forecasting and, consequently, fiscal policy by requiring an independent assessment of government forecasts. Since its creation, the OBR has produced regular medium-term forecasts and long-term projections for the UK public finances³³.

33) Overview of the Fiscal risks report, July 13th, 2017
<https://obr.uk/overview-of-the-fiscal-risks-report/>



The Budget Responsibility and National Audit Act 2011 required government to establish a Charter³⁴⁾ regarding the formulation and implementation of fiscal policy and policy for the management of the national debt. The purpose of the Charter is to improve the transparency of the government's fiscal policy framework. It set out the government's objective for fiscal policy and the mandate for fiscal policy; the required contents of the Treasury's annual Budget Report; the Treasury's objective for the management of the national debt; and the required contents of the Treasury's annual debt management report and the debt management remit. The OBR is directly accountable to Parliament for the Economic Outlooks and Fiscal Risk/Sustainability Report and is accountable to Treasury for the use of resources.

This approach is different to other comparable countries that have a robust approach to fiscal risk management. Indeed, there is no standard reporting requirements/rules for the presentation of fiscal risks as there is for preparing government financial statements. The OBR reviewed other methodologies to fiscal risk management as part of the consultation process to develop their approach.

For example, in Finland, fiscal risk reporting remains a core function within the Ministry of Finance, reported by the lead government official; Politicians are required to formally respond to the fiscal risk reports. The UK decided to set up an independent entity, the OBR to fulfill its responsibility and as described on its website "It is the duty of the Office to examine and report on the sustainability of the public finances"³⁵⁾. In establishing an independent function, the OBR recognizes it is "unusual in outsourcing it to an independent fiscal institution" (OBR FRR 2017).

The Charter required the OBR to prepare the Fiscal Risk Report (FRR) and Fiscal Sustainability Report (FSR) at least every two years and the first was prepared in 2017. In addition, it requires Government to formally respond to the issues raised and how government is managing the risks identified within one year of the FRR being published.

34) Charter for Budget Responsibility: Autumn 2016 update (January 2017)

35) From the OBR website <https://obr.uk/fiscal-risks-reports/>

The OBR consulted³⁶⁾ widely before developing the fiscal risk report. The first issue to consider was the definition of fiscal risk. The IMF defines fiscal risk as “the possibility of deviations of fiscal outcomes from what was expected at the time of the Budget or other forecast”³⁷⁾. This definition has been interpreted as a potential deviation from the 5-year-ahead central forecasts for public sector spending, receipts, borrowing, and debt contained in our Economic and Fiscal Outlooks (EFO), and from the corresponding 50-year-ahead projections in our Fiscal sustainability reports (FSR)³⁸⁾. The latter draws significantly from the Whole of Government Accounts.

The development of the FRR also addressed concerns raised by the IMF in the UK Fiscal Transparency Evaluation (2016) “In many cases, the government’s control of risks falls short of the Code’s standards of good or advanced practice” and “The absence of summary reporting of specific risks is a weakness that should be addressed”. This recognized that the existing risk management framework was disparate.

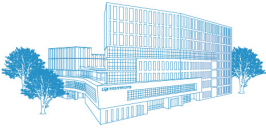
Again, the way fiscal risks are reported are different too in separate jurisdictions. For example, New Zealand, Specific Fiscal Risks in the Economic and Fiscal Updates are disclosed in a full separate chapter³⁹⁾. All specific risks must be quantified and any above the materiality threshold of NZD 100 million must be disclosed and classified by nature and status compared to the previous Economic and Fiscal Update i.e. whether it is new, changed or unchanged. In addition, their impact on revenue, expenses or capital expenditures is required.

36) OBR Discussion Paper: What should our fiscal risks report cover? October 2016
http://obr.uk/docs/dlm_uploads/Fiscal-risks-discussion-paper-1.pdf

37) IMF Fiscal Affairs Department, Fiscal risks – sources, disclosure, and management, 2009.

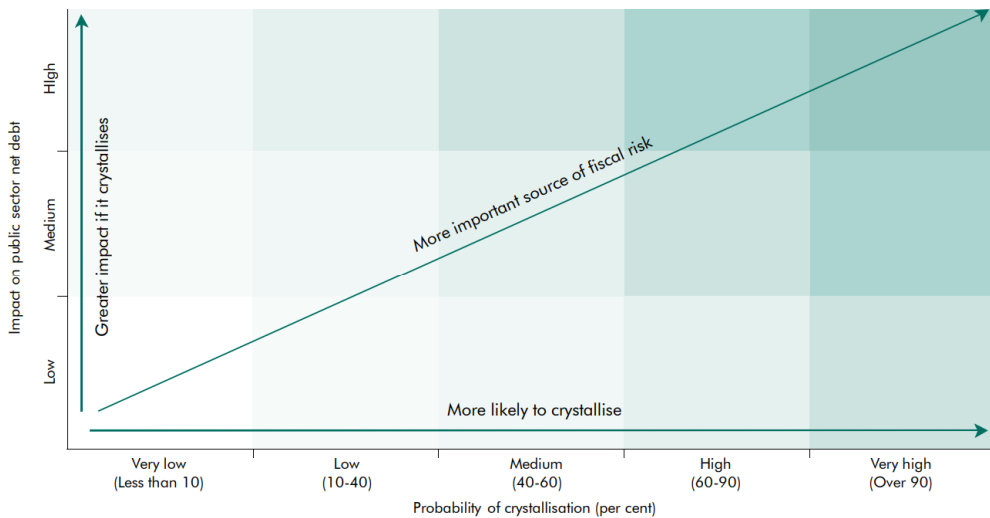
38) OBR FRR July 2017 Introduction page 18

39) OECD Managing Fiscal Risks Case studies of Australia, Finland, the Netherlands, New Zealand and the United Kingdom, 7 October 2020 GOV/PGC/SBO (2020)7



The first Fiscal Risk report was a substantial document, over 300 pages in length and identified 57 different risks over the medium and long term. There was a greater emphasis on the downside risk of both economic forecasts over the medium term and the fiscal sustainability over the longer term. The probability and potential impact of the risks, whether they are correlated with other risks and what government is doing about them.

Figure 5 OBR's stylised fiscal risk matrix



Risks were analysed into six distinct risk groups: Macroeconomic risks; Financial sector risks; Revenue risks; Primary spending risks; Balance sheet risks; and Debt interest risks over the medium term and in the long term. Like the approach in New Zealand, stress tests were applied to each to scenario plan for the different impact of the risks to aid prioritization of the risk.

Figure 6 Sources of fiscal risk over the medium term FRR 2017⁴⁰⁾

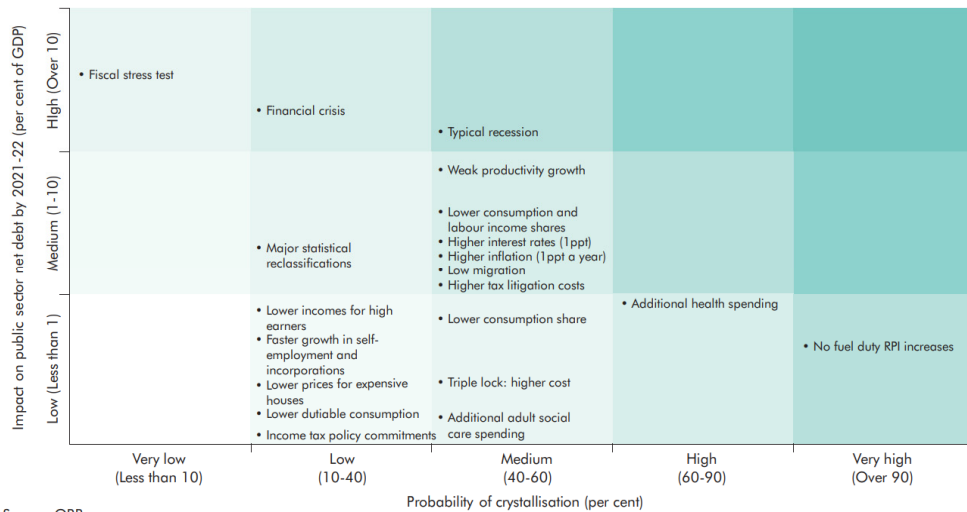
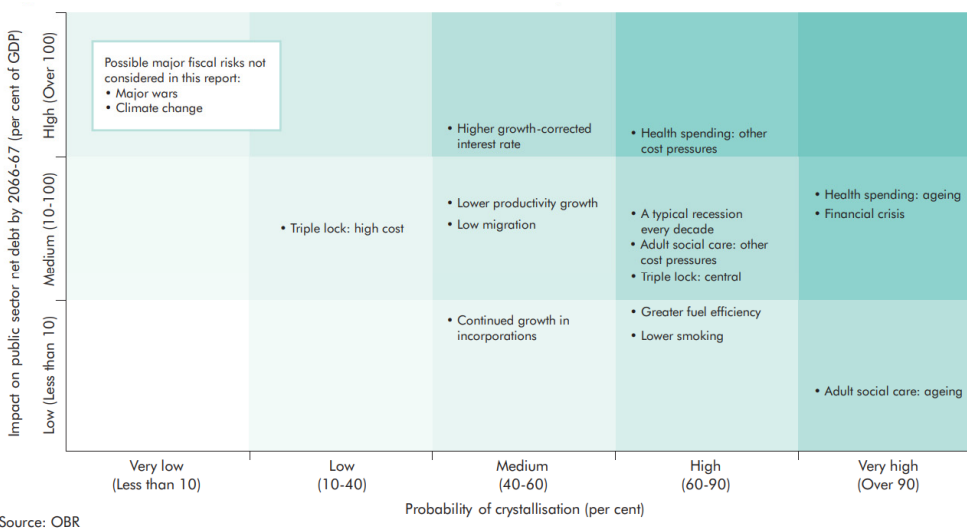
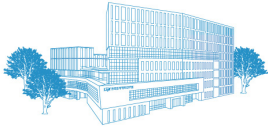


Figure 7 Sources of fiscal risk to fiscal sustainability FRR 2017



40) OBR are content to use this image.

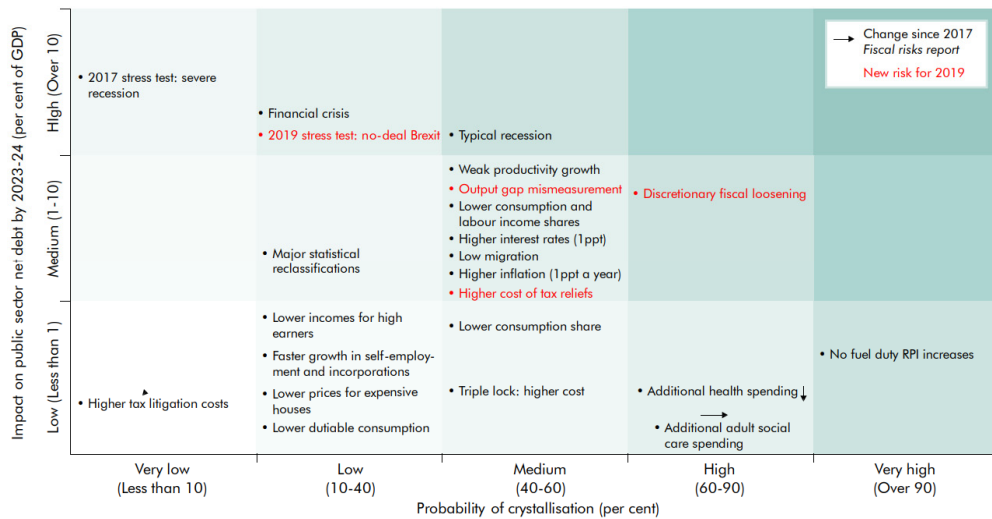


In addition to the fiscal risks, the OBR set out policy lessons in the conclusion to the report.

The comprehensive government response to the OBR 2017 Fiscal Risk Report provided detail on how it is responding to the 57 risks identified and allocated these to individual government entities as appropriate in the Fiscal Risk Register (Annex A) delivering greater transparency and accountability⁴¹).

The second FRR published in 2019⁴²) marked ‘a continuation of the conversation’ in response to government’s response to the OBR’s first FRR in 2017. This was remarked as unsurprising given that the government can only manage and mitigate risks identified and not eliminate them.

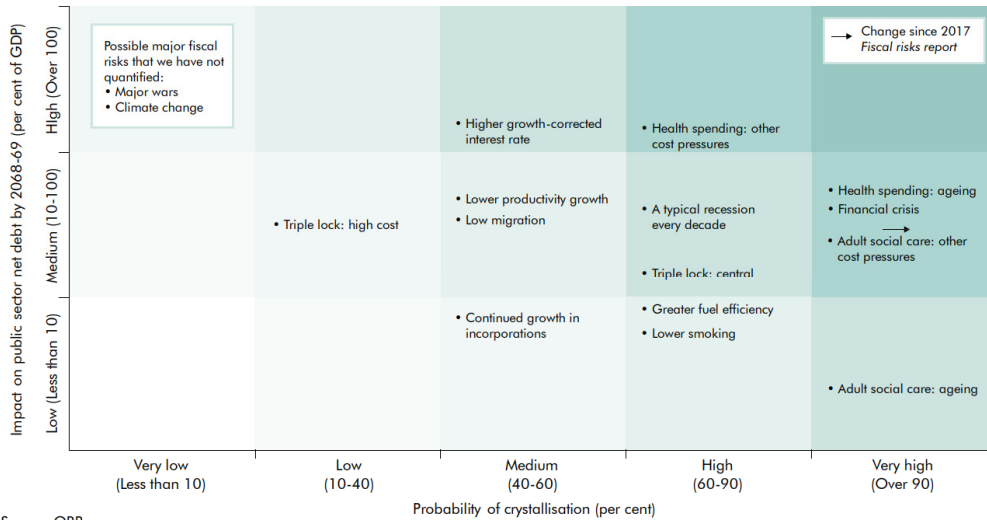
Figure 8 Sources of fiscal risk over the medium term FRR 2019



41) <https://obr.uk/frr/fiscal-risk-report-july-2017/>

42) OBR: Fiscal Risk Report July 2019 Executive Summary

Figure 9 Sources of fiscal risk to fiscal sustainability FRR 2019

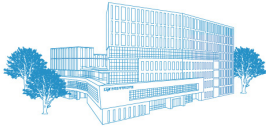


Source: OBR

The 2019 report noted policy risks were significant to public finances and added a further two categories: climate change and risks associated with the UK’s departure from the Economic Union (commonly referred to as Brexit) to the six distinct risk groups previously reported in the 2017 report. The government’s response to the 2019 FRR was superseded by the response required to address the impact of the COVID19 pandemic⁴³). Therefore, it is not as comprehensive as the previous government response to the fiscal risk report.

The presentation of the risks is clear and the likely trajectory of the risks are understandable and accessible to all.

43) OBR 2020 Fiscal Sustainability Report and response to the OBR 2019 Fiscal Risks Report, Statement made on 14 July 2020, Statement UIN HCWS364 by the Chancellor of the Exchequer <https://questions-statements.parliament.uk/written-statements/detail/2020-07-14/HCWS364>

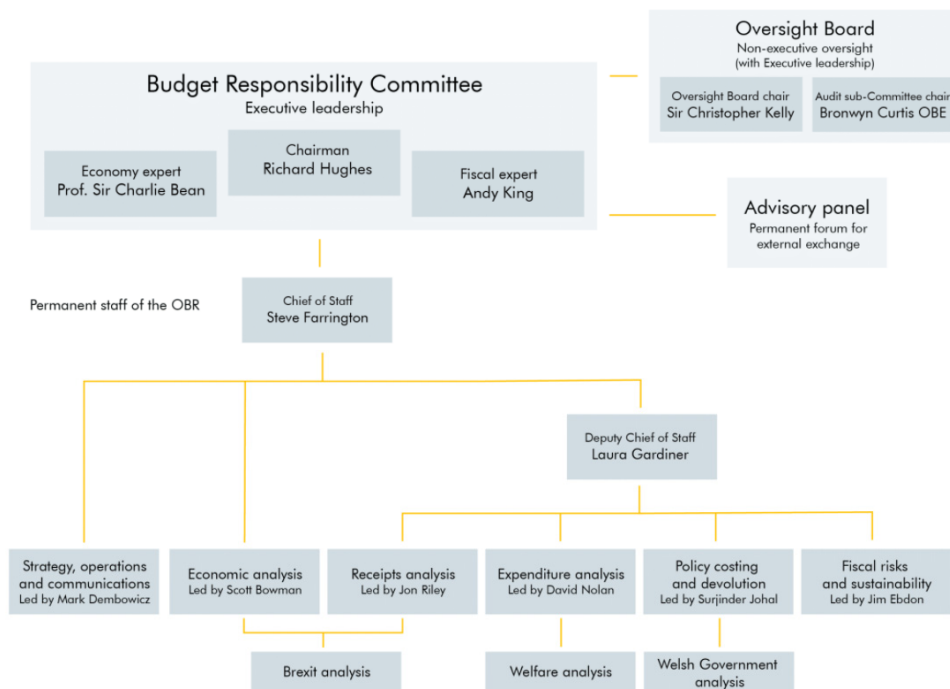


Fiscal Risk Reporting Process

The OBR has a relatively small team, comprising of 35 staff which various technical competence such as economists, statisticians, and analysts and the fiscal risk team comprise 3 core staff. Staff will focus on the preparation of the Economic Outlook twice a year, (published in March and October respectively). Once this is complete all staff devote their attention to the development and production of the FRR. This process commences in December to discuss what would be useful and then work starts fully in March after the publication of the Economic Outlook. The OBR is able to draw on data from various sources and in the case of the WGA, independently audited by the NAO.

The diagram below sets out the Organisational structure of the Office for Budget Responsibility.

Figure 10 Organisational structure of the Office for Budget Responsibility



The next stage is to write to Treasury with 15 questions together with the previous report seeking an update on progress made on the previous report's recommendations. In addition to Treasury the OBR reach out to other entities such as the National Audit Office (NAO), Government Actuary's Department⁴⁴ (GAD), Bank of England, Advisory Council, and independent think tanks: Institute of Fiscal Studies (IFS), Institute for Government (IFG), Health Foundation. OBR seek insight as to any issues that they need to be aware of and what information is needed and on what basis.

The OBR have established Memoranda of Understanding (MOUs) with government departments to determine how the OBR will obtain data whilst maintaining their independence. This is essential to the effective gathering of data for the team to prepare the required reports on a timely basis and maintain independence, perceived and reality.

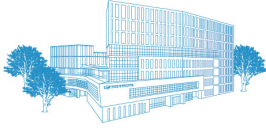
Impact of the OBR

In the short time since its creation, the OBR has been internationally recognised as having a significant impact on the management of risk. 'It shows how the systematic identification and measurement of fiscal risks since 2017 and definition by the government of a detailed management strategy have triggered decisions on mitigation approaches for a range of fiscal risks in only a few years' (OECD 2020).

The 2019 FRR recognized the improvements to the monitoring and management of fiscal risks, these include:

- Better management of contingent liabilities, through new guidance and now the creation of the CLCC
- More transparent reporting on the balance sheet and,

⁴⁴ The Government Actuary's Department provides actuarial solutions including risk analysis, modelling and advice to support the UK public sector.



- Better disclosures of student loans to address the ‘pervasive fiscal illusions’ in the way student loans are captured in the public finances by working with the ONS.
- Reducing its exposure to inflation surprises by relying less on issuing index-linked debt to finance government borrowing.
- Further reduction in the budget deficit and has begun to lower public sector net debt as share of GDP.

Government Insurer of Last Resort

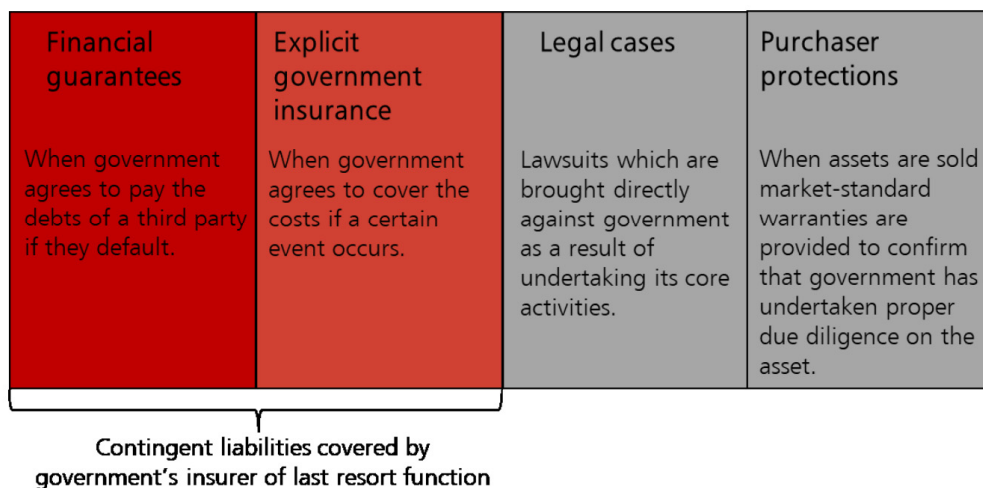
This report, published alongside the Budget March 2020, recognized government’s role as insurer of last resort and it manages contingent liabilities in the public sector. The objectives were to improve **expertise** to quantify and price risk effectively; improve **compensation for risk** taken by taxpayer; establish incentives to reduce probability and cost of risks materializing and clarify risk ownership to provide more certainty on how losses will be shared between the Exchequer, departments, and the private sector⁴⁵).

The report classifies contingent liabilities into 4 types: financial guarantees (where government agrees to pay the debts of a third party if they default), explicit government insurance (where government agrees to cover the costs if a certain event occurs), legal cases and purchaser protections. The insurer of last resort covers the first two types of contingent liabilities.

45) Government Insurer of Last Resort: managing contingent liabilities in the public sector HM Treasury
<https://www.gov.uk/government/publications/government-as-insurer-of-last-resort--2>

Figure 11 Typology of contingent liabilities: Government as Insurer of Last Resort report

Chart 1.A: Typology of contingent liabilities



Source: Treasury report

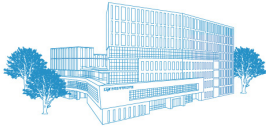
The report makes ten recommendations that draw on international best practice from the International Monetary Fund (IMF)⁴⁶ and the OECD⁴⁷.

Figure 12 Recommendations to improve management of contingent liabilities

Objective	Proposals	Detail
Expertise 1	Establish a central capability to support Departments with pricing, issuing, and managing guarantees and insurance	This central capability will bring together the necessary expertise to quantify and price risk
Expertise 2	Introduce independent verification of charges for government guarantees and insurance	Guarantees and insurance should be independently verified by the central capability to ensure that risk has been calculated accurately and that fees have been appropriately priced.

46) 'How to strengthen the management of government guarantees', IMF, October 2017

47) 'Budgeting for contingent liabilities', OECD, June 2013. 'The role of public debt managers in contingent liability management', OECD, Feb 2017



Objective	Proposals	Detail
Expertise 3	Integrate contingent liabilities with wider fiscal risk management	The central capability should monitor the government's portfolio of contingent liabilities on an ongoing basis and carry out regular stress tests.
Expertise 4	Improve the oversight of the stock of contingent liabilities	The central capability should undertake an exercise to assess, quantify and price the stock of existing contingent liabilities, including estimating unquantified contingent liabilities.
Expertise 5	Improve the reporting on the government's portfolio of contingent liabilities	The government should report regularly on the portfolio of contingent liabilities, including estimates for unquantified contingent liabilities and the results of stress tests.
Compensation for risk 6	Seek appropriate compensation when the government provides insurance and guarantees	The government should move towards adopting international best practice of charging fees, covering at least expected loss for guarantees and insurance, where appropriate.
Incentives 7	Improve budgetary incentives to make departments indifferent between policies with similar types and levels of risk	Where departments choose to subsidise guarantees and insurance by not passing on the full cost of expected losses to beneficiaries the subsidy should be recognised and budgeted for.
Risk ownership 8	Improve risk sharing by formalising the hierarchy of losses between HMT, departments and the private sector	Risk sharing agreements and risk frameworks should be established more widely across the government.
Risk ownership 9	Improve awareness within the government of implicit risks and establish frameworks for managing them where doing so would reduce the risk	The government should undertake an exercise to systematically identify implicit risks that could be better managed.
Risk ownership 10	Expand coverage of existing risk management where appropriate	The government should consider its stock of contingent liabilities and investigate where it may be appropriate to expand the scope of current pooling schemes.

Source: Treasury

One of the direct results of these recommendations has been the creation of the Contingent Liability Central Capacity.

UKGI Contingent Liability Central Capability

In April 2021, the Government Investments⁴⁸), UK government's centre of expertise in corporate finance and corporate governance, created the Contingent Liability Central Capability⁴⁹). The CLCC was established to strengthen contingent liability expertise across government. It is an analytical and advisory unit bringing together expertise from the Government Actuary's Department (GAD), credit risk experts, policy professionals and analysts.

The CLCC builds on the framework introduced for the approval and evaluation of all risks over £3 million that are 'novel, contentious or repercussive'. The evaluation involves five criteria: rationale; exposure; risk and return; risk management and mitigation; and affordability.

Bringing material contingent liabilities under one umbrella drawing on expert support is a great way forward and will continue to hone government's ability to effectively manage contingent liability risks to fiscal sustainability. The main focus of the work is to:

- Analyse new contingent liabilities, working with departments to quantify risks, incorporate risk mitigations and charge appropriate premiums for risk transferred to the government.
- Review existing contingent liabilities on both an individual and portfolio basis, to inform risk management and contingency planning.
- Work with departments, providing guidance and promoting best practice across government⁵⁰)

This work will inform Treasury's approach to risk management and contingency planning.

In April 2020, the Treasury has updated and published the Green Book, which provides guidance on how to appraise and evaluate policies, projects and programmes. Other key risk management reforms included a new financial oversight framework for the Bank of England and a comprehensive bank resolution regime.

48) <https://www.gov.uk/government/organisations/uk-government-investments>

49) <https://www.gov.uk/government/news/introducing-the-ukgi-contingent-liability-central-capability>

50) CLCC <https://www.ukgi.org.uk/>



FRR 2021

The 2021 iteration of the FRR was the third report and the OBR adapted their approach to make it more focused and accessible as the previous reports were ‘encyclopaedic⁵¹⁾’, both over 300 pages. The OBR have focused on three sources of risk in greater detail, set in the wake of the ‘largest peacetime fiscal risk to crystallise’ the pandemic.

These are:

- Learning lessons from the pandemic
- Consider the potential economic and fiscal risk of climate change
- Public debt, evaluating historic drivers of debt and interest rates; consider potential scenarios for the future path of interest rates; and implications for long-run fiscal sustainability.

In narrowing down the list from 97 risks to these three risks the OBR analysed several catastrophic risks and assessed whether there was the breadth and depth of data and research to consider the impact independently and comprehensively on debt, deficit, and ultimately public finances. Moreover, given the medium to long term nature of the risks identified, the incremental value provided by biannual updates to the FRR was deemed to be limited.

Pandemic

The report analyses the fiscal impact of the pandemic in both the historical and international context. It goes on to consider the potential medium to long term legacy for the public finances. Finally, the OBR offers lessons learnt from the pandemic for how forecasters and policymakers should approach other potentially catastrophic fiscal risks.

51) FRR 2021 OBR Chair, Richard Hughes speaker notes <https://obr.uk/the-chairmans-presentation-on-our-third-fiscal-risks-report/>

Climate Change

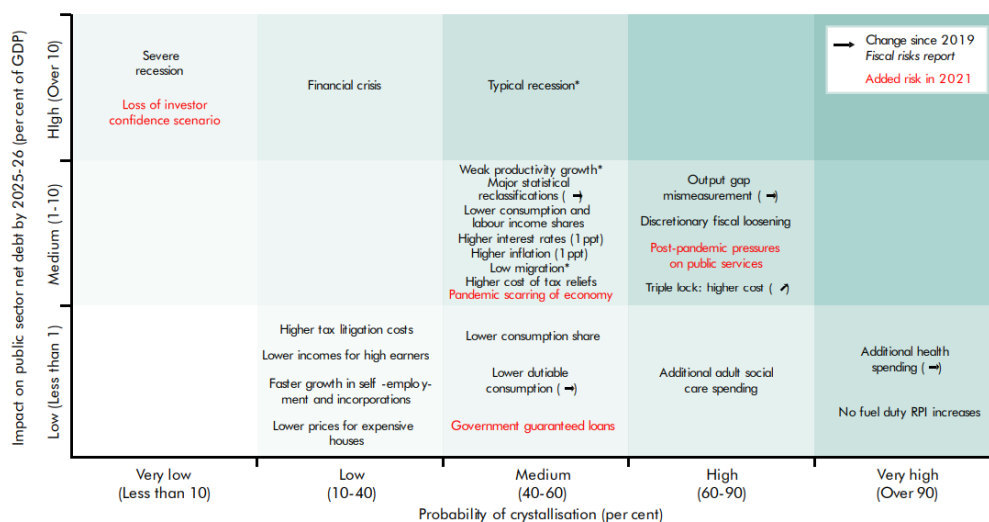
The government’s commitment to reducing net greenhouse gas emissions to zero by 2050⁵²⁾ the OBR’s second area was to focus on fiscal risks posed by climate change, and the economic and fiscal implications of alternative paths to meeting the commitment.

Cost of government debt

UK government, like many globally, have accumulated significant debt to meet the challenges of the pandemic. Debt is now over 100% of GDP. The FRR considers the potential impact of interest rates, inflation, and growth on the cost of debt.

In addition, there is an update on the 97 risks identified in the 2019 FRR. Fig 132: shows the fiscal risk over the medium term (defined as 5 years)

Figure 13 Sources of fiscal risk over the medium term 2021



52) The UK’s sixth Carbon Budget will incorporate the UK’s share of international aviation and shipping emissions for the first time, to bring the UK more than three-quarters of the way to net zero by 2050. <https://www.gov.uk/government/news/uk-enshrines-new-target-in-law-to-slash-emissions-by-78-by-2035>

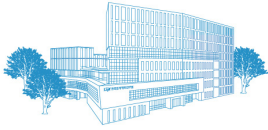
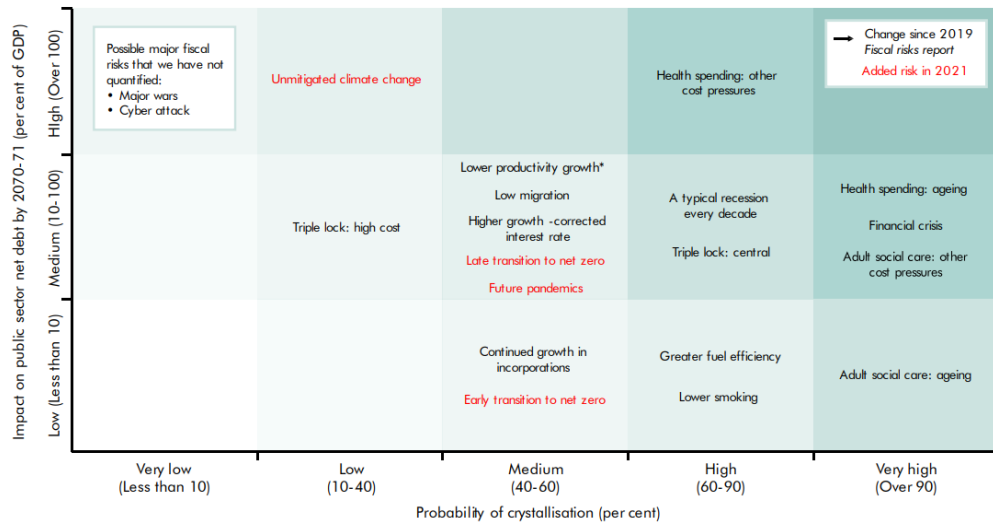


Figure 14 Sources of fiscal risk to fiscal sustainability (long term) 2021



Note: We judge the 'Higher growth-corrected interest rate' risk to have increased but has moved from high to medium impact due to improved scenario estimations. * denotes crystallised but remains active
Source: OBR

These charts have made the assessment of risk easier and it is easier to assess risks relative to each other and these are now regularly used by Ministers in their management of risk.

Management of the Government Balance Sheet

The publication of the Whole of Government Account (WGA) has brought many interesting insights to the fore. These coalesced in 2016 where many were seeking to promote and harness the value of the government balance sheet. This section provides an overview of the individual organisations and their impact in shaping the approach to the management of the government balance sheet.

Role of the NAO

Independent audit ensures the data is credible, meets the highest international financial reporting standards and has played an important role in the development of the WGA. The NAO challenged the preparers, Treasury, and data providers to improve data quality and reduce the number of qualifications. The NAO has driven up standards in financial reporting by bringing best practice lessons and showcasing best practice exemplars through the annual public sector awards⁵³).

In 2016 NAO published a series of reports using the WGA to give constructive advice to government on how best to use the information in the WGA to drive better decision making and explore some of the major risks to public finance. The Comptroller and Auditor General (C&AG) and head of the NAO said that the WGA “provides an essential insight into the financial impact of the government’s decisions and the effect that the government’s actions today might have on public finances for generations to come. It highlights the most significant, strategic issues and financial risks that the government is facing now and in the future⁵⁴.”

53) Building Public Trust Awards – good practice in annual reports February 2021
<https://www.nao.org.uk/report/building-public-trust-awards-good-practice-in-annual-reports-february-2020/>

54) C&AG’s comments on the issue of the Evaluating the government balance sheet: pensions report (June 2016) <https://www.nao.org.uk/report/evaluating-the-government-balance-sheet-pensions/>



These series of reports also addressed the recommendation made by the Committee of Public Accounts that Treasury makes better use of the WGA to inform decisions⁵⁵).

The reports are all substantial documents and draw on the observations of the WGA, trend analysis and other value for money audit activity. The scope of the reports was to explore the major risk to public finances, how this has changed over time and how the government manages the risk.

- Financial Assets and Investments⁵⁶)
- Public Sector Pensions⁵⁷)
- Provisions, Contingent Liabilities and Guarantees⁵⁸)
- Government Borrowing⁵⁹)

The next section provides a short summary of each of these reports.

Financial Assets and Investments

Financial Assets represented a significant proportion of the total assets held by government (one-quarter as at 31 March 2015 generating £7.2bn income⁶⁰). Some of these were acquired because of government policy decisions such as the financial support provided to the banking industry following the global financial crisis and the drive to encourage more students into higher and further education through student loans and housing policy to increase home ownership.

55) HC Committee of Public Accounts, Whole of Government Accounts 2012-13, Twenty-sixth Report of Session 2014-15, HC 678, January 2015

<https://publications.parliament.uk/pa/cm201415/cmselect/cmpubacc/678/678.pdf>

56) <https://www.nao.org.uk/report/evaluating-the-government-balance-sheet-financial-assets-and-investments/>

57) <https://www.nao.org.uk/report/evaluating-the-government-balance-sheet-pensions/>

58) <https://www.nao.org.uk/wp-content/uploads/2016/06/Evaluating-the-government-balance-sheet-provisions-contingent-liabilities-and-guarantees.pdf>

59) <https://www.nao.org.uk/report/evaluating-the-government-balance-sheet-borrowing/>

60) <https://www.nao.org.uk/report/evaluating-the-government-balance-sheet-financial-assets-and-investments/>

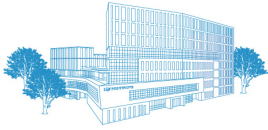
The NAO observed that:

- The UK government had a significant portfolio of assets ranging from the very short-term investments (trading on the markets) to long term (student loan book) which require different expertise to manage effectively.
- The financial assets comprise mainly of the banking, housing and student finance sectors which are more volatile given the link to the economy i.e., employment, interest rates, inflation, private sector investment). Valuing these is difficult as it is not always possible or desirable to look at market values. For example, the student loan book valuation is very difficult as repayments are based on a number of factors such as student's salary once in employment. It is difficult to model where there is no precedent.
- The creation of the UK Government Investments (UKGI), a Treasury owned company that brings together the UK Financial investments (UKFI) and the Shareholder Executive (ShEx) professionalises government's management of assets and recognised as a positive step.
- Greater accountability and transparency could be achieved through increasing parliamentary input to government's decisions to sell the investment assets (such as the shares in banks supported through the financial crisis) and to provide more detail on the sales to discourage short term priorities (i.e. cash to boost government income) overtaking long term best value for the citizen.

Public Sector Pensions

Public sector pensions represent the largest liability on the government balance sheet and has increased significantly since the first WGA was published in 2009–10. Government needs to balance its responsibility to ensure former employees have sufficient retirement income and these are affordable long term. An ageing population adds pressure to affordability, hence questions long term sustainability.

Since the first WGA was published, government has taken various steps to ensure the affordability of public sector pensions such as increasing the pension age to 68, increasing



employee contributions, and changing the scheme from final salary to career average. However, despite these changes the pension liability has been increasing. This is in part due to the number of employees contributing to the schemes decreasing by 15%, although fewer employees will yield long term benefits. The main impact is the discount rate, where the pensions are adjusted to reflect today's prices. The rate is based on the rate of return on corporate bonds and inflation assumptions which increases year on year volatility.

The report highlighted how demographic changes and economic trends affect the pension liability and the government guarantees for private sector pensioners in the case of corporate insolvency is an additional risk that is not transparent in the WGA.

The NAO recommend that:

- A comprehensive view of government's total current and future exposure across its pension schemes was required.
- Need greater clarity about how government assessed long term risks associated with the affordability of pensions.
- Government provides more detailed explanations on the drivers in the movement in pensions and improve data quality.

Provisions, Contingent Liabilities and Guarantees

Governments must manage exposure to risks associated with significant liabilities where the timing, size or probability is uncertain. Provisions are defined as those that will probably need to be paid at some point in the future, but the amount or timing is uncertain. These are included in the Balance Sheet and contingent liabilities, where the risk is determined as possible are disclosed as a note to the accounts. Since publication of the first WGA provisions and contingent liabilities increased considerably. Added to this policy changes to stimulate the economy has increased potential risk exposure.

The NAO grouped significant liabilities with similar profiles into four broad categories:

- Liabilities for long term energy policies e.g. nuclear decommissioning costs.
- Legal challenges to government e.g. clinical negligence claims and tax disputes.
- Liabilities arising from market interventions.
- Government's role as insurer of last resort

The NAO recommended that government needed to look at its approach to the management of liabilities, particularly how to reduce uncertainty. It should seek to minimise the costs of legal challenges, manage the portfolio of liabilities, limit the impact of economic shocks, enhance disclosures in the WGA and develop guidance on remote contingent liabilities.

Government Borrowing

Government debt was continuing to increase despite policy focus to reduce the deficit i.e. the annual borrowing to cover the shortfall in government income compared to spend. Longer term increasing debt becomes unsustainable.

Government borrowing is usually through issuing gilts (government bonds) where there is a regular interest payment and the final payment of the amount borrowed and to encourage savers through Premium Bonds. These represent secure investments and are low risk to investors. Treasury support to the banking sector during and after the global financial crisis was £137bn and a further £1 trillion in guarantees.

The NAO recommended that there needed to be clarity regarding the reporting of government debt and the measures used to aid transparency. These needed to focus on the reporting needs of Parliament and taxpayers and encouraged the use of Public Sector Net Financial Liabilities (PSNFL) measure to inform management of the Balance Sheet and asset sales approach.



Recommendations in the C&AG Report on the WGA

In addition to the reports the NAO also made recommendations in the Report of the Comptroller and Auditor General⁶¹⁾ to the WGA 2017–18 to drive further improvement to the data and encourage greater use of the insights from the WGA to manage fiscal risk and consider sustainability of public finances.

It is evident in the following years that Treasury have implemented many of the recommendations made by the NAO and are continuing to work on the remainder, although progress has stalled in the wake of the pandemic.

Balance Sheet Management

In the 2017 Budget statement the Chancellor of the Exchequer announced a review of the Balance Sheet. “to make more effective use of these holdings, looking at areas such as estates optimisation, improving the return on investments, and reducing the cost of liabilities. The Review will help to release resources for further investment in public services and improve the sustainability of the public finances⁶²⁾”.

The review was concentrated on examining how balance sheet management could release previously untapped resources to improve public services and improve the sustainability of public finances; how to make more effective use of public sector assets (including under-recorded and under-exploited knowledge assets) and how to manage exposure to public sector liabilities and to make the case for why balance sheet management matters. This was also an opportunity to build on the recommendations that the NAO had made in their WGA audit and other reports.

61) WGA 2017-18

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/803751/WGA_2017-18_WEB_1.pdf

62) Autumn Budget 2017

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/661480/autumn_budget_2017_web.pdf

This led to the creation of the Balance Sheet Management team. The team has 10 staff from different professional backgrounds including economics and policy expertise and accountants and the head of the Balance Sheet Management team has substantial experience having worked on the WGA since 2011.

The team works across Treasury such as the departmental Spending Teams to promote best practice and develop and embed new guidance to better management balance sheet risks such as contingent liabilities. The team have also worked with the OBR to examine the government 'boundary' issues to align the WGA to the National Accounts and later with other government departments and agencies such as with the UKGI to lead the Contingent Liability Central Capacity. This cross-government collaborative approach ensures that the risks and opportunities arising from balance sheet insights is located with those with the responsibility and best able to manage these effectively.

The Balance Sheet review approach was to make more effective use of UK's holdings, to release resources for further investment in public services and improve the sustainability of the public finances.

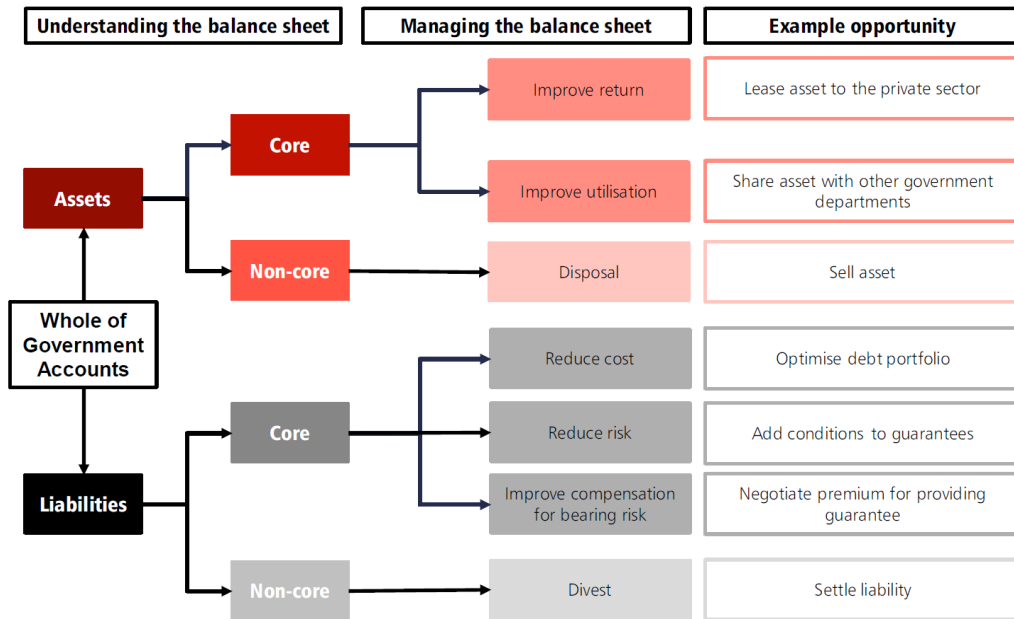
Initially the team focused on how to use the Balance Sheet to increase government income. Better asset management could yield up to 3% of GDP annually; to reduce debt interest costs as countries with higher net financial worth pay lower interest and increase resilience to shocks as IMF found that countries with stronger balance sheets experience shorter and shallower recessions⁶³).

The approach was to understand the balance sheet to then manage it through different activities (per figure 15)

63) IMF found in a sample of emerging and advanced economies, a 1% GDP increase in government net worth/net financial worth lowers yields on government borrowings by some 0.7/0.6 bps, while a 1% increase in gross debt corresponded to a 1 bp increase in yields. 'Fiscal Monitor: Managing Public Wealth', IMF, October 2018



Figure 15 Balance Sheet Management Approach

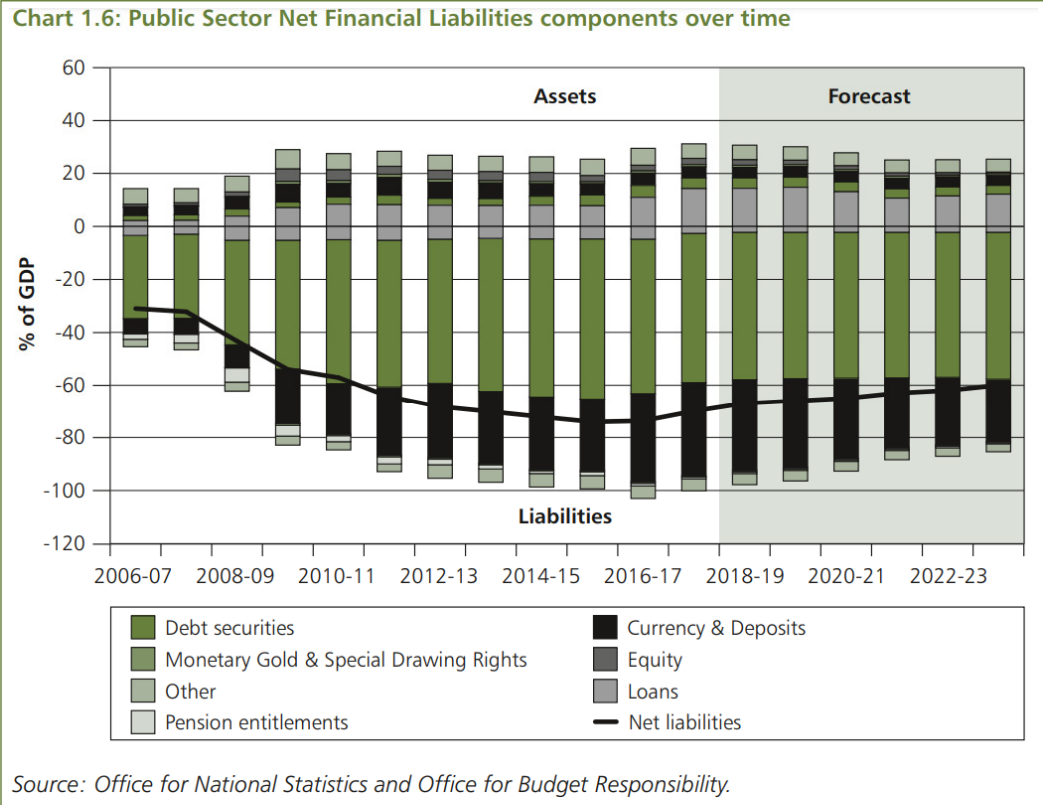


In the first year of the review the team were able to make substantial progress as reported in the Budget 2018⁶⁴):

- Improved Balance Sheet reporting: building on the information in the WGA the OBR produced the first 5-year forecast balance sheet (figure 13) and to implement the IMF Government Financial Statistics Manual.

64) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/752202/Budget_2018_red_web.pdf

Figure 16 OBR first 5-year forecast balance sheet



- Intangible Assets: to obtain a better return on the £150bn intellectual property⁶⁵⁾ and other intangibles and the launch of the Getting smart about intellectual property strategy⁶⁶⁾. The strategy highlights the stark difference between the recognition of knowledge assets in the leading private sector companies compared to government, hence the opportunity for government.

65) SPINTAN database of intangibles in public sector <http://www.spintan.net/spintan-data/>

66) Getting Smart about intellectual property and other intangibles in the public sector <https://www.gov.uk/government/publications/getting-smart-about-intellectual-property-and-intangible-assets>

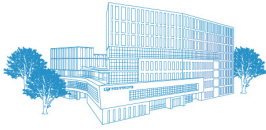
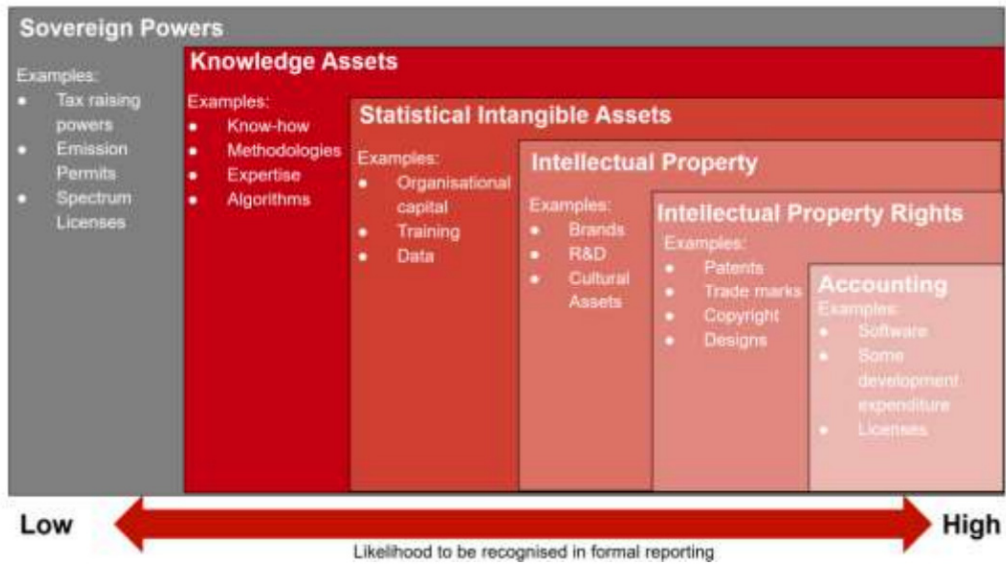


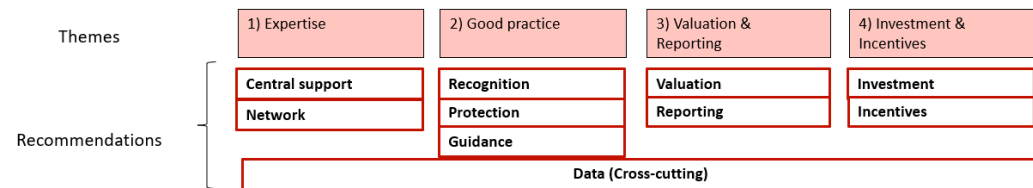
Figure 17 Getting smart about intellectual property: Spectrum of recognition



As seen in figure 14, a spectrum of intangible assets was developed, extending beyond the narrow accounting definition that is included on the government balance sheet.

In the report Treasury focused on intellectual property and intangible assets in the public sector made 10 recommendations clustered around the following four themes expertise, good practice, valuation and reporting and investments and incentives.

Figure 18 Getting smart about intellectual property: recommendations made in the report



1. **Central support:** create a centre of expertise to advise and support on the technical, legal, commercial and financial aspects of generating and exploiting knowledge assets
2. **Network:** develop a network of leaders and experts from across sectors to help generate value from knowledge assets, share best practices and exploit synergies cross government.
3. **Valuation:** create new standards and approaches for measuring and reporting knowledge assets in the public sector
4. **Recognition:** create a central database of government knowledge asset holdings and their value
5. **Protection:** register intellectual property assets with the most commercial potential to maximise their value.
6. **Reporting:** publish an annual report on the government's knowledge asset holdings with progress in their realization.
7. **Guidance:** devise and implement best practice protocols for development, protection and commercialisation of public sector knowledge assets
8. **Data:** as part of the National Data Strategy, explore how the public sector can further exploit its data and the associated knowledge assets it generates
9. **Investment:** develop financial, contractual, and organisational structures that facilitate knowledge asset commercialisation and effective partnerships with the private sector
10. **Incentives:** enhance organisational and professional incentives for knowledge asset development and exploitation⁶⁷⁾

- Public Finance Initiative and Public Finance II (PF2)

The Public Finance Initiative is a form of Public–Private Partnership, in which the upfront capital costs are paid by the private sector; in exchange, the government pays an annual “charge” that comprises repayment of the initial capital, interest on that initial capital, and ongoing maintenance usually this happens over a 25–30 year period. PFI was designed to be a partnership between private and public sector to share the risks and rewards of the asset. However, in reality this was not the case.

67) Getting smart about intellectual property and other intangibles in the public sector: Budget 2018
<https://www.gov.uk/government/publications/getting-smart-about-intellectual-property-and-intangible-assets>



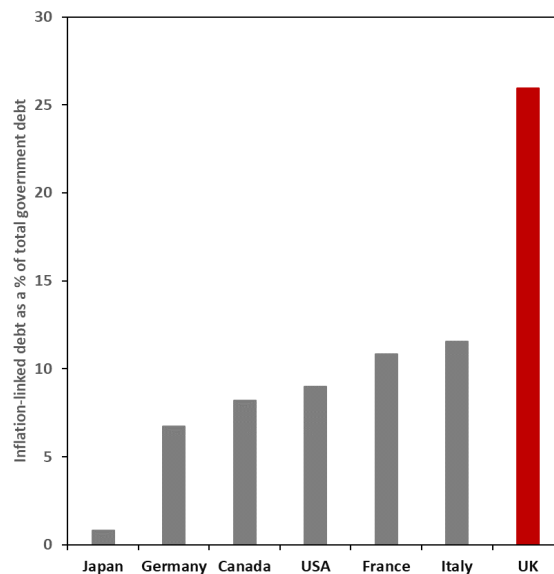
The NAO, PAC and OBR had criticised PFI as it was seen as overly complex, inflexible, and opaque. Therefore, the decision was taken to no longer use PFI.

A new centre of best practice was established in Department for Health and Social Care (DHSC) as there are a significant number of PFIs across the health service. As many of these approach the end of the PFI, the centre of excellence which is part of the Infrastructure and Projects Authority will provide expert support and advice to departments and contracting authorities⁶⁸⁾ in response to the NAO report on Managing PFI assets and services as contracts end⁶⁹⁾.

- Reduce inflation exposure

The OBR and NAO highlighted the risk posed by servicing government debt through the issue of government index linked gilts. In their analysis Treasury found that its exposure was considerably higher than other comparable countries (figure 19).

Figure 19 Share of Inflation-Linked Debt (G7 Countries) 2019



Source: Treasury analysis

68) PFI Centre of Excellence <https://www.gov.uk/government/collections/public-private-partnerships> (Feb 2021)

69) Managing PFI assets and services as contracts end (June 2020)

<https://www.nao.org.uk/report/managing-pfi-assets-and-services-as-contracts-end/>

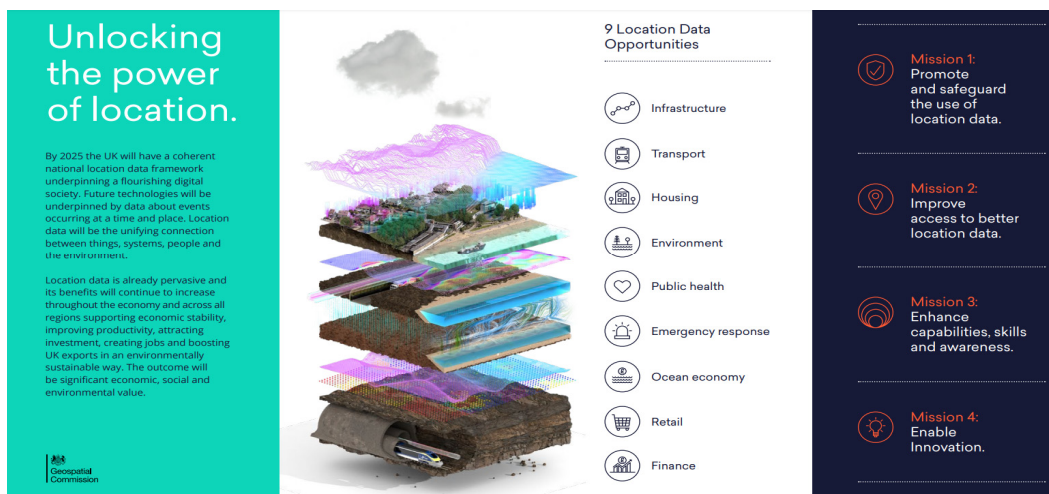
Government set a policy to reduce the proportion of gilts issued and to change the interest paid to savers (from the higher retail price index (RPI) measure to the lower consumer prices index (CPI) measure).

- Property

The Government Property Strategy 2018 was launched. This built on the 2014 strategy and the achievements including raising £2 billion in sales and saved £300 million per annum in running costs through the disposal of over 1000 properties and reduced the vacant space within central estate to only 1.5% (the private sector average is 7.5%), with an average property cost of £493 per sq m (£40 per sq m less than the average for the private sector)⁷⁰.

The geo-spatial digital national asset register⁷¹ was launched to ‘unlock the value of location’ by looking at assets from a citizen perspective rather than government structures such as central government, local government, education, health etc. The aim is to better manage and commercialize the £420 bn government property assets and bring the Whitehall estate onto a single balance sheet within 5 years.

Figure 20 Geospatial strategy 2020 to 2025⁷²

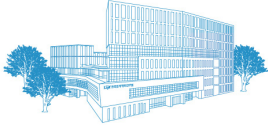


70) Government Property Strategy 2018

<https://www.gov.uk/government/publications/government-estate-strategy-2018>

71) <https://www.gov.uk/government/publications/unlocking-the-power-of-locationthe-uks-geospatial-strategy>

72) <https://www.gov.uk/government/publications/unlocking-the-power-of-locationthe-uks-geospatial-strategy>



- Debt owed to government
Over £20bn is owed to government. To recover more of this new performance management measures were introduced and £472m was recovered in 3 years.
- Contingent liabilities
This has been a significant area of focus as the risk exposure is increasing as identified in the FRR and the NAO. New controls were introduced over the issue of government guarantees and new guidance⁷³⁾ and controls has been implemented as a result 60 new liabilities totaling £158bn have been reviewed of which £1bn was rejected immediately and others were approved after significant modification to reduce risk exposure.
- Asset sales
New stricter disclosure requirements to be introduced for asset sales⁷⁴⁾ and revised budgetary treatment for financial transactions⁷⁵⁾ to remove any unintended consequences (as seen in the box below)

Asset Sales:

NAO found that the first sale of student loans in 2017 by the government raised around £1.7 billion. This was to ensure government policy to reduce government's headline debt measure of PSND was met. Whilst the sale of student loans for cash did reduce PSND by the sale value of £1.7 billion, it had the unintended consequence of increasing the broader measure of public sector net financial liabilities by £1.8 billion. It also resulted in a loss of £0.9 billion in the Department for Education's accounts for the year ended 31 March 2018, as the loans had been valued at £2.6 billion on its balance sheet.

73) Contingent liability approval framework: guidance July 2017
<https://www.gov.uk/government/publications/contingent-liability-approval-framework>

74) Asset sale disclosures: guidance for government March 2019
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/788708/asset_sale_disclosures_guidance_for_government_web.pdf

75) Amended in the Consolidated Budgeting Guidance (updated annually)

- The team also worked with specific departments to improve the management of balance sheets:
 - Working with DHSC to optimise £3.3bn sales proceeds enabling reinvestment. Develop a new strategy to manage the rising cost of clinical negligence liabilities. For instance, obstetrics represented 10% of the total number of cases in 2018–19 (1,076 cases) but represented 50% of the total value of the claims at £2.5bn⁷⁶).
 - Working with Ministry of Defence to optimise the value from the rural and built estate which is 1.8% of UK land mass valued at £32bn. The Defence estates optimisation programme aims to reduce the estate by 30% by 2040.
 - Working with the Department for Transport to commercialise the value of transport assets and use the surrounding land for social housing.

Balance Sheet Review Report

The Balance Sheet Management team built on work achieved and presented the Balance Sheet Review Report⁷⁷) published November 2020 alongside the Spending Review⁷⁸). The report showcased successes and achievements of the balance sheet approach. Underpinning the work of the Balance Sheet Management team is the new Balance Sheet Framework (figure 21)

76) Resolution Foundation

<https://resolution.nhs.uk/2019/07/11/clinical-negligence-numbers-steady-but-rising-costs-remain-a-concern/>

77) The Balance Sheet Review report

<https://www.gov.uk/government/publications/the-balance-sheet-review-report-improving-public-sector-balance-sheet-management>

78) Spending review 2020

<https://www.gov.uk/government/publications/spending-review-2020-documents/spending-review-2020>

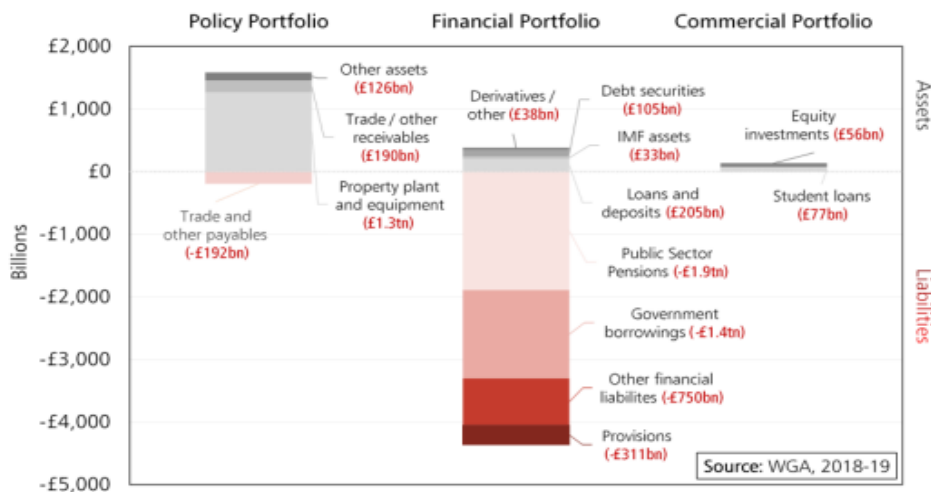


Figure 21 Balance Sheet Management Review Report

Box 2.A: Public sector balance sheet framework

Policy portfolio	Financial portfolio	Commercial portfolio
<p>Composition: fixed and specialised assets, e.g. schools, hospitals, defence</p> <p>Management objectives: support government policy objectives, e.g. delivery of public services, and achieve value for money</p> <p>Governance: ministers establish policy objectives, and decide when to buy and sell assets</p> <p>Exit strategy: assets held until they no longer serve a policy purpose, and then sold to achieve value for money</p>	<p>Composition: financial assets, e.g. equity stakes, forex reserves, pensions</p> <p>Management objectives: build buffers for future shocks, fund liabilities from contractual obligations</p> <p>Governance: ministers decide liabilities to be funded. Assets managed professionally arm's-length from the government</p> <p>Exit strategy: assets sold when required for liquidity purposes, when liabilities materialise, on discretion of fund managers</p>	<p>Composition: state owned enterprises, public corporations</p> <p>Management objective: achieve public interest objectives and maximise returns while limiting risk for taxpayers</p> <p>Governance: assets managed arm's-length from the government, subject to ministerial mandates</p> <p>Exit strategy: asset sales conducted by fund managers, subject to overall ministerial mandates</p>

UK balance sheet by portfolio classification, 2018-19



Source: Treasury

The framework is based on international best practice, New Zealand and the IMF COFOG standards⁷⁹⁾. There are three stages:

1. Split public sector assets and liabilities into three portfolios: policy, financial and commercial.
2. Align the long-term management objectives, governance and exit strategies for each portfolio to optimise portfolio management.
3. Identify portfolio management opportunities for similar assets/liabilities to improve risks and returns.

The balance sheet management approach and framework sought opportunities to increase balance sheet efficiency centred around three core aims:

- **Transparency** to make the long term impact of policies on the balance sheet
- **Asset management** to deliver better value for money
- **Risk management** by strengthening controls of long term risks and costs of liabilities.

The report goes on to showcase what has been achieved in each aim:

Transparency

The Balance Sheet approach has strengthened fiscal decision making by looking at the entire public sector balance sheet which extends beyond public debt.

79) 1 'The International Handbook of Public Financial Management', Allen R., Hemming R., Potter B.H. (eds) 'Chapter 26 The Development and Use of Public Sector Balance Sheets', Warren K. 2013

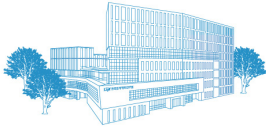


Figure 22 Reconciliation of the National Accounts to the WGA (extract from WGA 2018–19)

	National Accounts measures			WGA
	Public Sector Net Debt	Public Sector Net Financial Liabilities	Public Sector Net Worth*	WGA Net Liabilities
Assets			Non-financial assets	Non-financial assets
		Illiquid financial assets	Illiquid financial assets	Illiquid financial assets
	Liquid financial assets	Liquid financial assets	Liquid financial assets	Liquid financial assets
Liabilities	Government borrowing	Government borrowing	Government borrowing	Government borrowing
		Other financial liabilities	Other financial liabilities	Other financial liabilities
		Funded public sector pensions	Funded public sector pensions	Funded Public sector pensions
			Unfunded Public sector pensions*	Unfunded Public sector pensions
			PFI contracts*	PFI contracts
				Provisions

* Unfunded public sector pensions and PFI contracts will be included in the Government Financial Statistics Manual measure of PSNW, but not in the European Statistics Agency 2010 based measure

Source: WGA 2018-19

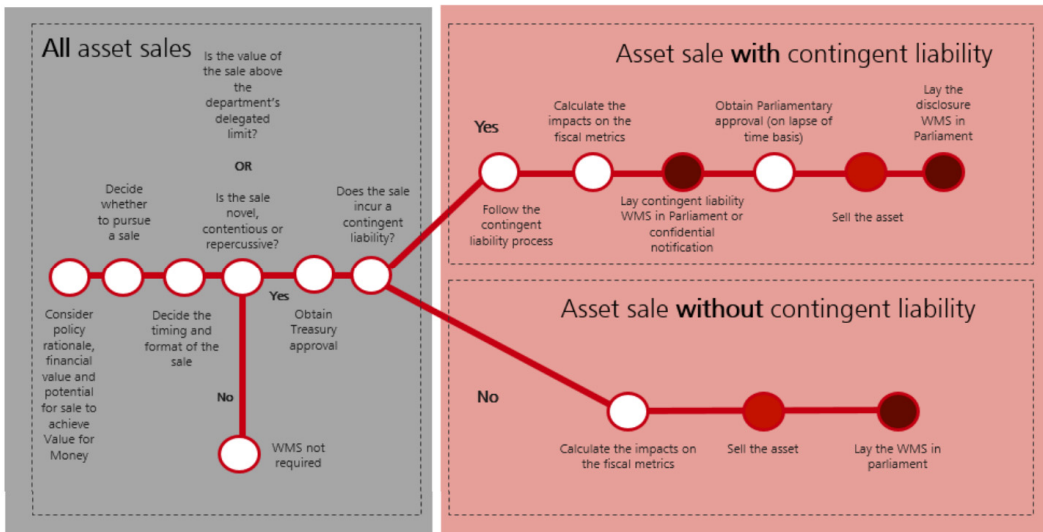
The approach means better informed asset disposal/acquisition decisions or to incur or settle a liability and to disclose the impact of asset sales as discussed in greater detail in the next section.

Asset Management

1. Recognize long term impact of spending decisions so that short term policies do not adversely impact long term. New budgetary rules⁸⁰⁾ were developed to allow government entities to retain income from sale of assets. Previously government departments were not able to retain any additional income from the sale of government assets over and above that which was forecast which disincentivized the department to secure higher sales figures.

80) In the latest edition of the Consolidated Budgeting Guidance 20-21.

Figure 23 Approach for government departments to follow when considering asset sales

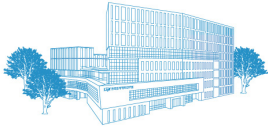


All sales are disclosed in departmental accounts at year end and then consolidated into the Whole of Government Accounts

In addition, arbitrary asset sales targets have been removed in favour of the principle to ensure sales that achieve value for money. The Spending Review 2015 set a requirement to achieve £5bn income from the sale of assets. The axiom, what gets measured gets managed is so apt. The measure was to achieve the income target. This is likely to have led to unintended consequences for government by prioritising short term objectives over what is best for the taxpayer longer term by leading to the sale of assets for less than should have been achieved (see box below).

Sale of Admiralty Arch

The iconic admiralty arch that sits at the end of the Mall on one side and Trafalgar Square on the other was disposed of for £60m. Today the first residential apartment in the complex that includes a hotel is being sold for £150m. Questions will invariably be raised as to whether government was able to secure the most from the sale of such a landmark asset steeped in history.



2. Departments are now required to show how they will improve balance sheet management. Departments will need to consider: what strategies will be used to improve returns from core assets? What are the plans to reduce the cost and/or minimise the risk of core liabilities? How can they improve compensation for bearing risk? How will they identify assets that are not fulfilling a policy objective that should be disposed? Addressing these questions will lead to a greater understanding of the balance sheet in spending allocations.
3. Ensure assets are financed and managed to achieve long term value for money. The PFI and PF2 schemes were retired as discussed previously. However, there are still 700 such schemes used to build schools, hospitals, prisons, waste management, energy from waste infrastructure, housing, military accommodation, and equipment. The PFI cost is £10bn annually.
The exposure of significant long-term risk was highlighted by the WGA compared to the National Accounts measure: PFI Public Sector Net Debt was £6bn whereas the PFI liability in the WGA was £39bn.
4. BST, working in collaboration with the Government Property Office and government departments found that better maintenance of assets extended the estimated useful economic life (EUEL) of public sector assets, reducing long term costs associated with having to replace assets. Research highlighted that deferring asset maintenance had an incremental detrimental effect on asset lives, raising costs by 1.5 times in 2–4 years. Treasury developed new guidance to promote better asset maintenance/management which has yielded significant savings⁸¹).
5. Apply best practice in asset management to optimise returns
Various initiatives were implemented as reported in the Budget 2019. Work on these continued on these such as seeking to capture the increase in land values where transport infrastructure is developed. Typically, house prices increase by 30% closer to transport infrastructure development.

81) Balance Sheet Review Report 2020

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/937804/The_Balance_Sheet_Review_report____.pdf

6. Improve returns from foreign currency reserve savings

In October 2020 £177bn foreign exchange was held in the Exchange Equalisation Account (EEA). A review by the BSR, Bank of England and Treasury implemented a step change. The objective was reset to focus on the tradeoff between policy readiness, financial risk, and investment return. The impact is to extend the EEA investment horizon, broadening the range of assets in which reserves are invested and reducing the proportion of reserves that is hedged for foreign exchange risk.

7. Improve the management of financial assets to deliver value for money

The BSR reviewed whether it is best for government to hold assets against liabilities. Where all the financial risk sits with central government, it is generally more efficient to fund these liabilities through gilt financing when required. Where the government holds existing assets against liabilities, it should consider retaining them unless there is a strong value for money rationale for disposal and it supports wider policy considerations. Examples include the changes to the local government pension scheme (box below) and nuclear decommissioning costs (box overleaf).

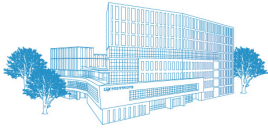
Local Government Pension Scheme (LGPS)

The LGPS is one of the top 6 funded schemes globally and comprises 86 administering authorities with 6.1m members and scheme valued at £272bn at 31 March 2020. In 2016 reforms have pooled the funds to diversify risk and lower costs and delivering savings of £300m.

Nuclear Decommissioning Costs

One of the largest provisions on the WGA is the cost of nuclear decommissioning 8 nuclear plants which is currently forecast at a cost of £149.1bn up to 2137. The long-time scales add significant uncertainty in able to accurately quantify the potential commitment.

A Nuclear Liabilities Fund has been set up to meet the long term costs. The Fund was able to take remedial action to redress shortfalls in yields.



Risk Management

1. Inflation risk exposure from government

Government Gilts

To mitigate the risk of inflation exposure on government bonds by reducing the proportion of indexed linked gilts issued to 4.9% in 2019–20. This change addressed the risks identified by the OBR in the FRR 2017.

2. Control of local government purchasing commercial property

Local Government Purchasing Controls

Local government have been increasing its investment in commercial property to generate income to help fund public services. LG can use Public works Loan Board (PWLB) to borrow at low rates. This exposes the sector to increased risks and volatility in the housing market. Treasury have launched a consultation to change policy by impose purchasing controls to manage risk exposure.

3. Clinical negligence

Clinical Negligence

Clinical negligence claims are the second largest provision and rapidly increasing: In 10 years the number of cases has doubled, and payments quadrupled. Possible future payments and legal fees are forecast to increase by over 550%, rising from £700 to £3,600 per household). This is unsustainable.

A cross government review focused on preventative measures and patient safety. Obstetrics was identified as the highest value of the claims hence pilots were launched as part of the maternity services strategy looking to reduce the devastating impact on brain injury. This is both the morally right thing to do as well as best for the sustainability of public finances.

In addition, legal costs have been limited fixed costs for claims to £25,000.

4. Charge private sector for risk borne by taxpayers.

Several large corporate failures have demonstrated that government has been the insurer of last resort⁸²⁾ As a result Treasury is developing options to charge fees to cover the expected cost for the guarantees and insurance provided. This approach will have a double benefit: firstly, this approach reduces the government's total risk exposure and incentivizes corporates to better manage their risk.

Forward Look

The BSR will focus on further improving Balance Sheet Management and have several projects and initiatives in progress including:

- Better assessment of performance across portfolios
- Development and measurement of the balance sheet
- Further work with the ONS and OBR to develop forecast broader balance sheet metrics to improve decision making
- Embedding balance sheet management impact on spending decisions
- Establish fund to encourage investment in intangibles
- Strengthen risk management through the new CLCC
- Formalise risk management compensations
- Improve maternity safety pilots
- Develop the tax approach to derive £7bn public value over 10 years from land adjoining new transport links i.e. train stations
- Balance sheet management to be used to support the COVID19 response
- Review balance sheet and risk exposure in the context of climate change and developing a greener economy.

82) Government as Insurer of Last Resort (March 2020)

<https://www.gov.uk/government/publications/government-as-insurer-of-last-resort--2>



Challenges and Opportunities

The approach to fiscal risk reporting and the management of government assets and liabilities is one of the most sophisticated globally and is continuously advancing, by developing and applying international best practice. However, there are opportunities to make further improvements.

The Public Administration and Constitutional Affairs Committee (PACAC) report on Accounting for Democracy⁸³⁾ and the follow up report⁸⁴⁾ observed that the financial statements do not fully achieve the aim to deliver transparency and accountability to Parliament, the taxpayer, and the citizen. The report made several recommendations to put the user at the heart of the presentation of the financial statements so that these are readable and user friendly.

Treasury accepted the recommendations. A working group was established to make data available in a downloadable format (such as a CSV or excel file) so that the data can be used internal and external to government by independent think tanks such as the Institute for Government (IfG) and the Institute for Fiscal Studies. Disappointingly, external users like thinktanks do not use much of the information in the accounts to measure government performance. For instance, the IFG publish the Whitehall Monitor⁸⁵⁾ annually which brings together over 100 datasets to provide information on central government data on staff, diversity etc. an engaging presentational style. The IFG also provide the Performance Tracker⁸⁶⁾ with CIPFA to assess performance in key policy areas. These

83) Accounting for democracy: making sure Parliament, the people and ministers know how and why public money is spent <https://publications.parliament.uk/pa/cm201617/cmselect/cmpubadm/95/95.pdf>

84) Accounting for Democracy Revisited: The Government Response and Proposed Review <https://publications.parliament.uk/pa/cm201719/cmselect/cmpubadm/1197/1197.pdf>

85) Institute for Government <https://www.instituteforgovernment.org.uk/publications/whitehall-monitor-2021>

86) Institute for Government and CIPFA Performance Tracker <https://www.instituteforgovernment.org.uk/our-work/performance-tracker>

include prisons and reoffending etc. but these do not refer to the WGA. In their 2017 report, PACAC also noted that few Parliamentarians use these accounts⁸⁷). Note that whilst the audited accounts provide a lot of information, they do not include everything, so there will always be a need to supplement with other data sources.

Also, the Government and other bodies such as the NAO and House of Commons Scrutiny Unit need to educate and upskill the users to be confident to approach the annual accounts to be able to gather insights. The annual reports are designed to provide transparency and accountability for public finances. However, if the reports are not used then this aim is not achieved. It would be helpful to guide users of the accounts by signposting a series of questions such as: are the accounts qualified? Did the department deliver what it said it was going to? Is there a good appreciation of the risks facing the departmental policy options and what is it doing to manage and mitigate the risks? To more complex areas such as explain the long-term commitments and liabilities. Parliament's Scrutiny Unit⁸⁸) prepare various explanatory reports⁸⁹) for Members to aid their understanding and review of the accounts (Ferry, Midgley and Honeysett⁹⁰). The challenge is to go beyond the accounts to provide information that the users want in an understandable and accessible format.

In making the information more accessible there needs to be a greater public sector focus. The application of the same international financial reporting standards as are applied to the private sector has elevated the quality and completeness of the accounts. However, the accounts need to be converted into meaningful data to enable insight. For example, the profit or cash flows do not really work as measures in the public sector. The move to implementing Public Value⁹¹) will help try to bridge the gap between input to output to outcomes.

87) Accounting for democracy: making sure Parliament, the people and ministers know how and why public money is spent <https://publications.parliament.uk/pa/cm201617/cmselect/cmpubadm/95/95.pdf> pp. 34-5

88) <https://www.parliament.uk/mps-lords-and-offices/offices/commons/scrutinyunit/>

89) <https://www.parliament.uk/mps-lords-and-offices/offices/commons/scrutinyunit/reports-and-publications/>

90) Holding the government to account for its finances: the "Unsung" heroes of the UK parliament scrutiny unit <https://www.emerald.com/insight/1096-3367.htm>

91) <https://www.gov.uk/government/publications/public-value-framework-and-supplementary-guidance>

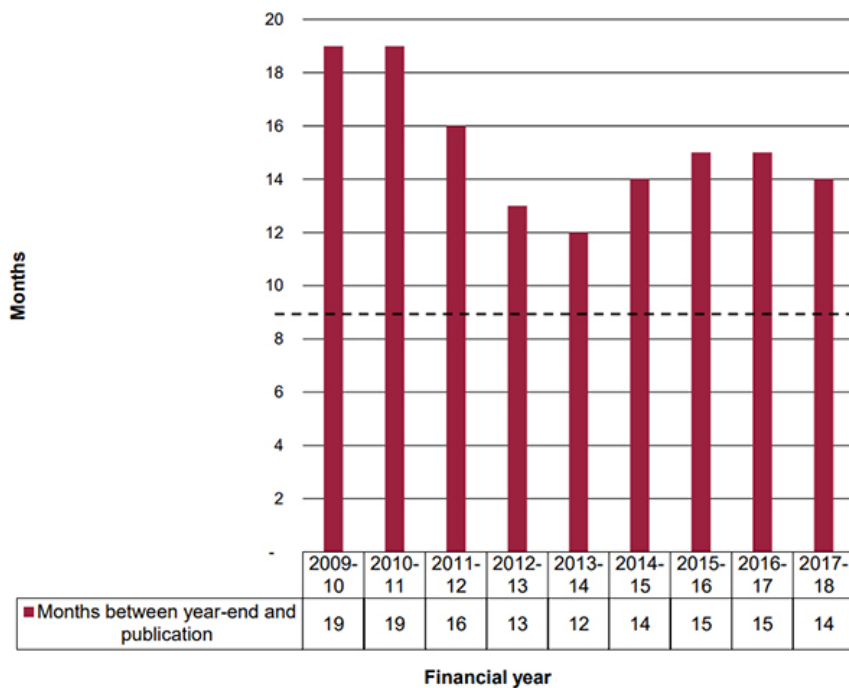


One of the biggest limitations of the WGA is the timeliness. The publication of the WGA has improved as acknowledged by the NAO⁹²⁾ but it is still more than a year after the end of the financial year end. This makes it less relevant to political debate which is focused on contemporary issues. Treasury are committed to delivering the WGA quicker but are subject to delays in the preparation of the underlying data. This has been exacerbated with the COVID19 environment where individual entities have been granted more time to prepare the accounts.

Figure 24 C&AG report extract

Timeliness of the Whole of Government Accounts

The Treasury typically publishes the WGA around 15 months after the end of the financial year



Source: WGA

92) https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/803751/WGA_2017-18_WEB_1.pdf

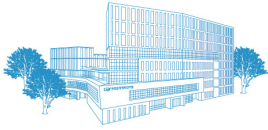
Conclusions

Significant progress has been made in strengthening fiscal risk management in the UK in a relatively short timeframe. By adopting international best practice established by IMF and OECD UK government has delivered significant improvements to risk management process, strengthened the framework, updated supporting guidance e.g. the Orange Book (management of risk) and Green Book (on how to appraise policies, programmes and projects), strengthen capability through the new creation of the CLCC.

The outsourcing of fiscal risk reporting to the independent OBR makes the UK an outlier amongst other countries in its approach. However, the OBR has quickly established itself as a credible and independent commentator delivering transparency to government future economic projections in the twice yearly Economic and Fiscal Outlook publications, the fiscal risks and sustainability reports. The OBR has brought issues to the fore such as the increase in contingent liabilities in the WGA. Treasury, in response to the findings and recommendations, have corralled all levers of government to work together to deliver tangible benefits through a combination of changes in policy, guidance, rules and regulations, training etc. The UK Government acknowledges that risks cannot be eliminated but they can be better managed, to deliver upside benefits and avoid downside disbenefits.

The OBR has been able to draw on the WGA data working with the Balance Sheet Management Team to help identify trends, opportunities, and threats to assess the impact on long term fiscal sustainability of public finances.

Formalising the Balance Sheet management function and the creation of the approach and framework is yielding significant benefits across so many areas. Building on valuable insights from the NAO, OBR and collaborating across government the BSR demonstrates the areas to focus on and how to turn this into innovative opportunities such as the geospatial survey and ways to optimise knowledge assets as well as identify concerning trends such as the unsustainable growth in contingent liabilities or even exposing some



areas that were not serving government such as PFI.

There has been an increased professionalisation across government in areas such as the management of contingent liabilities, or the management of government gilts to reduce exposure to interest rate fluctuations or its exposure as lender of last resort (where experts have been drafted in to consider options for how the government deals with this responsibility).

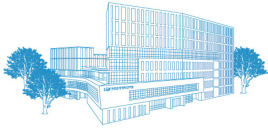
The balance sheet approach has raised wider questions such as how to ensure the right decisions are encouraged through spending controls and how to incentivize attention to long term rather than short term gains (for example through looking at the disposal of assets through value for money rather than income maximization). As a result of the BSR the budgeting guidance has been changed.

The challenge is to get even more engagement with decision makers by highlighting the value of the government balance sheet by demonstrating the art of the possible. But transparency is a double-edged sword especially in a public sector context.

By combining the benefits of statistics (GFS) and government financial reporting – the former provides data quickly at a high level, the Govt Financial Reports provides granular information on individual government entities and importantly these have all been subject to independent audit review, UK government is well placed to provide insight to deliver policy outcomes in a sustainable way.

Annex 1: Meetings

Olivia Halliday	Head of the Treasury Balance Sheet Management Team
Graham Prentice	Balance Sheet Management Team
Muiz Agbaje	Balance Sheet Management Team
Vicky Davies	National Audit Office
Graham Atkins	Institute for Government
Tom Pope	Institute for Government
Larry Honeysett	Head of the UK Parliamentary Scrutiny Team
Gavin Freeguard	Part of the Users & Preparers Advisory Group to implement the recommendations of the Accounting for Democracy Report (formerly head of data at IfG)
Jim Ebdon	Head of Fiscal Risk, Office for Budget Responsibility
Henry Midgley	Associate Director, University of Durham UK



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Author Biography

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Manj has over 25 years' experience working in public sector, focusing on implementation of accrual accounting across UK central Govt departments and the Whole of Government Accounts consolidation. She has advised several jurisdictions on implementing accrual accounting.

Manj has particular interest in supporting governments to address the practicalities of implementing IPSASs.

International
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Research

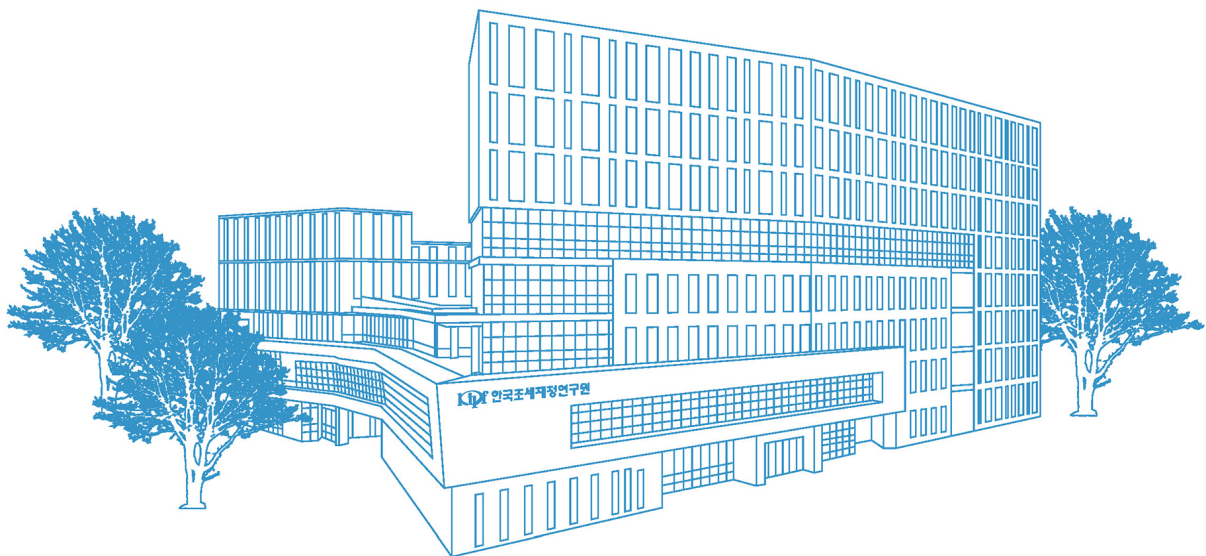
New Zealand

The Role of Accrual Accounting

Information in Fiscal Risk Identification and Management
a New Zealand Perspective

2021

Thu Phuong Truong





KOREA INSTITUTE OF PUBLIC FINANCE

Government Accounting and Finance Statistics Center

Statement of Submission

The research was undertaken by the agreement for the research project “USE OF ACCRUAL INFORMATION: Focusing on Fiscal Risk Identification and Assets and Liabilities Management” between the Korea Institute of Public Finance (KIPF) and NTF HOMES LIMITED.

Hence, this publication, *‘THE ROLE OF ACCRUAL ACCOUNTING INFORMATION IN FISCAL RISK IDENTIFICATION AND ASSETS AND LIABILITIES MANAGEMENT A NEW ZEALAND PERSPECTIVE’*, is a result from the agreement proposed by KIPF with the purpose to conduct an in-depth study on the use of accrual information in New Zealand.

Date Submitted: October, 2021

Signature: *Thu Phuong Truong*

Author of the report: Associate Professor

Thu Phuong Truong



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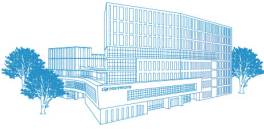
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The Role of Accrual Accounting Information in Fiscal Risk Identification and Management

I . Overview of the report

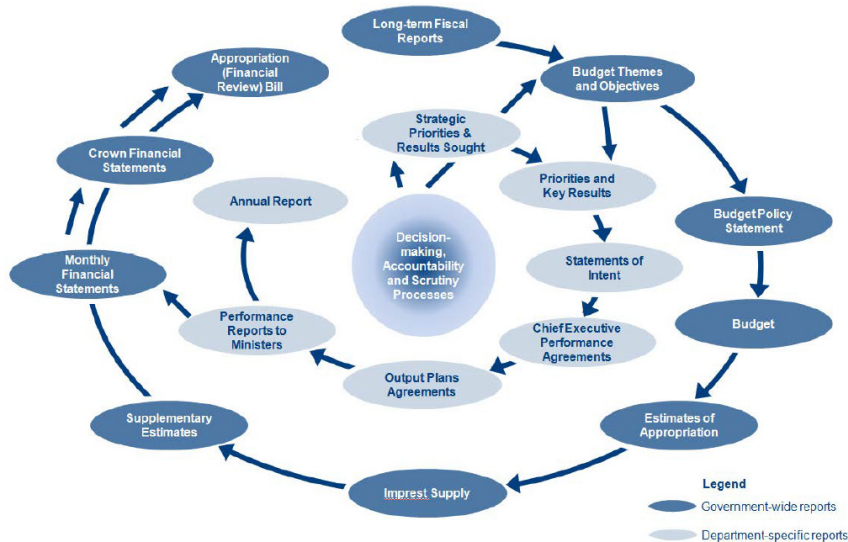
New Zealand's public financial management system is unique in its integrated use of accrual accounting throughout the whole system from the principles of responsible fiscal management contained in the Public Finance Act 1989 to the development of budget strategy and policy, appropriations, budget execution and monitoring, interim monthly and annual financial reporting and audit and review and feedback process (Ball, 2021). First, this research report thoroughly reviews the current implementation of accrual accounting in New Zealand's Central Government in three key areas: (1) fiscal policy and budgeting, (2) financial reporting, and (3) strategies and plans. Second, it presents the degree of usage of accrual accounting information in New Zealand. Third, it analyses the role of accrual information in two aspects: (1) fiscal risk identification, and (2) assets and liabilities management. Last, it identifies potential difficulties in assets and liabilities measurement under accrual accounting in New Zealand's Central Government.



II. The objectives of use of accrual accounting in New Zealand’s Central Government

The purpose of New Zealand’s public financial management system is to (1) help the government of the day translate its strategy into action, (2) focus spending on outcomes sought by the Government, (3) promote informed decision-making and accountability (4) identify and actively manage fiscal and non-fiscal risks, and (5) encourage a responsive, prudent, efficient and effective state sector. These five aims are accomplished through a thorough planning, decision-making and scrutiny process from budgeting, financial reporting, review and feedback and incentives for managing efficiently. Such process applies for both the whole government reporting entity and individual government entities (The Treasury New Zealand, 2011). The figure below shows key documents in the public financial management process where the outer (inner) cycles illustrate the process for whole government reporting entity (individual government entities).

Figure 1 Key Documents in the Financial Management Cycle



Source: The Treasury New Zealand, 2011, Putting It Together: An Explanatory Guide to New Zealand’s State Sector Financial Management System, Figure 1: Key Documents in the Financial Management Cycle

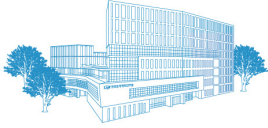
New Zealand' public financial management system is unique in its integrated use of accrual accounting throughout the whole system from the principles of responsible fiscal management contained in the Public Finance Act 1989 to the development of budget strategy and policy, appropriations, budget execution and monitoring, interim monthly and annual financial reporting and audit and review and feedback process (Ball, 2021). While cash-flow information has its own importance and is publicly available¹⁾, New Zealand Government chooses to use accrual accounting as accrual accounting provides records and reports on financial position and performance more comprehensively and accurately than cash accounting by itself (The Treasury New Zealand, 2011). It is stated clearly in the explanatory guide to New Zealand's public sector financial management system published by The Treasury New Zealand in 2011 that:

1. Accrual accounting measures expenses when incurred and revenue when earned. As accrual accounting captures the full cost of resources used to produce outputs, it provides better information to support costing, purchase, and ownership decisions than cash accounting provides.
2. Accrual accounting helps government agencies, and the Government as a whole, to present their financial positions in a balance sheet that sets out assets and liabilities of each reporting entity. The result is a clear picture of financial capacity at the reporting date.

The New Zealand public financial management system uses independently established financial reporting standards based on International Public Sector Accounting Standards, is of a high level of transparency, and has led to greater harmonisation with best international practice (Ball, 2021; Cordery and Simpkins, 2016, The Treasury New Zealand, 2011).

The integrated use of accrual accounting throughout the whole public financial management system significantly enhances the comprehensiveness and timeliness of information on financial position and performance, financial forecasts, and actual fiscal consequences of crisis responses (Ball, 2021).

1) New Zealand Government publishes cash-flow information together with accrual accounting information on its overall financial position and performance (The Treasury New Zealand, 2011).



III. Current implementation status of accrual accounting in New Zealand's Central Government

Accrual accounting is used consistently throughout the whole public financial management system in New Zealand, ranging from fiscal policy and budgeting, financial reporting to strategies and plans.

1. Fiscal policy and budgeting

New Zealand's fiscal policy and budgeting is solely based on accrual accounting information²). The Budget presents the financial and performance plans of the New Zealand Government for each financial year from 1 July to 30 June. The budget process forecasts revenues and expenses, states priorities and performance goals, and authorises spending of the New Zealand Government for the coming financial year. The budget effectively provides individual government entities certainty about allocated resources and expenditure. Specifically, the budget process allows New Zealand Government to (1) plan for the years ahead, (2) refresh policy priorities and set spending tracks, (3) allocate resources in line with priorities, and reallocate spending that is under-delivering against priorities and performance expectations, (4) set performance expectations for the period ahead, and (5) seek authority from Parliament for spending (The Treasury New Zealand, 2011).

The Budget specifically includes the Estimates, the Supporting Information and Statements of Intent.

1. The Estimates request authority from Parliament to incur expenses and capital expenditure in specific Votes (i.e. appropriation requests and appropriations are stated in accrual terms).

2) It should be well noted that even though New Zealand's fiscal policy and budgeting is solely based on accrual accounting information, cash flow information is also provided, primarily in the statement of cash flows in monthly and annual financial statements.

2. The Supporting Information describes how expenditure plans fit with government priorities, limit how money can be spent, lay out the outputs to be produced, explain changes in appropriations, and present performance indicators against which delivery can be assessed.
3. Statements of Intent provide more detail on outcomes sought by agencies using the appropriation and measures agencies will use to report performance.

(The Treasury New Zealand, 2011)

The Estimates

The Government's request for appropriations is presented to Parliament in a formal document known as the main Estimates (the 'Estimates of Annual Appropriations for the Government of New Zealand').

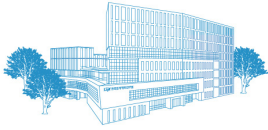
The Estimates detail appropriations sought from Parliament by Ministers for expenses and capital expenditure for a number of purposes, including classes of outputs. Information on the price, quantity and standards of, eg, outputs, is laid out in the Information Supporting the Estimates. The Information Supporting the Estimates also set out how appropriations are linked to the Government's priorities and intended outcomes.

Appropriation

An appropriation is a Parliamentary authorisation allowing a Minister to use resources for a specified purpose. Appropriations are limited by scope, by timeframe and to a maximum level of spending.

There are six appropriation types. The Government requests an appropriation for classes of outputs, capital expenditure (investment in agencies, and the purchase or development of Crown capital assets) and borrowing expenses. The other three types of appropriation are for benefits or other unrequited expenses, 'other expenses', and the expenditures of intelligence and security departments.

Source: The Treasury New Zealand, 2011, Putting It Together: An Explanatory Guide to New Zealand's State Sector Financial Management System, Section 3 Planning and Budgeting



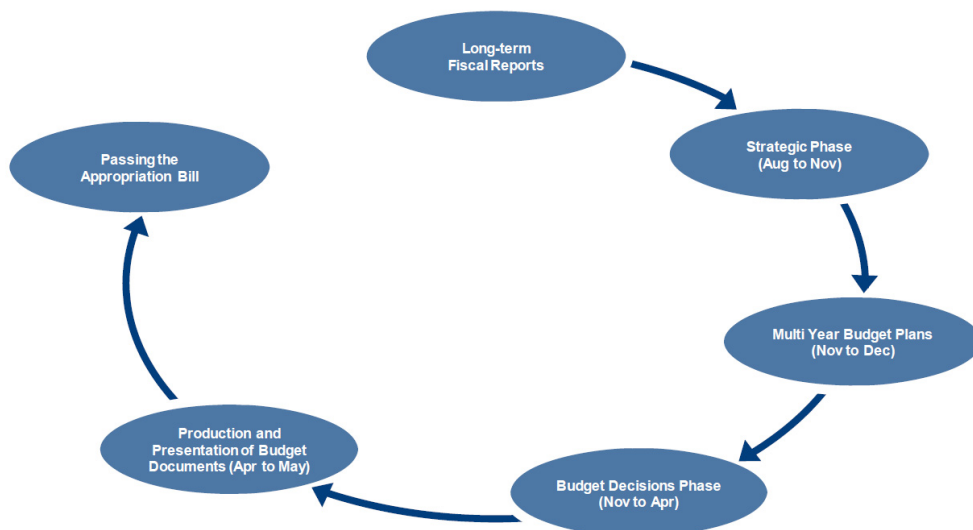
There are four steps in the annual budget process:

1. The strategic phase, when government priorities, intentions and spending limits are decided.
2. The budget decisions phase, which starts with Ministers submitting budget plans to deliver on the Government's priorities and intentions to live within spending limits over the coming years.
3. Production and presentation of budget documents on Budget Day.
4. Passing the Appropriation Bill

(The Treasury New Zealand, 2011)

The figure below presents phases of the Budget Cycle.

Figure 2 Phases of the Budget Cycle



Source: The Treasury New Zealand, 2011, Putting It Together: An Explanatory Guide to New Zealand's State Sector Financial Management System, Figure 3: Phases of the Budget Cycle

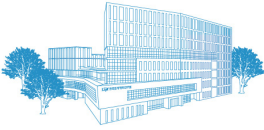
The Wellbeing Budget 2020 – Rebuilding Together and the Wellbeing Budget 2021 – Securing Our Recovery provides ample evidence for the use of accrual accounting information in the budget process.

1. The Government’s short-term intentions and long-term objectives for fiscal policy is demonstrated through the management of debt, operating balance, expenses, revenue, and net worth.

Table 1 Short-term intentions and long-term objectives

	Short-term intention	Long-term objective
Debt	Our intention is to allow the level of net core Crown debt to rise in the short term to fight COVID-19, cushion its impact and position New Zealand for recovery.	The Government will stabilise net core Crown debt as a percentage of GDP by the mid-2020s and then reduce it as conditions permit (subject to any significant shocks).
Operating balance	The Government will use fiscal policy to secure the economic recovery for New Zealand and reduce deficits over the forecast period as economic conditions allow.	The Government will run an operating balance consistent with meeting the long-term debt objective.
Expenses	Our intention is to ensure expenses are consistent with the operating balance objective.	The Government will ensure operating expenses support a responsible and proportionate role for the Government in maintaining a productive, sustainable and inclusive economy, consistent with the debt and operating balance objectives.
Revenue	Our intention is to ensure revenue is consistent with the operating balance objective.	The Government will ensure a progressive taxation system that is fair, balanced and promotes the long-term sustainability and productivity of the economy, consistent with the debt and operating balance objectives.
Net worth	Our intention is to use the Crown's net worth to fight COVID-19, cushion its impact and position New Zealand for recovery. Significant risks will be transferred onto the Crown's balance sheet through the response period.	The Government will use the Crown's net worth to maintain a productive, sustainable and inclusive economy, consistent with the debt and operating balance objectives.

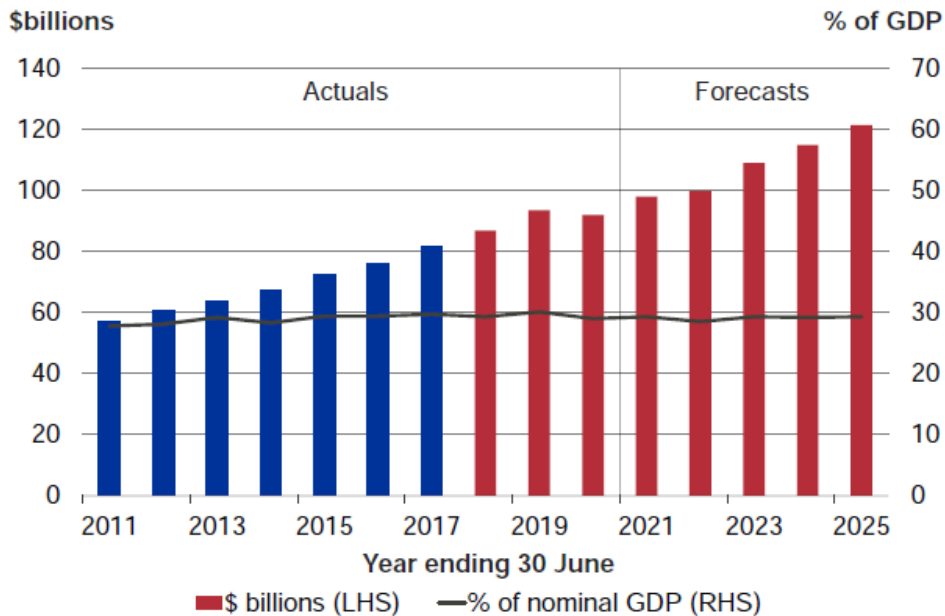
Source: New Zealand Wellbeing Budget 2021 – Securing our Recovery, Table 7 – Short-term intentions and long-term objectives



2. Revenues and expenses management:

Revenues management: The Core Crown revenue is forecasted to remain stable at an average of 29.1 percent of GDP. The key objective is to maintain a sufficient level of revenue to achieve targeted social, financial, and commercial expenditure while ensuring a sustainable fiscal outlook. The revenue level must be maintained at a level consistent with the goal to consistently reduce operating deficits and stabilise and reduce (if conditions permit) net core Crown debt as a percentage of GDP (Wellbeing Budget 2021).

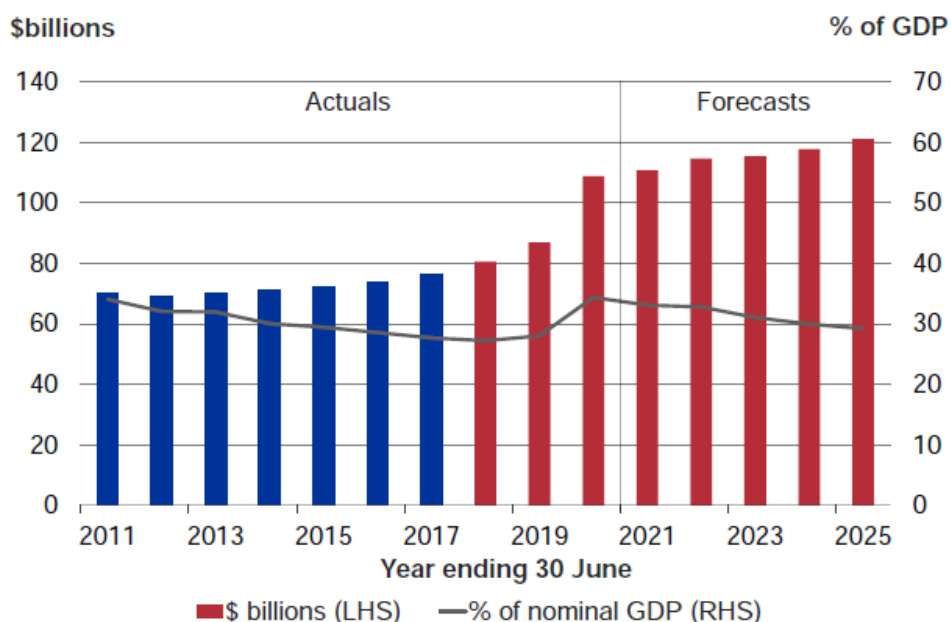
Figure 3 Core Crown revenue



Source: New Zealand Wellbeing Budget 2021 – Securing our Recovery, Figure 17 – Core Crown revenue

Expenses management: A balanced approach to manage Core Crown expenses is adopted where expenses are forecasted to decline as a percentage of GDP from 33.1 percent in 2020/2021 to 29.2 percent in 2024/2025. The forecast decline in Core Crown expenses has incorporated the fact of fiscal support to cushion the economic shock caused by the COVID-19 pandemic being gradually withdrawn.

Figure 4 Core Crown Expenses



Source: New Zealand Wellbeing Budget 2021 – Securing our Recovery, Figure 16 – Core Crown Expenses

3. Assets and liabilities management: The net worth has been used to cushion the impact of the COVID-19 pandemic and secure the recovery. While the Crown's current liabilities have increased through public borrowing to fund the recovery process, the net worth is forecasted to strengthen over time due to the Government's intention to stabilise and reduce (if conditions permit) net Core Crown debt as a percentage of GDP. The rebuilding of the net worth is extremely essential to ensure greater resilience against future shocks. The assets are strategically invested to improve the wellbeing of New Zealanders (e.g. \$3.8 billion for Housing Acceleration Fund, \$810 million for KiviRail to purchase new locomotives and wagon, and complete upgrades to mechanical facilities and invest in core assets, and \$700 million for District Health Boards to invest in new assets (Wellbeing Budget 2021).

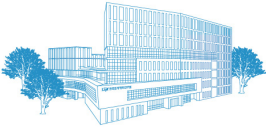
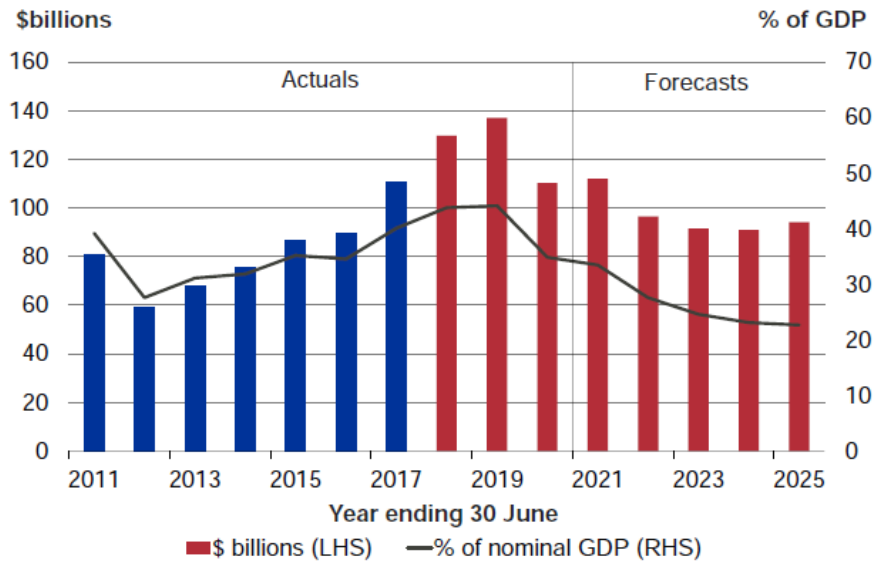
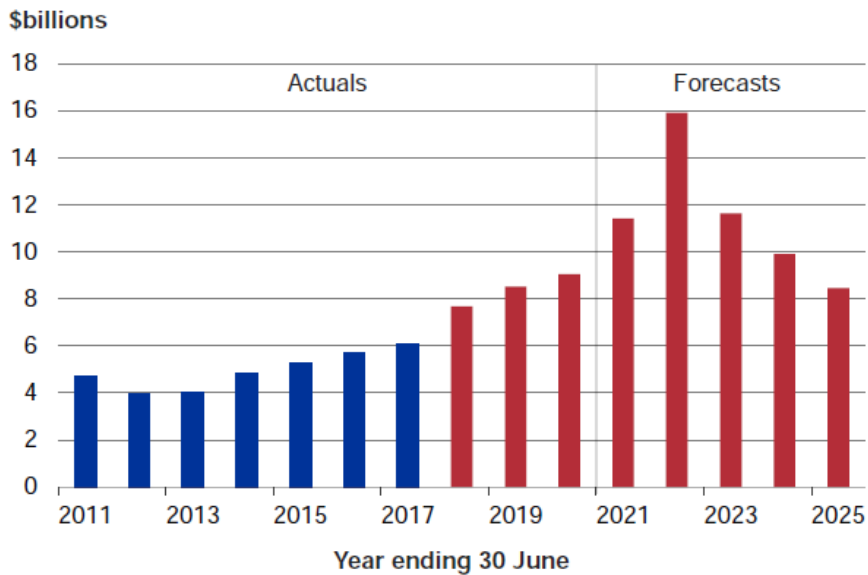


Figure 5 Net worth attributable to the Crown



Source: New Zealand Wellbeing Budget 2021 – Securing our Recovery, Figure 18 – Net worth attributable to the Crown

Figure 6 Net capital spending



Source: New Zealand Wellbeing Budget 2021 – Securing our Recovery, Figure 19 – Net capital spending

4. Fiscal forecasts and projections: All fiscal forecasts and projections and sensitivity analysis contained in the Budget are solely based on accrual accounting information (e.g. revenue, expenses, OBEGAL, operating balance, net debt, and net worth).

Table 2 Summary of fiscal projections

Year ending 30 June	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	...	2035
% of GDP	Forecasts					Projections							
Core Crown revenue	29.3	28.5	29.3	29.2	29.3	29.3	29.3	29.4	29.4	29.4	29.4	...	29.5
Core Crown expenses	33.1	32.8	31.1	30.0	29.2	28.7	28.6	28.6	28.5	28.4	28.3	...	28.0
Core Crown residual cash	-7.6	-11.2	-6.9	-1.5	0.8	0.9	-0.8	-0.6	-0.4	-0.1	0.0	...	0.6
Total Crown revenue	36.2	35.4	36.1	36.0	35.8	36.0	36.0	36.1	36.1	36.1	36.2	...	36.3
Total Crown expenses	40.7	40.6	38.5	37.3	36.3	35.9	35.9	35.9	35.9	35.9	35.9	...	36.0
Total Crown OBEGAL ¹	-4.5	-5.3	-2.6	-1.4	-0.6	-0.1	0.1	0.1	0.1	0.2	0.2	...	0.2
Total Crown operating balance ²	0.4	-4.5	-1.4	-0.2	0.7	1.3	1.4	1.5	1.6	1.7	1.7	...	1.8
Gross sovereign-issued debt	40.9	49.9	53.4	51.7	48.2	45.4	44.5	43.5	42.2	40.8	39.3	...	32.7
Net core Crown debt ³	34.0	43.8	48.0	46.9	43.6	40.7	39.7	38.6	37.3	35.9	34.4	...	27.8
Total Crown net worth	35.1	29.2	26.1	24.5	24.0	24.3	24.7	25.2	25.8	26.4	27.1	...	30.2
Net worth attributable to the Crown	33.5	27.6	24.6	23.1	22.7	22.9	23.3	23.8	24.3	25.0	25.7	...	28.7

Notes ¹ Operation balance (before gains and losses)

² Excludes minority interests

³ Excludes the NZS Fund and advances

Source: New Zealand Wellbeing Budget 2021 - Securing our Recovery, Table 9 - Summary of fiscal projections

Figure 7 OBEGAL

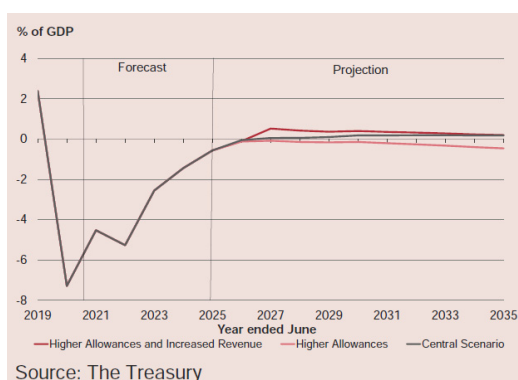
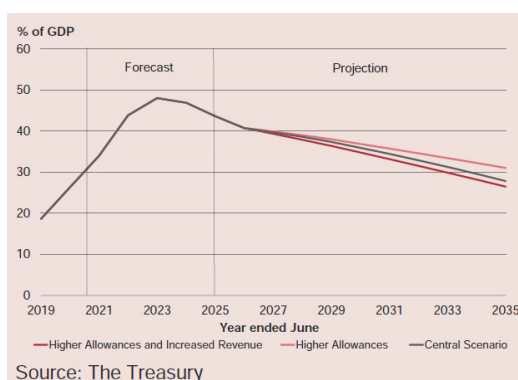
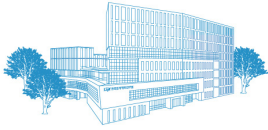


Figure 8 Net core Crown debt



Source: New Zealand Wellbeing Budget 2021 - Securing our Recovery, Figure 20 - OBEGAL and Figure 21 - Net core Crown debt



The Treasury New Zealand provides forecasts for Government finances and the economy through other important Budget documents titled Economic and Fiscal Updates. The Economic and Fiscal Updates provide a detailed statement of the Government's financial position including updated economic and fiscal forecasts, analysis of the fiscal position and summarise specific fiscal risks (refer to <https://www.treasury.govt.nz/publications/budgets/forecasts>). There are three types of Economic and Fiscal Updates.

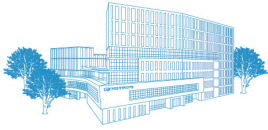
1. The Budget Economic and Fiscal Update: to be published with the main Budget documents in May annually.
2. The Half Year Economic and Fiscal Update: to be published in December annually.
3. The Pre-election Economic and Fiscal Update: to be published prior to a general election every three years.

One important feature of these Economic and Fiscal Updates is their sole reliance on accrual accounting information. Specifically, it is indicated in the Budget Economic and Fiscal Update 2021, Section Significant Accounting Policies that: (1) The Forecast Financial Statements have been prepared in accordance with the accounting policies that are expected to be used in the comparable audited actual Financial Statements of the Government. They comply with generally accepted accounting practice (GAAP) as required by the Public Finance Act 1989 and have been prepared in accordance with *Public Benefit Entity Financial Reporting Standard 42: Prospective Financial Statements*, (2) All forecasts use the accrual basis of accounting. Forecasts have been prepared for the consolidated Financial Statements of the Government reporting entity, which includes all entities controlled by the Government (as defined by applicable financial reporting standards), and (3) The Forecast Financial Statements reflect the accounting standards in place in the year that they are prepared. Adoption of new accounting standards in future financial years are consequently not reflected in these Forecast Financial Statements. Where accounting standards are to be adopted within the fiscal forecasts period, this has been signalled in the note disclosures where impacts may be significant.

Table 3 Fiscal indicators

Year ending 30 June	2020 Actual	2021 Forecast	2022 Forecast	2023 Forecast	2024 Forecast	2025 Forecast
\$billions						
Core Crown tax revenue	85.1	91.5	93.2	101.7	107.1	113.2
Core Crown expenses	108.8	110.7	114.7	115.4	117.8	121.1
Total Crown OBEGAL	(23.1)	(15.1)	(18.4)	(9.5)	(5.7)	(2.3)
Total Crown operating balance	(30.0)	1.3	(15.6)	(5.2)	(0.9)	3.0
Core Crown residual cash	(23.7)	(25.3)	(39.2)	(25.7)	(6.0)	3.3
Net core Crown debt	83.4	113.7	153.3	178.5	184.2	180.8
Gross debt	102.3	97.0	95.9	114.4	136.4	154.6
Total borrowings	152.7	173.2	215.2	245.2	254.5	255.1
Net worth attributable to the Crown	110.3	112.0	96.6	91.5	90.8	94.0
% of GDP						
Core Crown tax revenue	26.9	27.4	26.6	27.4	27.3	27.3
Core Crown expenses	34.4	33.1	32.8	31.1	30.0	29.2
Total Crown OBEGAL	(7.3)	(4.5)	(5.3)	(2.6)	(1.4)	(0.6)
Total Crown operating balance	(9.5)	0.4	(4.5)	(1.4)	(0.2)	0.7
Core Crown residual cash	(7.5)	(7.6)	(11.2)	(6.9)	(1.5)	0.8
Net core Crown debt	26.3	34.0	43.8	48.0	46.9	43.6
Gross debt	32.3	29.0	27.4	30.8	34.7	37.3
Total borrowings	48.2	51.8	61.5	66.0	64.8	61.6
Net worth attributable to the Crown	34.9	33.5	27.6	24.6	23.1	22.7

Source: New Zealand Budget Economic and Fiscal Update 2021, Table 2.1 – Fiscal indicators



2. Financial reporting

The Financial Statements of the Government of New Zealand are prepared on both audited annual and unaudited interim monthly bases. Both set of financial statements are prepared on a full accrual accounting basis as indicated in the Notes to the Financial Statements as below.

Notes to the Financial Statement

Note 1: Basis of Reporting

Statement of compliance

These financial statements have been prepared in accordance with the Public Finance Act 1989 and with New Zealand Generally Accepted Accounting Practice (NZ GAAP) as defined in the Financial Reporting Act 2013.

For the purposes of these financial statements, the Government reporting entity has been designated as a public benefit entity (PBE). PBEs are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.

These financial statements have therefore been prepared in accordance with Public Sector PBE Accounting Standards (PBE Standards) – Tier 1. These standards are based on International Public Sector Accounting Standards (IPSAS).

The use of public resources by the Government is primarily governed by the Public Finance Act 1989, the State Sector Act 1988, the Crown Entities Act 2004 and the State-owned Enterprises Act 1986.

These financial statements were authorised for issue by the Minister of Finance on 5 November 2020.

Source: The Financial Statements of the Government of New Zealand for the year ended 30 June 2020

Basis of Preparation and General Accounting Policies

These unaudited interim financial statements of the Government reporting entity comply with generally accepted accounting practice as defined in the Financial Reporting Act 2013 and have been prepared in accordance with Public Sector PBE Accounting Standards (PBE Standards) – Tier 1, as set out in PBE IAS 34: *Interim Financial Reporting*. The Government reporting entity is a public benefit entity. Public benefit entities (PBEs) are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders.

The measurement base applied is historic cost modified by the revaluation of certain assets and liabilities, and prepared on an accrual basis, unless otherwise specified (for example, the Statement of Cash Flows).

These financial statements have been prepared on a going concern basis.

Source: Interim Financial Statements of the Government of New Zealand for the ten months ended 30 April 2021

It is important to note that the Government's fiscal strategy via long-term objectives and short-term intentions for fiscal policy and balance sheet management are solely based on accrual accounting concepts, in including OBEGAL (Operating Balance before Gains and Losses), revenues, expenses, debt and net worth.

Table 4 Key fiscal indicators

Year ending 30 June						Forecast 30 June 2020	
	Actual 2016	Actual 2017	Actual 2018	Actual 2019 ¹	Actual 2020	Budget 2019 ¹	Budget 2020
\$millions							
Core Crown tax revenue ²	70,445	75,644	80,224	86,468	85,102	89,245	82,330
Core Crown expenses	73,929	76,339	80,576	86,959	108,832	93,344	113,998
Residual cash	(1,322)	2,574	1,346	(710)	(23,692)	(4,191)	(32,031)
Gross debt ³	86,928	87,141	88,053	84,449	102,257	86,845	99,427
Net core Crown debt	61,880	59,480	57,495	57,736	83,375	64,695	88,935
Total borrowings	113,956	111,806	115,652	110,248	152,717	118,005	164,799
OBEGAL ⁵	1,831	4,069	5,534	7,429	(23,057)	1,155	(28,293)
Operating balance ⁵	(5,369)	12,317	8,396	389	(30,040)	4,650	(35,491)
Net worth attributable to the Crown	89,366	110,532	129,644	136,949	110,320	131,846	100,093
Total net worth	95,521	116,472	135,637	143,339	115,943	137,680	106,018
% of GDP							
Core Crown expenses	27.3%	27.5%	27.4%	28.5%	27.6%	28.2%	28.0%
Residual cash	28.7%	27.8%	27.5%	28.6%	35.3%	29.5%	38.7%
Gross debt ³	(0.5)%	0.9%	0.5%	(0.2)%	(7.7)%	(1.3)%	(10.9)%
Net core Crown debt ⁴	33.7%	31.7%	30.0%	27.8%	33.2%	27.4%	33.8%
Total borrowings	24.0%	21.7%	19.6%	19.0%	27.0%	20.4%	30.2%
OBEGAL ⁵	44.2%	40.7%	39.5%	36.3%	49.5%	37.2%	56.0%
Operating balance ⁵	0.7%	1.5%	1.9%	2.4%	(7.5)%	0.4%	(9.6)%
Net worth attributable to the Crown	(2.1)%	4.5%	2.9%	0.1%	(9.7)%	1.5%	(12.1)%
Total net worth	34.7%	40.2%	44.2%	45.1%	35.8%	41.6%	34.0%
	37.1%	42.4%	46.3%	47.2%	37.6%	43.4%	36.0%

¹ The 'Actual 2019' and 'Budget 2019' comparators have been restated for the impact of new accounting standards effective from 1 July 2019. At this point in time, the earlier years in the table have not been restated. Refer to note 28 in the financial statements for more details.

² Core Crown tax revenue is higher than total Crown tax revenue owing to taxes paid by entities consolidated within Government.

³ Gross sovereign-issued debt excluding Reserve Bank of New Zealand (RBNZ) settlement cash and RBNZ bills.

⁴ Net core Crown debt excluding the New Zealand Superannuation Fund (NZS Fund) and advances.

⁵ Excluding minority interests.

Source: The Financial Statements of the Government of New Zealand for the year ended 30 June 2020, Table 1 - Key fiscal indicators



Table 5 Composition of the total Crown balance sheet

Year ended 30 June						Forecast 30 June 2020	
\$millions	Actual 2016	Actual 2017	Actual 2018	Actual 2019	Actual 2020	Budget 2019	Budget 2020
Financial assets	138,255	147,050	157,520	164,121	183,315	160,238	179,718
Property, plant and equipment	134,499	144,550	159,018	177,625	186,502	169,151	185,382
Other assets	19,925	22,009	23,394	22,906	23,583	22,644	21,555
Total assets	292,679	313,609	339,932	364,652	393,400	352,033	386,655
Borrowings	113,956	111,806	115,652	110,248	152,717	118,005	164,799
Insurance liabilities	42,126	42,786	45,294	58,216	66,690	50,610	60,533
Other liabilities	41,076	42,545	43,349	52,849	58,050	45,738	55,305
Total liabilities	197,158	197,137	204,295	221,313	277,457	214,353	280,637
Total net worth	95,521	116,472	135,637	143,339	115,943	137,680	106,018
Minority interests	(6,155)	(5,940)	(5,993)	(6,390)	(5,623)	(5,834)	(5,925)
Net worth attributable to the Crown	89,366	110,532	129,644	136,949	110,320	131,846	100,093

Source: The Financial Statements of the Government of New Zealand for the year ended 30 June 2020, Table 9 – Composition of the total Crown balance sheet

Similarly, the interim monthly financial reports providing updates on the Government’s financial position and performance toward the year end are anchored on key accrual accounting concepts in consistence with the accounting policies for the annual financial statements as below.

Table 6 Key indicators for the ten months ended 30 April 2021 compared to BEFU 2021

	Year to date				Full Year
	April 2021	April 2021	Variance ²	Variance	June 2021
	Actual ¹ \$m	BEFU 2021 Forecast ¹ \$m	BEFU 2021 \$m	BEFU 2021 %	BEFU 2021 Forecast ³ \$m
Core Crown					
Core Crown tax revenue	79,124	77,158	1,966	2.5	91,543
Core Crown revenue	84,606	82,525	2,081	2.5	97,942
Core Crown expenses	88,283	88,979	696	0.8	110,745
Core Crown residual cash	(19,207)	(21,937)	2,730	12.4	(25,277)
Net core Crown debt ⁴	107,505	110,077	2,572	2.3	113,655
<i>as a percentage of GDP</i>	33.9%	34.8%	(3,694)	(3.6)	34.0%
Gross debt ⁵	107,322	103,628			97,028
<i>as a percentage of GDP</i>	33.9%	32.7%			29.0%
Total Crown					
Operating balance before gains and losses	(5,048)	(8,614)	3,566	41.4	(15,127)
Operating balance (excluding minority interests)	12,133	6,665	5,468	82.0	1,274
Total borrowings	167,740	165,445	(2,295)	(1.4)	173,227
Net worth attributable to the Crown	122,887	117,457	5,430	4.6	111,990
<i>as a percentage of GDP</i>	38.8%	37.1%			33.5%

¹ Using the most recently published GDP (for the year ended 31 December 2020) of \$316,687 million (Source: Statistics NZ).

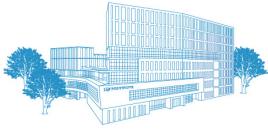
² Favourable variances against forecast have a positive sign and unfavourable variances against forecast have a negative sign.

³ Using BEFU 2021 forecast GDP for the year ending 30 June 2021 of \$334,399 million (Source: The Treasury).

⁴ Net core Crown debt excluding student loans and other advances. Net debt may fluctuate during the year largely reflecting the timing of tax receipts.

⁵ Gross sovereign-issued debt excluding settlement cash and Reserve Bank bills.

Source: Interim Financial Statements of the Government of New Zealand for the ten months ended 30 April 2021, Table 1 – Key indicators for the ten months ended 30 April 2021 compared to Business Economic and Update 2021



3. Strategies and plans³⁾

Investment statements: The Public Finance Act 1989 was amended in 2013 to require the Treasury to report to Parliament with an Investment Statement at least every four years. The Investment Statement must (1) describe and state the value of the Crown’s significant assets and liabilities, (2) state how those assets and liabilities have changed in value over time, (3) forecast how those assets and liabilities are expected to change in value in each of at least the next two financial years after the financial year in which the investment statement is presented, and (4) identify any significant differences between the information specified in paragraphs (a) to (c) and the equivalent information reported in the most recent previous investment statement. (<https://www.treasury.govt.nz/publications/strategies-and-plans/investment-statements>)

The most recent Investment Statement 2018 provides detail on balance sheet management and review and assessment of government investment performance in three dimensions (social, financial, and commercial).

Table 7 Balance sheet functional classifications

Social	Assets and liabilities held to provide public services. These include, for instance, roads, schools, and the national parks. For the purposes of this Statement, social assets also include tax receivables and student loans managed by the Inland Revenue Department (IRD), and Crown-owned companies that do not have purely commercial objectives such as Crown Research Institutes.
Financial	Assets and liabilities that finance or prefund government expenditure and obligations for future expenditure. This category consists of the Crown Financial Institutions (CFIs) ¹⁰ , the Reserve Bank of New Zealand, and government borrowing via the Treasury’s New Zealand Debt Management Office.
Commercial	Assets and liabilities of entities with commercial objectives. The companies are largely independent entities operating in competitive environments. This category comprises of commercial priority companies and listed companies.

Source: New Zealand Investment Statement 2018, Balance sheet functional classifications

3) Under the recent changes in the Public Finance Act and the new Public Service Act, the Treasury are required to regularly produce four reports: (1) Long-term Fiscal Statement every four years, (2) Long-term Insights Briefing every three years, (3) Investment Statement every four years, and (4) Wellbeing Report every four years.

Table 8 The government's balance sheet

June Years \$ millions	2005 Actual	2009 Actual	2013 Actual	2017 Actual	2018 Forecast	2019 Forecast	2020 Forecast	2021 Forecast	2022 Forecast
Assets									
Cash and cash equivalents	3,710	6,268	14,924	18,732	15,512	15,214	15,654	16,255	16,843
Receivables	10,883	14,619	19,883	18,529	18,900	19,876	20,588	21,988	22,220
Marketable securities, deposits and derivatives in gain	22,166	45,708	44,000	50,506	47,214	43,562	43,467	41,791	53,612
Share investments	10,896	11,160	17,359	30,700	34,512	36,492	38,749	42,838	47,138
Advances	8,536	15,604	22,613	28,583	29,411	30,428	31,280	32,015	32,735
Inventory	946	1,082	1,140	1,167	1,057	1,007	994	978	973
Other assets	453	1,630	2,295	3,079	2,619	2,661	2,661	2,679	2,698
Property, plant & equipment	67,494	110,135	109,833	144,550	149,323	154,300	157,627	158,638	160,278
Equity accounted investments	5,010	8,777	9,593	14,210	14,678	15,161	15,617	16,171	16,694
Intangible assets and goodwill	737	2,168	2,776	3,553	3,887	3,916	3,896	3,812	3,716
Forecast for new capital spending	..	..	..	..	304	2,269	4,734	7,479	10,199
Top-down capital adjustment	..	..	..	..	-1,100	-1,550	-1,800	-1,900	-1,950
Total Assets	130,831	217,151	244,416	313,609	316,317	323,336	333,467	342,744	364,796
Liabilities									
Issued currency	3,197	4,005	4,691	5,980	6,085	6,267	6,455	6,649	6,849
Payables	11,371	9,139	11,160	14,794	12,306	12,387	12,323	13,136	12,852
Deferred revenue	..	1,426	1,714	2,224	2,118	2,184	2,200	2,244	2,270
Borrowings	36,864	61,953	100,087	111,806	110,904	111,832	112,722	109,605	117,503
Insurance liabilities	11,384	26,567	37,712	42,786	43,364	44,186	45,784	47,721	49,708
Retirement plan liabilities	14,952	8,993	11,903	11,006	10,388	9,825	9,287	8,777	8,289
Provisions	3,080	5,553	7,138	8,541	8,704	8,328	7,892	7,499	7,071
Total liabilities	80,848	117,636	174,405	197,137	193,869	195,009	196,663	195,631	204,542
Net Worth	49,983	99,515	70,011	116,472	122,448	128,327	136,804	147,113	160,254
Total net worth attributable to the Crown	54,025	99,068	68,071	110,532	116,568	122,512	131,055	141,458	154,647
Net Worth attributable to minority interest	-4,042	447	1,940	5,940	5,880	5,815	5,749	5,655	5,607
Net Worth	49,983	99,515	70,011	116,472	122,448	128,327	136,804	147,113	160,254

Source: New Zealand Investment Statement 2018, The government's balance sheet

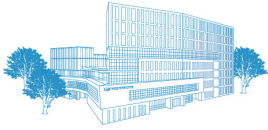
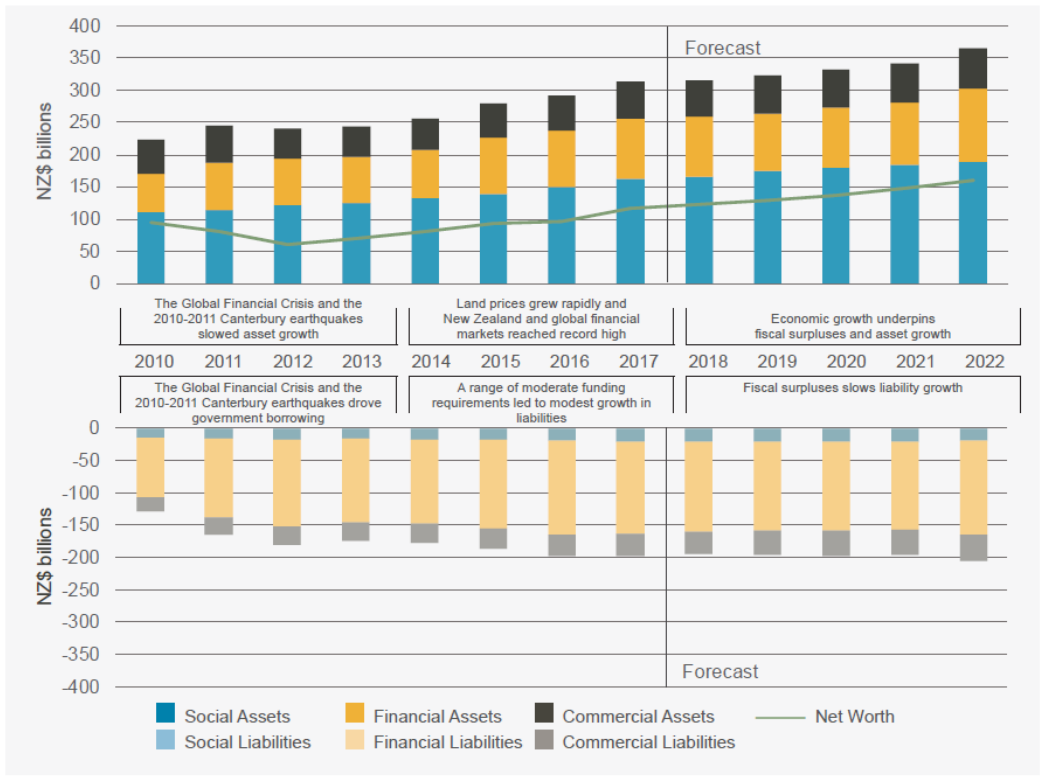


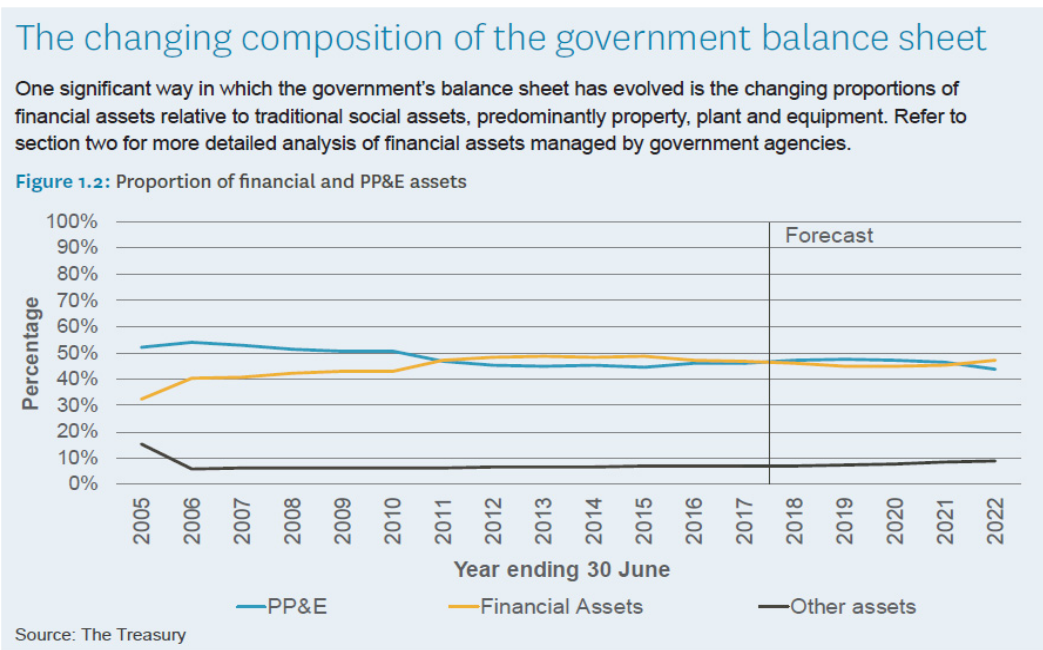
Figure 9 Investments by functional classification



Source: The Treasury

Source: New Zealand Investment Statement 2018, Investments by functional classification

Figure 10 The changing composition of the government balance sheet



Source: New Zealand Investment Statement 2018, The changing composition of the government balance sheet

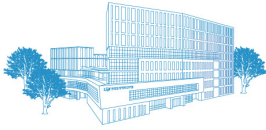
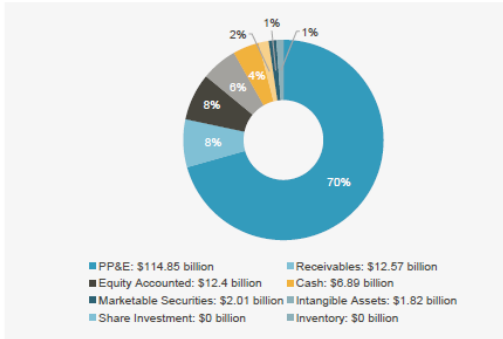


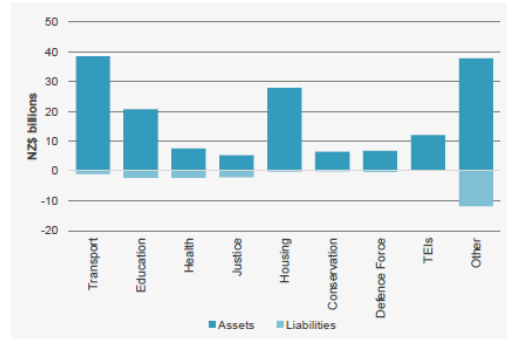
Figure 11 Social assets and liabilities

Figure 1.3: Social assets by type



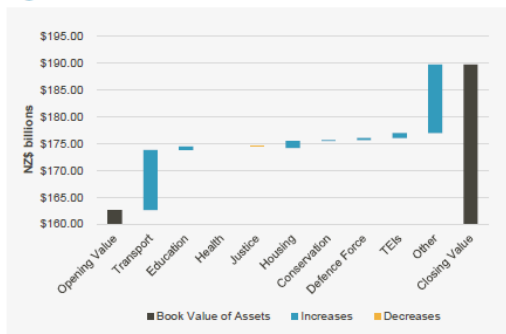
Source: The Treasury

Figure 1.4: Social assets and liabilities by sector



Source: The Treasury

Figure 1.5: Forecast movements 2017 - 2022¹¹

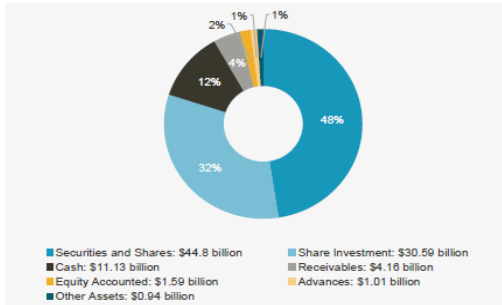


Source: The Treasury

Source: New Zealand Investment Statement 2018, Social assets and liabilities

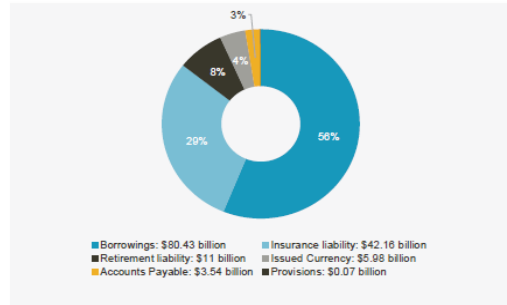
Figure 12 Financial assets and liabilities

Figure 1.6: Assets for the Financial Portfolio as at 30 June 2017



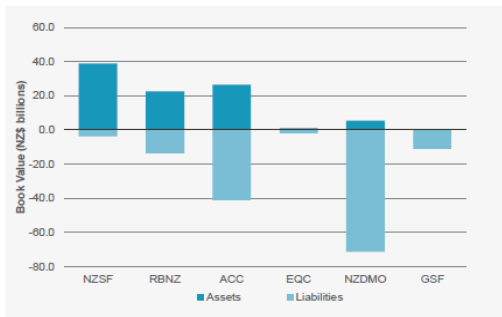
Source: The Treasury

Figure 1.7: Liabilities for the Financial Portfolio as at 30 June 2017



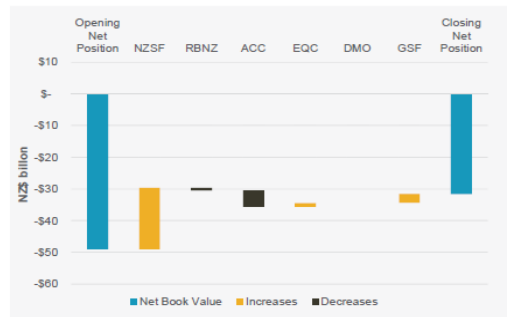
Source: The Treasury

Figure 1.8: Assets and liabilities for the Financial Portfolio as at 30 June 2017



Source: The Treasury

Figure 1.9: Forecast movements 2018 - 2022

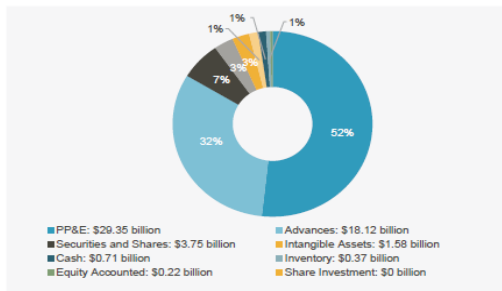


Source: The Treasury

Source: New Zealand Investment Statement 2018, Financial assets and liabilities

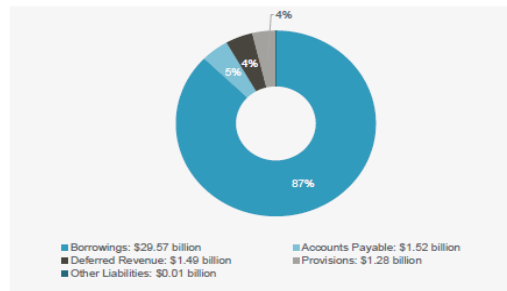
Figure 13 Commercial assets and liabilities

Figure 1.10: Assets for the Commercial Portfolio as at 30 June 2017



Source: The Treasury

Figure 1.11: Liabilities for the Commercial Portfolio as at 30 June 2017



Source: The Treasury

Source: New Zealand Investment Statement 2018, Commercial assets and liabilities



Long-term fiscal position: The Treasury is required to produce a statement on the long-term fiscal position of the Government covering a period of at least 40 years on at least a every four-year basis. Specifically, the Treasury uses its Long-term Fiscal Model to indicate possible trends in spending, revenue, operating balance, and debt over this period, based on both current policy settings and recent history.

(<https://www.treasury.govt.nz/publications/strategies-and-plans/long-term-fiscal-position>)

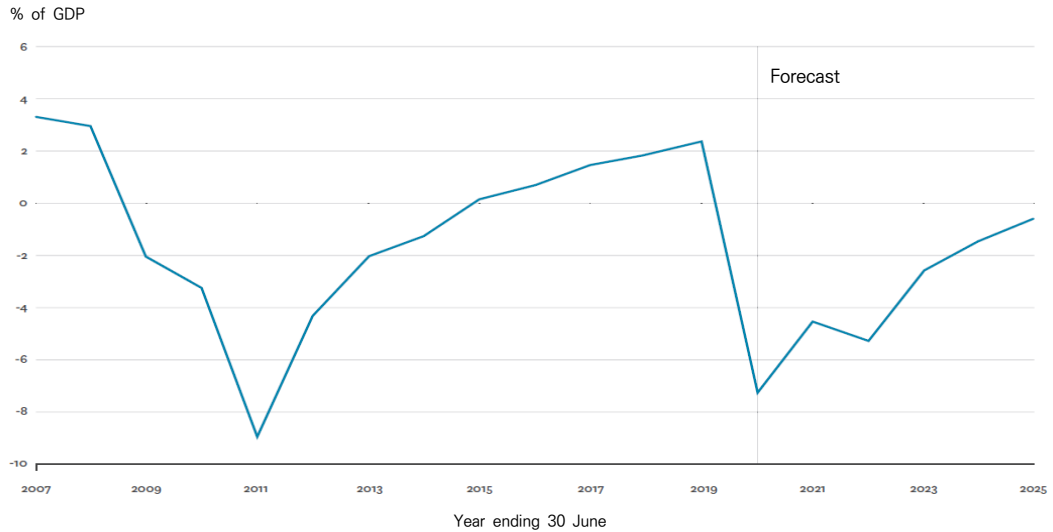
The most recent long-term fiscal position statement was issued in 2021. Due to COVID-19 pandemic, the 2020 long-term fiscal position statement was not issued until September 2021. The forecast and discussion of long-term fiscal position is again solely anchored on accrual accounting concepts.

Table 9 Fiscal projections in the historical trend scenario

	(% of GDP)			
Historical trends scenario	2021	2030	2045	2061
Healthcare	6.9	6.8	8.6	10.6
Gross New Zealand Superannuation (NZS)	5.0	5.6	6.6	7.7
Education	4.7	5.0	5.4	6.4
Debt-financing costs	0.6	1.6	3.7	8.4
Other expenses	15.9	12.1	12.1	11.9
Total expenses	33.1	31.1	36.4	45.0
Total revenue	29.3	29.5	29.5	29.6
Operating balance	-2.6	-0.3	-5.1	-13.3
Primary balance	-3.5	-0.2	-3.3	-7.3
Net debt	34.0	42.9	84.2	196.9
Net worth	11.7	7.7	-30.3	-137.1
Nominal GDP (\$ billion)	334.4	508.8	872.9	1,474.7

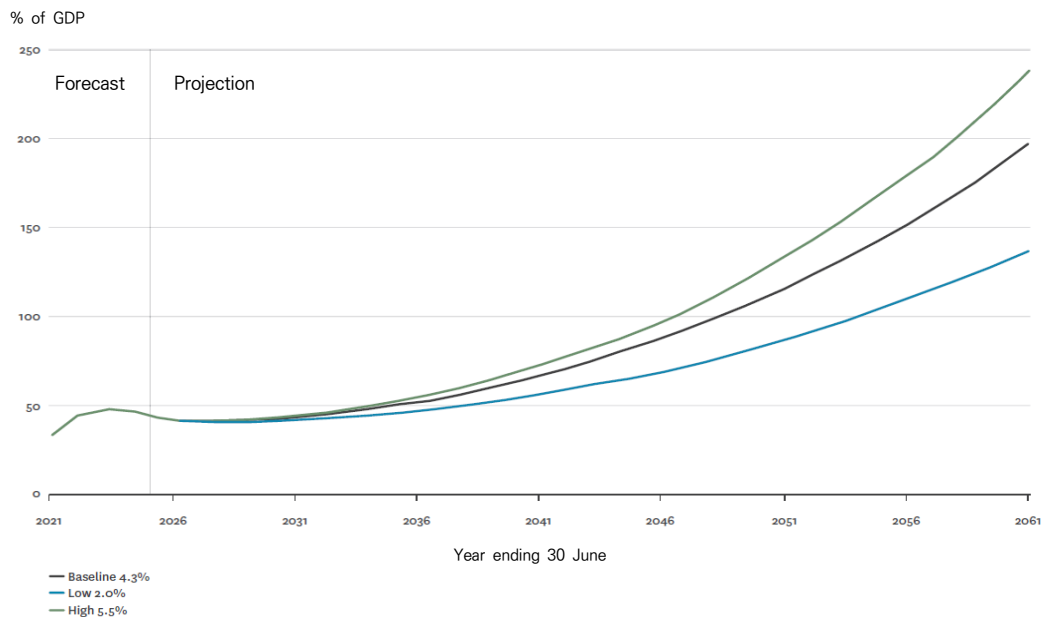
Source: Long-term Fiscal Position Statement 2021, Table 3 – Fiscal projections in the historical trend scenario

Figure 14 Operating balance before gains and losses (OBEGAL)

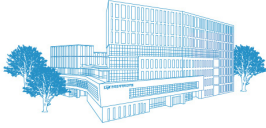


Source: Long-term Fiscal Position Statement 2021, Figure 4 – Operating balance before gains and losses (OBEGAL)

Figure 15 Net core Crown debt as a % of GDP under different interest rate scenarios



Source: Long-term Fiscal Position Statement 2021, Figure 11 – Net core Crown debt as a % of GDP under different interest rate scenarios



IV. Degree of usage of accrual accounting information in New Zealand

The degree of usage of accrual accounting information in New Zealand is summarised in Table 1 as below.

Table 10 Degree of usage of accrual accounting information in New Zealand

Production	Analysis ²	Usage ²	Impact
<p>Governments, Core Crown entities, and other government related entities at this stage produce accrual information.</p> <p>Examples:</p> <ol style="list-style-type: none"> 1. The Wellbeing Budgets. 2. The Economic and Fiscal Updates: annual (budget), half-year and pre-election. 3. Financial Statements of the Governments: month end and year end. 4. The Investment Statements. 5. The Long-term Fiscal Position Statements. 6. Financial Statements of Core Crown Entities and Other Government Related Entities. <p>The Treasury of New Zealand is in charge of preparing these set of documents as required under the Public Finance Act 1989.</p>	<p>Governments, Core Crown entities, and other government related entities at this stage analyse the accrual information they have produced.</p> <p>Examples:</p> <ol style="list-style-type: none"> 1. The analysis of revenue, expense, OBEGAL, net worth, net debt and net capital spending are provided in the Wellbeing Budgets. 2. The analysis of revenue, expense, OBEGAL, net worth, net debt and net capital spending are provided in the Economic and Fiscal Updates. 3. The analysis of changes in significant assets and liabilities into three key categories including social, financial, and commercial over time are provided in the Investment Statements. 	<p>Governments, Core Crown entities, and other government related entities at this stage take a step further from the analysis and make use of the analysed accrual information for a specific purpose.</p> <p>Examples:</p> <ol style="list-style-type: none"> 1. The analysis of revenue, expense, OBEGAL, net worth, net debt and net capital spending is used to estimate fiscal forecasts (e.g. the Economic and Fiscal Updates). The fiscal forecasts are based on assumptions and judgements developed from the best information available at the time they were prepared (e.g. Budget Economic and Fiscal Update May 2021). 2. The current produced accrual accounting information is used in conjunction with the fiscal risk identification to 	<p>At this stage, the impact is referred to as the impact of the usage that reports, projects, institutions or teams are established based on the result from the usage stage.</p> <p>Examples:</p> <ol style="list-style-type: none"> 1. Given the Government's balance sheet information as at the beginning of Covid-19 pandemic crisis, the Government can decide on certain fiscal support measures and monetary policy measures to respond to the crisis (e.g. \$12 billion initial package to support New Zealanders and the establishment of \$50 billion Covid-19 Response and Recovery Fund (CRRF)). 2. The Small Business Cash Flow Scheme has been decided to be a Loan Scheme, not a Grant Scheme. 3. The Wage Subsidy Scheme is a Grant Scheme. 4. The Reserve Bank of New Zealand decided to commence the Large-Scale Asset Purchase programme to inject money into the economy to lower borrowing costs to households and businesses. 5. The information provided in the Investment Statement 2014 has led to programs/schemes

Production	Analysis ²	Usage ²	Impact
	<p>4. The analysis of the changing composition of the government balance sheet are provided in the Investment Statements.</p> <p>5. The analysis of revenue, expense, net debt, capital expenditure and debt-financing costs are provided in the Long-term Fiscal Position Statements.</p>	<p>estimate the potential impact of various fiscal risks on the government's performance and balance sheet (e.g. Budget Economic and Fiscal Update May 2021).</p> <p>3. The Investment Statement describes and states the value of Government's portfolio of significant assets and liabilities, how it has changed in the past and how it is expected to change in the future. It discusses importance, principles of and progress towards good balance sheet management, including efficient asset management, sustainable funding, prudent risk management, collection of supporting information, and the use of that information to inform subsequent decisions and actions to ensure high-quality and cost-effective public services (e.g. Investment Statement 2018).</p>	<p>to improve balance sheet management (e.g. government agencies are required to target asset performance and report against indicators including utilisation, condition and fitness for purpose and required to provide more information about long-term plans, improve their cost benefit analysis for investment proposals and project implementation; introduce Investor Confidence Rating (ICR) which provides an incentive mechanism that rewards good investment management performance and proactively addresses the gaps in investment management performance (refer to Cabinet Office Circular CO(15)5).</p>

Note:

- ¹ Core Crown Entities
1. Ministers of the Crown
2. Government departments
3. Offices of Parliament
4. The Reserve Bank of New Zealand
5. New Zealand Superannuation Fund



Other Government Related Entities

1. State-owned Enterprises
2. Crown entities (excluding Universities and Wānanga which are equity accounts)
3. Air New Zealand Limited
4. Regenerate Christchurch
5. Christ Church Cathedral Reinstatement Trust
6. Kiwi Group Holdings Limited
7. Venture Capital Fund
8. Organisations listed in Schedule 4 and 4A (Non-listed companies in which the Crown is majority or sole shareholder) of the Public Finance Act 1989
9. Organisations listed in Schedule 5 (Mixed ownership model companies) of the Public Finance Act 1989
10. Legal entities listed in Schedule 6 (Legal entities created by Treaty of Waitangi Settlement Acts) of the Public Finance Act 1989

² It should be well noted that economists and analysts working for private organisations also use accrual information published by the Treasury to write up reports forecasting future performance and evaluating the impact on the economy overall.

V. The role of accrual information in fiscal risk identification and assets and liabilities management in New Zealand's Central Government

1. Fiscal risk identification

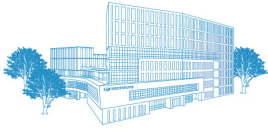
Fiscal risk is the risk that the actual fiscal performance will differ from expectations. Fiscal risk can be either positive or negative, and can affect revenues, expenses or assets and liabilities. The Treasury New Zealand broadly classifies fiscal risks into five main categories as follows:

Figure 16 Type of Risks to Fiscal Forecasts

Type of risk	Description
1. Fundamentally uncertain events	Significant events relating to changes in the external environment (eg, climate-induced events, natural disasters, pandemics, and international events).
2. Deviation from key assumptions and judgements	Any deviations from the key assumptions and judgements used for the economic and fiscal forecasts (eg, changes in nominal GDP used to forecast tax revenue) that have flow-on impacts for the fiscal forecasts.
3. Contingent liabilities and assets	Potential costs or income to the Crown that depend on whether particular events occur.
4. Policy changes	Potential decisions likely to be taken by the Government related to both new policy and existing policy settings (eg, changes to eligibility criteria for a benefit).
5. Cost pressures and variances associated with existing policies	Changes in demand or pricing that impact the cost of delivering services under existing policy settings (eg, an increase in the number of students enrolling in schools). This category includes variances to costs of policies included in the fiscal forecasts.

Source: Budget Economic and Forecast Update 2021, Type of Risks to Fiscal Forecasts

From early 2020 to the present, the COVID-19 pandemic has significantly negatively impacted on the Government's financial performance and position (1) OBEGAL is a deficit of \$23.1 billion for the year ended 30 June 2020, and (2) Net core Crown debt increased by nearly 8 percent of GDP. The Treasury presents the fiscal risk caused by the COVID-19



pandemic separately in four dimensions: (1) the impact on the economy, (2) the Government's response, (3) the Government's role in recovery and managing any future outbreaks, and (4) the impact on valuations of assets and liabilities, and contingent liabilities as below.

Table 11 The impact of COVID-19 pandemic

The continued uncertainty created by the COVID-19 pandemic poses a risk to the fiscal forecasts presented in the *Budget Economic and Fiscal Update 2021*. The statement of specific fiscal risks in this chapter identifies a number of fiscal risks directly and indirectly affected by COVID-19. Despite the disclosure of risks in this chapter, the level of uncertainty means there are risks to the fiscal forecasts that remain too broad in nature to disclose in the statement of specific fiscal risks. These risks concern:

- *The impact on the economy* – the economic recovery from COVID-19 will be dependent on many unknown factors. Forecasts for tax revenue, benefit expenses and finance costs are particularly sensitive to economic conditions. The Economic Outlook chapter, from page 15, includes a scenario that models the fiscal impact of how the economy might evolve if some of the key judgements around COVID-19 in the main forecast were to be altered.
- *The Government's response* – the Government has already implemented policies to respond to COVID-19, mostly funded through the \$50 billion COVID-19 Response and Recovery Fund (CRRF). Policies announced and communicated up to 30 April 2021 have been included in the fiscal forecasts based on the best information available. There is a risk that the actual costs and/or timing of these policies may differ from the judgements and assumptions used to prepare the fiscal forecasts.
- *The Government's role in recovery and managing any future outbreaks* – the fiscal forecasts include funding of around \$5.1 billion that is left in the CRRF to manage future costs of recovery and fight any further outbreaks of the virus. The inclusion of the unallocated portion of the CRRF in the fiscal forecasts has required some judgement around the nature (eg, operating or capital) and timing of future COVID-19 response initiatives. In addition, there is uncertainty about the level of funding that may be required for future costs of recovery and fighting any further outbreaks.
- *The impact on valuations of assets and liabilities, and contingent liabilities* – a number of assets and liabilities on the Crown balance sheet are valued using market information (eg, land and buildings, share investments and ACC outstanding claims liability). The impact of COVID-19 is likely to cause some ongoing volatility in the market that will affect the future value of assets and liabilities on the Government's balance sheet. In addition, the effects from COVID-19 may result in costs from some of the Government's existing contingent liabilities converting into expenses during the forecast period. In particular, there is a risk that there may be calls on some uncalled capital facilities and some Crown guarantees and indemnities may crystallise.

Source: Budget Economic and Forecast Update 2021, The impact of COVID-19 pandemic

In order to assess the impact of each type of fiscal risk on the Government's balance sheet, it is important to evaluate the fiscal risk based on the functional classifications of the Government's balance sheet into three key categories discussed above: (1) social, (2) financial, and (3) commercial. The balance sheet risks are defined as "risks that assets and liabilities will not be able to provide public services, finance or pre-fund future government expenditure and obligations, or achieve commercial objectives". The resilience of the balance sheet is also defined as "its ability to absorb and adapt to shocks and stresses that might otherwise hinder the achievement of these objectives" (New Zealand Budget Economic and Fiscal Update 2021).

The Treasury New Zealand has categorised sources of social, financial, and commercial balance sheet risks as follows.

1. Sources of social balance sheet risk to public services
 - a. Physical assets such as land, buildings, state highways and military equipment are susceptible to external natural hazards and the quality of asset management in delivering services.
 - b. The replacement costs of physical assets are susceptible to valuation movements through changes in property market conditions, changes in demand and changes in the costs of construction.
 - c. Social insurance and retirement liabilities (including Accident Compensation, Veterans' disability entitlements and the Government Superannuation Fund) are prone to volatility through their actuarial valuations.
 - d. Concessionary lending (including student loans and the Small Business Cashflow Scheme) is exposed to counterparty risk and risks associated with changes in assumptions about the future value of money, affecting how these future repayments are discounted.
 - e. Contingent liabilities (including indemnities of activities in the public interest, environmental claims, and legal proceedings).



2. Sources of financial balance sheet risk to finance or prefund future government expenditure and obligations
 - a. The Large-Scale Asset Purchases (LSAP) programme has exposed the Government to significant interest rate risk.
 - b. Financial assets held by the Accident Compensation Corporation (ACC) and the New Zealand Superannuation Fund (NZSF) are exposed to interest rate risk, exchange rate risk and equity and bond market volatility.
 - c. Liquidity risk related to the Government's ability to raise cash to meet its financial obligations.

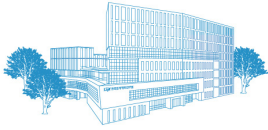
3. Sources of commercial balance sheet risk to meet commercial objectives
 - a. Changes in customer demand for products and services
 - b. The availability and price of business inputs to provide products and services
 - c. Changes in the competitive landscape led by new technologies
 - d. New market entrants
 - e. Externally generated shocks and trends

(Budget Economic and Fiscal Update 2021)

The Budget Economic and Fiscal Update 2021 also provides a statement of specific fiscal risks to be classified into (1) new risks, (2) changed risks, (3) updated risks, and (4) unchanged risks across all investment portfolios held by the Government. The below figures present examples of specific fiscal risk classifications.

Table 12 Statement of Specific Risks

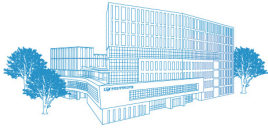
New Risks		
Portfolio	Risk Title	Type of Risk
Children	Oranga Tamariki Partnering with Māori to Find Appropriate Solutions for Children in Need	Policy Change – Expenses
Climate Change	Recycling Emissions Trading Scheme Proceeds	Policy Change – Expenses
Finance	Air New Zealand's Proposed Capital Raise	Cost Pressure or Variance – Capital
Housing	Housing Acceleration Fund	Cost Pressure or Variance – Expenses and Capital
Revenue	Tax Treatment of Rental Property	Policy Change – Revenue
Tourism	Proposed Changes to the International Visitor Levy	Policy Change – Revenue
Transport	Incentivising Uptake of Low Emissions Vehicles	Policy Change – Expenses
Changed Risks		
Portfolio	Risk Title	Type of Risk
COVID-19 Response	COVID-19 Vaccine Strategy	Cost Pressure or Variance – Expenses
	Managed Isolation and Quarantine	Cost Pressure or Variance – Expenses
Education	Free and Healthy Lunch Programme	Policy Change – Expenses and Capital
Finance	Business Finance Guarantee Scheme	Cost Pressure or Variance – Expenses
Health	Health and Disability System Reform	Policy Change – Expenses
	Health Capital Pressure	Cost Pressure or Variance – Capital
	Health System Sustainability	Cost Pressure or Variance – Expenses
Housing	Large-scale Housing and Urban Development Projects	Cost Pressure or Variance – Expenses and Capital
Local Government	Three Waters Infrastructure Investment and Reform Programme	Policy Change – Expenses and Capital
Transport	City Centre to Māngere Rapid Transit Project	Policy Change – Expenses and Capital
	Future of Rail Commitments	Policy Change – Capital
	New Zealand Upgrade Programme	Cost Pressure or Variance – Expenses and Capital
Cross-portfolio	Further COVID-19 Business Support	Policy Change – Expenses



Updated Risks		
Portfolio	Risk Title	Type of Risk
ACC	ACC Levies	Cost Pressure or Variance – Expenses and Revenue
Climate Change	Emissions Trading Scheme – Fixed Price Option and Auctioning	Cost Pressure or Variance – Revenue and Expenses
Defence	Defence Funding Requirements to Deliver New Zealand's Defence Strategy	Policy Change – Expenses and Capital
Economic and Regional Development	New Zealand Screen Production Grant – International	Cost Pressure or Variance – Expenses
	Provincial Growth Fund	Cost Pressure or Variance – Expenses and Capital
	Regional Strategic Partnership Fund	Policy Change – Expenses and Capital
Education	Change in Demand for Tertiary Education and Training	Cost Pressure or Variance – Expenses
	Education Operating Cost Pressures	Cost Pressure or Variance – Expenses
	Education Workforce Strategy	Policy Change – Expenses
	Learning Support	Cost Pressure or Variance – Expenses
	Replacing Deciles with the Equity Index	Policy Change – Expenses
	Response to the Tomorrow's Schools Review	Policy Change – Expenses
Finance	Alternative Monetary Policy Tools	Cost Pressure or Variance – Expenses
	Deposit Insurance Scheme	Policy Change – Revenue and Expenses
Finance, Earthquake Commission	Earthquake Commission	Cost Pressure or Variance – Expenses
Foreign Affairs	Official Development Assistance	Policy Change – Expenses
Health	Mental Health Support for Children	Policy Change – Expenses
	Reducing Planned Care Waiting Lists	Policy Change – Expenses
Māori Development	Waitangi Tribunal Recommendations and Claims	Policy Change – Expenses
Revenue	International Tax	Policy Change – Revenue
	Potential Tax Policy Changes	Policy Change – Revenue
	Research and Development Tax Incentive	Cost Pressure or Variance – Expenses
	Small Business Cashflow Scheme	Cost Pressure or Variance – Expenses and Capital
	Student Loans – Valuation	Cost Pressure or Variance – Expenses

Updated Risks		
Portfolio	Risk Title	Type of Risk
Social Development and Employment	Changes to the Welfare System	Policy Change – Expenses
	Implications for New Zealand Superannuation from Quarterly Employment Survey Redevelopment	Cost Pressure or Variance – Expenses
Speaker of the House of Representatives	Future Parliamentary Accommodation	Cost Pressure or Variance – Capital
Transport	Auckland City Rail Link Ownership Issues	Policy Change – Expenses
	Wellington Transport Investment Programme	Policy Change – Expenses and Capital
Cross-portfolio	Pay Equity Claims	Cost Pressure or Variance – Expenses
	Progressively Extending Living Wage Guarantees to Contractors in the Public Sector	Policy Change – Expenses
	Services Funded by Third Parties	Cost Pressure or Variance – Expenses
	State Sector Employment Agreements	Cost Pressure or Variance – Expenses

Unchanged Risks		
Portfolio	Risk Title	Type of Risk
ACC	Impacts of Changes to Accident Compensation Policy Settings	Policy Change – Expenses
	Non-Earners' Account	Cost Pressure or Variance – Expenses
	Work-related Gradual Process Disease and Infection	Policy Change – Expenses
Biosecurity	<i>Mycoplasma Bovis Biosecurity Response</i>	Policy Change – Revenue and Expenses
Broadcasting and Media	Delivery of the Government's Public Media Outcomes	Policy Change – Expenses and Capital
Conservation	Department of Conservation Compliance with Drinking Water Supply Infrastructure Requirements	Cost Pressure or Variance – Expenses and Capital
Defence	Disposal of New Zealand Defence Force Assets	Policy Change – Revenue and Expenses
Education	Early Learning Action Plan	Policy Change – Expenses
	Reform of Vocational Education (RoVE)	Policy Change – Expenses and Capital
Finance, Earthquake Commission	Southern Response Earthquake Services Support	Cost Pressure or Variance – Expenses and Capital



Unchanged Risks		
Portfolio	Risk Title	Type of Risk
Housing	Divestment and Development of Kāinga Ora – Homes and Communities’ Housing	Cost Pressure or Variance – Expenses
	Emergency Housing Special Needs Grants	Cost Pressure or Variance – Expenses
	Increases to Market Rent	Cost Pressure or Variance – Expenses
	KiwiBuild – Fiscal and Delivery Risks	Cost Pressure or Variance – Revenue, Expenses and Capital
Internal Affairs	Archives New Zealand Storage Capacity	Policy Change – Expenses and Capital
Research, Science and Innovation	Research and Development Spending Target	Policy Change – Expenses
Revenue	Cash Held in Tax Pools	Cost Pressure or Variance – Revenue
	Transformation and Technology Renewal	Cost Pressure or Variance – Expenses
Social Development and Employment	Increasing Special Needs Grant Limits for Emergency Dental Treatment	Policy Change – Expenses
Transport	Auckland City Rail Link	Cost Pressure or Variance – Expenses and Capital
Treaty of Waitangi Negotiations	Relativity Clause	Cost Pressure or Variance – Expenses
	Treaty Settlement Forecasts	Cost Pressure or Variance – Expenses
Veterans	Veterans’ Disability Entitlements	Cost Pressure or Variance – Expenses
Cross-portfolio	Achieving New Zealand’s International and Domestic Climate Change Targets	Policy Change – Expenses and Capital
	Carbon Neutral Public Service	Policy Change – Expenses and Capital
	Information and Communications Technology Operating and Capital Pressures	Cost Pressure or Variance – Expenses and Capital
	Non-Government Providers Receiving Funding from the Crown	Cost Pressure or Variance – Expenses
	Other Capital Cost Pressures	Cost Pressure or Variance – Capital
	Other Operating Cost Pressures	Cost Pressure or Variance – Expenses
	Outcomes from Other Government Inquiries and Reviews	Policy Change – Expenses
Unexpected Maintenance for Crown-owned Buildings	Cost Pressure or Variance – Capital	

Source: Budget Economic and Fiscal Update 2021, Statement of Specific Risks

2. Balance sheet management

The New Zealand government's balance sheet represents significant assets and liabilities which provide resources to raise the wellbeing of New Zealanders over the long-term. This significantly highlights the importance of good balance sheet management. Balance sheet management, as stated in the Investment Statement 2014, refers to a list of actions, including (1) managing the assets and liabilities that make it up, including making decisions about what assets to buy or sell or liabilities to incur or retire, (2) managing Crown finances appropriately through fiscal policy settings, using Crown debt to help manage the impact of economic cycles and/or to bring forward or defer spending, (3) managing off-balance sheet assets and liabilities, including the impacts of policies on future balance sheets and contingent or implicit liabilities, and (4) utilising the balance sheet to meet public policy objectives, such as saving now to meet future expenses or vice versa. Good balance sheet management, as stated in the Investment Statement 2018, includes (1) owning the right assets and managing them well – proactive alignment of assets with government priorities and managing them well to optimise the value that can be generated from existing resources, (2) managing risk efficiently – to enhance resilience of public services to shocks and to minimise costs, (3) sustainable financing – to ensure durable fiscal policy settings and resilience to shocks, and (4) strong systems – to support and ensure efficient and effective management of assets and liabilities by agencies and governments. Good balance sheet management will result in a number of benefits, including “(1) improved wellbeing through ensuring the public services delivered are those most valued by New Zealanders, (2) most efficient use of assets and liabilities releasing resources for other uses including: expanding the range and quality of government services, increasing government saving to strengthen the balance sheet, reducing government borrowing, and/or reducing tax, (3) allowing an equitable distribution of costs and benefits of public services across generations, such as: minimising the transfer of today's costs onto future generations, and/or spreading the cost of long-lived infrastructure across the generations that benefit, and (4) supporting fiscal sustainability and resilience, which improves wellbeing and economic growth through: maintaining essential public services during periods of poor economic



performance or shocks, encouraging economic growth through creating a stable environment of investment, reducing the cost of debt for the government and the private sector, and responding to circumstances on the basis of need and opportunity rather than when they are affordable” (Investment Statement 2018).

Assets and liabilities of New Zealand government are classified into three main categories based on their function for the ease of balance sheet management: (1) social, (2) financial, and (3) commercial.

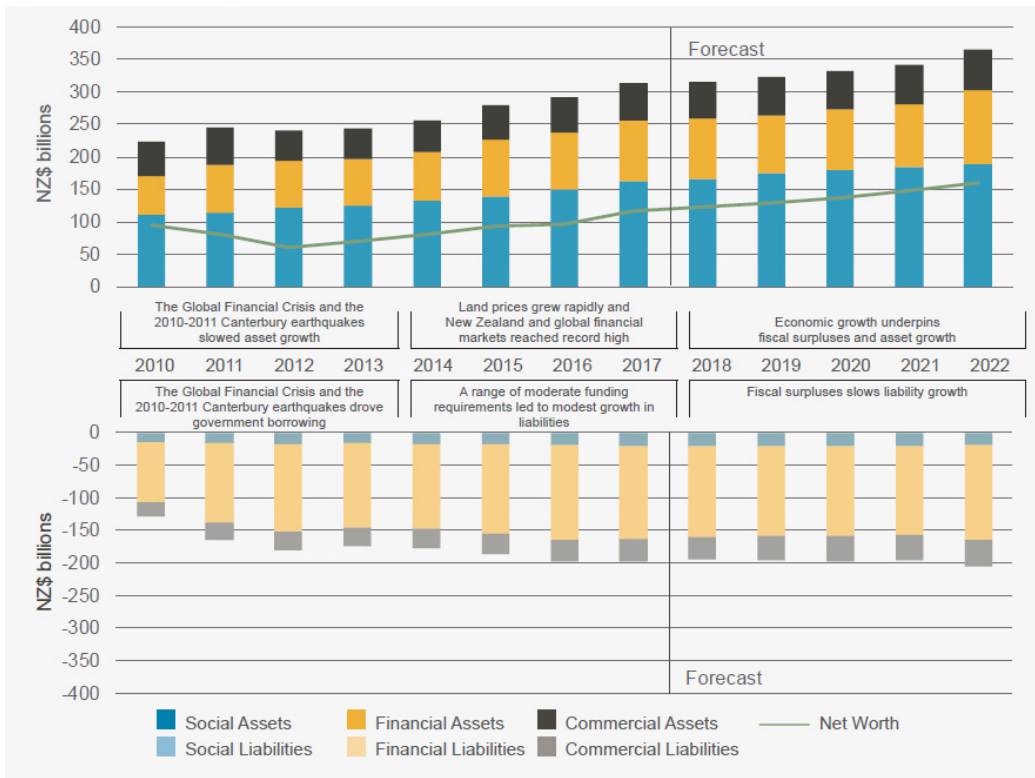
Table 13 ▶ Balance sheet functional classifications

Social	Assets and liabilities held to provide public services. These include, for instance, roads, schools, and the national parks. For the purposes of this Statement, social assets also include tax receivables and student loans managed by the Inland Revenue Department (IRD), and Crown-owned companies that do not have purely commercial objectives such as Crown Research Institutes.
Financial	Assets and liabilities that finance or prefund government expenditure and obligations for future expenditure. This category consists of the Crown Financial Institutions (CFIs) ¹⁰ , the Reserve Bank of New Zealand, and government borrowing via the Treasury’s New Zealand Debt Management Office.
Commercial	Assets and liabilities of entities with commercial objectives. The companies are largely independent entities operating in competitive environments. This category comprises of commercial priority companies and listed companies.

Source: Investment Statement 2018, Table 1.3 – Balance sheet functional classifications

A snapshot showing the growth of assets and liabilities by function since 2010 and the forecasted growth by 2022 is provided below.

Figure 17 Investments by functional classification



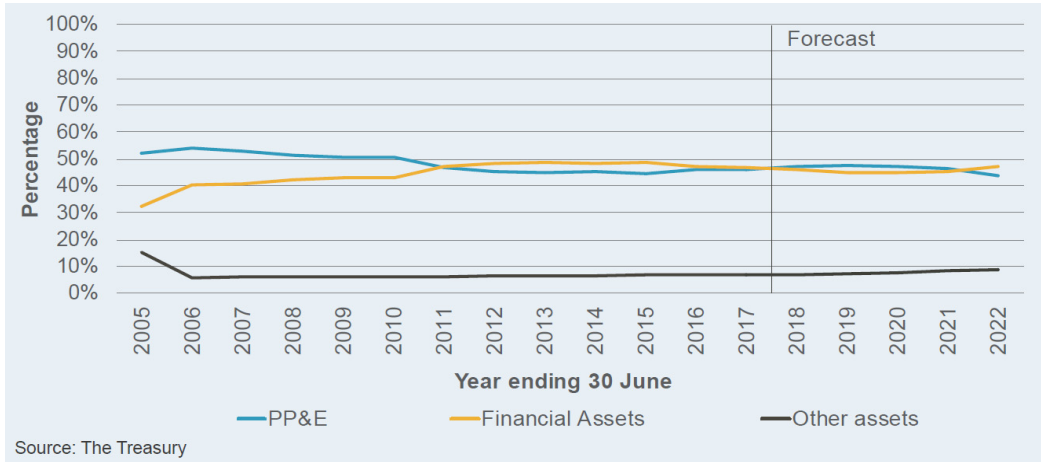
Source: The Treasury

Source: Investment Statement 2018, Figure 1.1 – Investments by functional classification

One key trend in the balance sheet of New Zealand government over the years is the increase in financial assets compared to social assets. The proportion of financial assets has increased from just above 30% back in 2005 to nearly 50% in 2018 and is projected to remain at this level (Investment Statement 2018, Figure 1.2).



Figure 18 Proportion of financial and PP&E assets

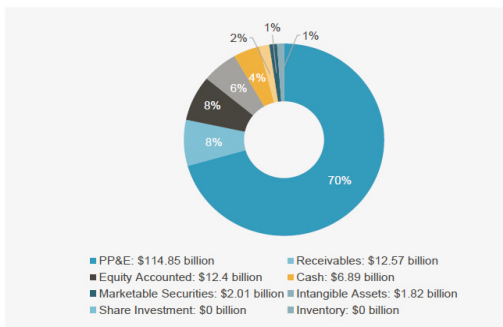


Source: Investment Statement 2018, Figure 1.2 – Proportion of financial and PP&E assets

A. Social Portfolio

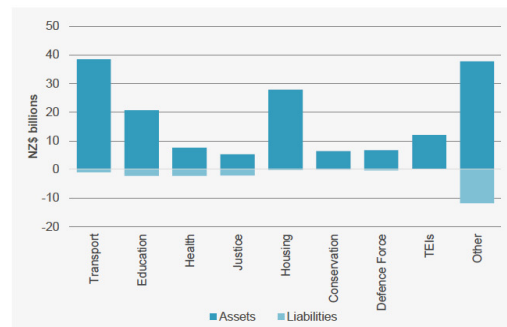
New Zealand government’s social portfolio is predominantly PP&E assets and across three main sectors, being (1) transport, (2) housing, and (3) education. Social liabilities are mainly occupied by other liabilities, including accounts payable and employee entitlement provisions (Investment Statement 2018).

Figure 19 Social assets by type



Source: The Treasury

Figure 20 Social assets and liabilities by sector



Source: The Treasury

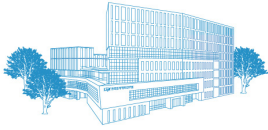
Source: Investment Statement 2018, Figure 1.3 – Social assets by type and Figure 1.4 – Social assets and liabilities by sector

Social assets are held to provide public services and the most significant challenge to government departments and Crown entities managing these social assets is to maintain the right mix and level of investment relative to other input (Investment Statement 2018).

The investment across the social portfolio are held by ACC, Department of Conservation (DOC), Ministry of Health (MoH), Housing New Zealand Corporation (HNZC), Inland Revenue and New Zealand Customs, Ministry of Education (MoE), New Zealand Defence Force, New Zealand Transport Agency (NZTA), Tertiary Education Institutes (TEIs), The Justice Sector (Ministry of Justice, Department of Corrections, and New Zealand Police).

Table 14 Social Portfolio contributions to wellbeing

Investment	Contribution to Wellbeing
Accident Compensation Corporation (ACC)	ACC "helps prevent injuries and gets New Zealanders and visitors back to everyday life if they've had an accident". Source: Accident Compensation Corporation
Department of Conservation (DOC)	DOC is the "government agency charged with conserving New Zealand's natural and historic heritage". Source: Department of Conservation
Healthcare	"The Ministry of Health's purpose is to lead and shape New Zealand's health and disability system to deliver a healthy and independent future for all." Source: Ministry of Health (MoH)
Housing	Housing New Zealand Corporation (HNZC) "focuses on the efficient and effective management of state houses and the tenancies of those living in them, to meet demand from MSD's social housing register". Source: Housing New Zealand Corporation
Inland Revenue and New Zealand Customs	"Inland Revenue plays a critical role in improving the economic and social wellbeing of New Zealanders. Inland Revenue collects 80% of the Crown's revenue as well as collecting and disbursing social support programme payments and providing the government with policy advice." Customs "provides border services that protect New Zealand and advances our economy. [Customs] promotes New Zealand's international trade, collects Crown revenue, and enforces the law by identifying and seizing prohibited imports and exports. [Customs] also makes sure that lawful travellers and items can move across our border as smoothly and efficiently as possible." Source: Inland Revenue and New Zealand Customs
Ministry of Education (MoE)	MoE "shape[s] an education system that delivers equitable and excellent outcomes." Source: Ministry of Education



Investment	Contribution to Wellbeing
New Zealand Defence Force	"The Defence Force provides essential support to the delivery of the Government's national security interests. Contingent military capabilities are held for unforeseen emergencies or to reinforce existing operations." Source: New Zealand Defence Force
New Zealand Transport Agency (NZTA)	"A great journey is easy, safe and connected. The Transport Agency is focused on providing one integrated land transport system that helps people get the most out of life and supports business." Source: New Zealand Transport Agency
Tertiary Education Institutes (TEIs)	TEIs deliver tertiary education and research in New Zealand, which plays a key role in producing knowledge and skills for industry and ensuring people have the competencies that enhance their social and economic outcomes. Source: The Treasury
The Justice Sector (Ministry of Justice, the Department of Corrections and the New Zealand Police)	The Ministry of Justice (MoJ) "is working with the judiciary and justice sector colleagues to help make sure New Zealand is a safe and just society by delivering modern, accessible, people-centred justice services". "The Department of Corrections creates lasting change by breaking the cycle of re-offending – public safety is their bottom line." "New Zealand Police is working with the community to make New Zealanders be safe and feel safe." Source: Ministry of Justice, Department of Corrections, and New Zealand Police

Note: Descriptions sourced from agency websites in February 2018 unless otherwise specified.

Source: Investment Statement 2018, Table 2.2 – Social Portfolio contributions to wellbeing

The 2018 review of the social portfolio documents the following observations:

1. The need to improve asset performance indicators
2. The ongoing difficulty to rejuvenate assets
3. Capacity constraints on future investment of the construction industry
4. Potential opportunities for efficiency gains across the social portfolio
5. The importance of regularly assessing the ability of existing social assets to meet service objectives

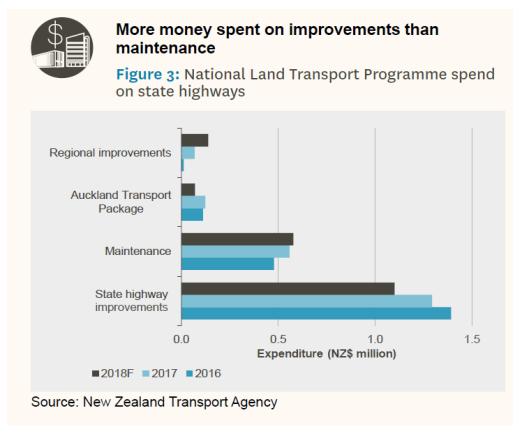
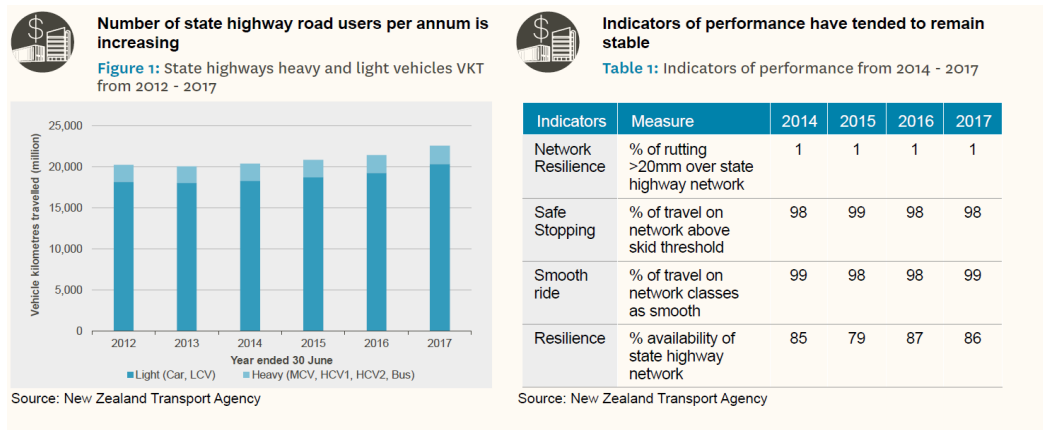
(Investment Statement 2018, Chapter 2.1)

The performance assessment of social portfolio has conducted across five dimensions: (1) effectiveness, (2) efficiency, (3) sustainability, (4) resilience, and (5) adaptability.

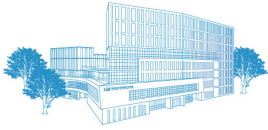
a) Transport

NZTA oversees the management of the state highway system, including planning, funding, designing, supervising, constructing, maintaining, and operating the system. The investor confidence rating regarding the management of state highway asset, the national land transport programme and delivery of state highway programmes and projects and corporate information systems is B (Investment Statement 2018). In general, as at 2018, there is consistent improvement of the state highway management, including: (1) increase in number of state highway road users per annum, (2) stable performance indicators, and (3) money spent more on improvements rather than maintenance.

Figure 21 State Highways



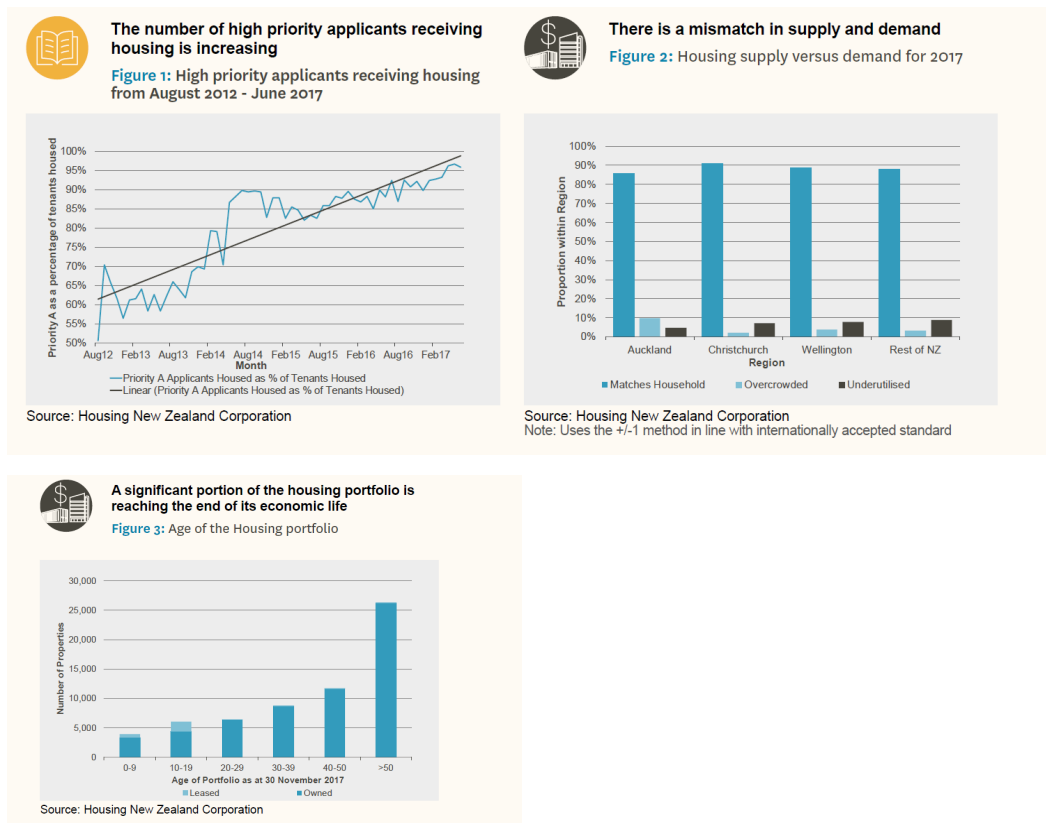
Source: Investment Statement 2018, Chapter 4 Detailed Sector Performance – State Highways



b) Housing

HNZC manages a property portfolio of around 63,000 properties with an approximate value of \$25.2 billion as at 2018. HNZC was granted an investor confidence rating of A for managing its property portfolio (Investment Statement 2018). There is a consistent increase in the number of high priority applicants receiving housing. However, there is still a mismatch in supply and demand and there is a very high proportion of housing portfolio reaching the end of its economic life.

Figure 22 Housing New Zealand Corporation

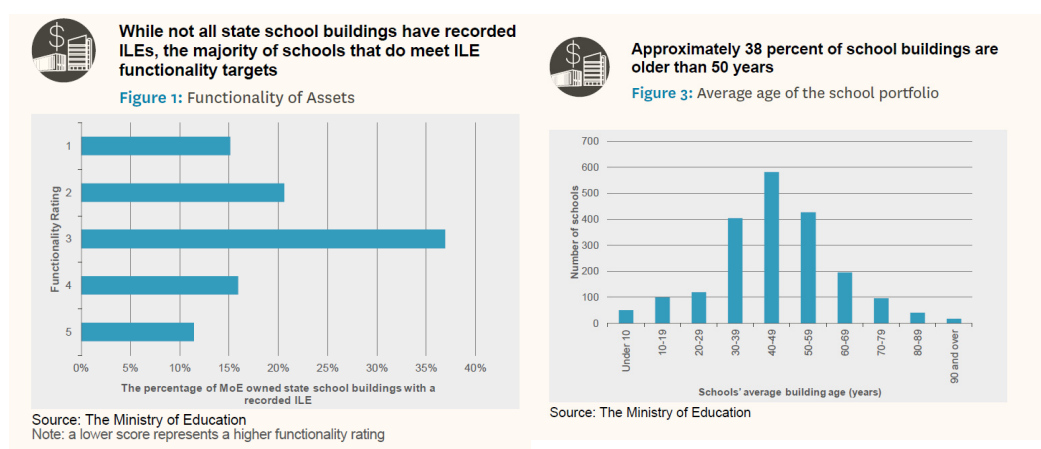


Source: Investment Statement 2018, Chapter 4 Detailed Sector Performance – Housing New Zealand Corporation

c) Education

MoE manages a social asset portfolio with approximate replacement value of \$30 billion. MoE was granted an investor confidence rating of C for managing its social asset portfolio (Investment Statement 2018). The review of the education sector reveals some key shortcomings (1) not all state school buildings have recorded innovative learning environments, and (2) a high proportion are old, reaching the end of their economic life.

Figure 23 Housing New Zealand Corporation



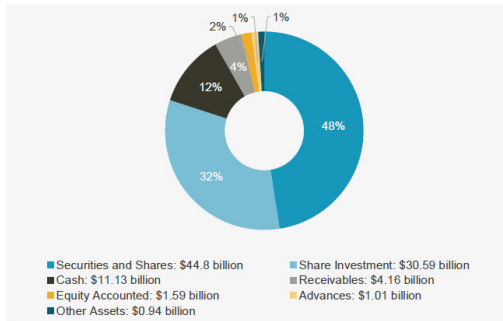
Source: Investment Statement 2018, Chapter 4 Detailed Sector Performance – Ministry of Education

B. Financial Portfolio

New Zealand government's financial portfolio is predominantly financial liabilities held by the Accident Compensation Corporation (ACC) and the Treasury's New Zealand Debt Management Office (NZDMO). The financial assets are held mainly by the New Zealand Superannuation Fund (NZSF), ACC and Reserve Bank of New Zealand (RBNZ). It should be noted that the financial portfolio shows a net liability as it includes government debt which finances the social portfolio and government operating expenditure (Investment Statement 2018).

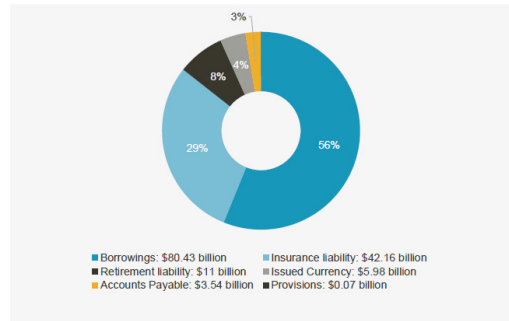


Figure 24 Assets for the Financial Portfolio as at 30 June 2017



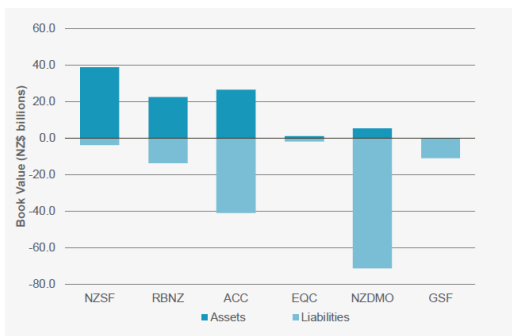
Source: The Treasury

Figure 25 Liabilities for the Financial Portfolio as at 30 June 2017



Source: The Treasury

Figure 26 Assets and liabilities for the Financial Portfolio as at 30 June 2017



Source: The Treasury

Source: Investment Statement 2018, Figure 1.6 – Assets for the Financial Portfolio, Figure 1.7 – Liabilities for the Financial Portfolio, and Figure 1.8 – Assets and liabilities for the Financial Portfolio as at 30 June 2017

Financial assets are acquired to fund government liabilities associated with contractual obligations and policy commitments, as well as to build buffers against adverse events. Financial liabilities represent government’s borrowings to fund investment or operating deficits (Investment Statement 2018).

The investment and liabilities across the financial portfolio are held by ACC Investments, Earthquake Commission (EQC), Government Superannuation Fund Authority (GSF), NZSF, RBNZ and NZDMO.

Table 15 The Financial Portfolio's contributions to wellbeing

Dimension	To know that the government is investing for wellbeing, we ask:
ACC Investments	ACC provides cover to all New Zealanders injured in accidents. In the 2017 financial year \$1.95 million new claims were received.
Earthquake Commission	EQC settled 99 percent of Canterbury earthquakes claims (paying out over \$10 billion) and 60 percent of claims from the Kaikoura earthquakes.
Government Superannuation Fund Authority	The GSF provides superannuation support to public sector employees (who commenced prior to 1992), improving their wellbeing in later life. Currently, the GSF has 45,279 annuitants and 8,356 contributors.
New Zealand Superannuation Fund	The NZSF prefunds a proportion of the future cost of New Zealand Superannuation. The funds under management in the NZSF have increased by \$11.53 billion since 2013.
Reserve Bank of New Zealand	The RBNZ supports financial stability and monetary policy through the effective use of its balance sheet to manage liquidity in the banking system and maintain capacity for crisis interventions.
New Zealand Debt Management Office	A business unit of the Treasury that manages and raises borrowings and associated assets for the government, to meet the government's financing and liquidity requirements.

Source: Investment Statement 2018, Table 2.3 - The Financial Portfolio's contributions to wellbeing

The 2018 review of the financial portfolio documents the following observations:

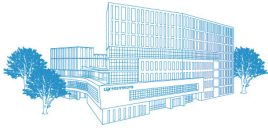
1. The financial portfolio is set to increase as a proportion of the government balance sheet over the medium term.
2. The financial portfolio faces sustainability challenges from an ageing and increasing population.
3. Strong investment returns in the portfolio have been partially driven by buoyant market conditions.

(Investment Statement 2018, Chapter 2.2)

The performance assessment of financial portfolio has conducted across five dimensions: (1) effectiveness, (2) efficiency, (3) sustainability, (4) resilience, and (5) adaptability.

a) ACC

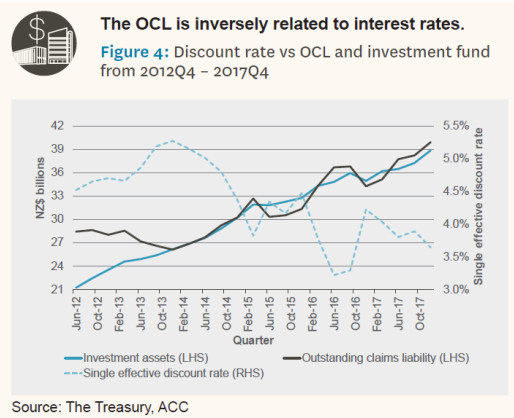
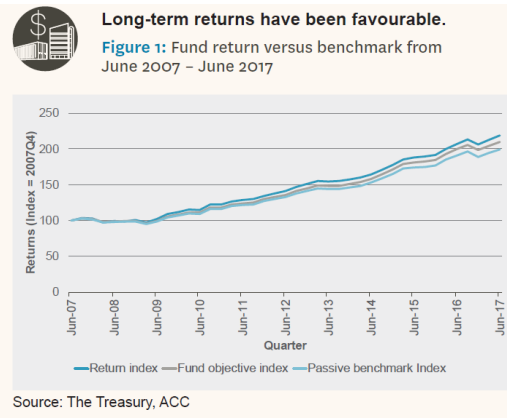
ACC manages the accident compensation scheme to provide comprehensive no-fault personal injury cover for all New Zealand residents and visitors. ACC was granted an



investor confidence rating of B of managing its portfolio (Investment Statement, 2018). Overall, ACC aims to maximise average investment returns and minimise unexpected mismatch between investment income and changes in the Outstanding Claims Liability (OCL). While the investment returns have consistently outperformed its benchmarks and expectations, there remains a significant risk of mismatch between future investment income and long-term growth in claim liabilities.

Figure 27 Accident Compensation Corporation

<h3>Effectiveness</h3> <p>ACC's returns have consistently outperformed its benchmarks and expectations, which has helped reduce levy rates.</p> <ul style="list-style-type: none"> Over the very long term ACC has recorded notable performance, with ACC's reserves portfolio outperforming its composite benchmarks for 24 of the past 25 years (see Figure 1). Table 1: ACC's annualised cumulative return over the past five years was 9.4 percent per annum, 0.9 percent per annum above its benchmark over the same period. The primary drivers for this strong investment performance have been ACC's large allocation to fixed interest assets (which benefit from declining interest rates) and strong equity markets. Figure 2: Levy revenue and investment returns increase funds under management (FUM). Since 2013, FUM has increased by \$12.52 billion, primarily due to strong investment returns. 	<h3>Efficiency</h3> <p>The management costs of ACC's New Zealand investments are much lower than the external management costs of offshore investments.</p> <ul style="list-style-type: none"> ACC measures the efficiency of its investment management by expressing total investment management costs as a proportion of the total funds under management. For 2017 this was 0.14 percent, or \$48 million, against a target of 0.15 percent. Approximately two thirds of ACC's investment assets are in New Zealand bonds and equities, all or which are all internally managed. This is significantly cheaper than would be the case for externally managed, offshore investments. 	<h3>Sustainability</h3> <p>There remains a significant risk that future investment income will not match long-term growth in claims liabilities.</p> <ul style="list-style-type: none"> ACC's best estimate is that future investment returns will average about 5 percent per annum (about half the historical average). A sustained low interest rate environment has the potential to limit ACC's long-term investment returns. The very long-term nature of ACC's liabilities can mean that there is difficulty in matching the term of investments with the liability due to the limited availability of very long-term investment options. Figure 3: ACC's focus on matching assets to the duration and risk of its liabilities leads to a higher weighting of lower-risk assets, such as bond investments and a preference for longer duration inflation-adjusted instruments.
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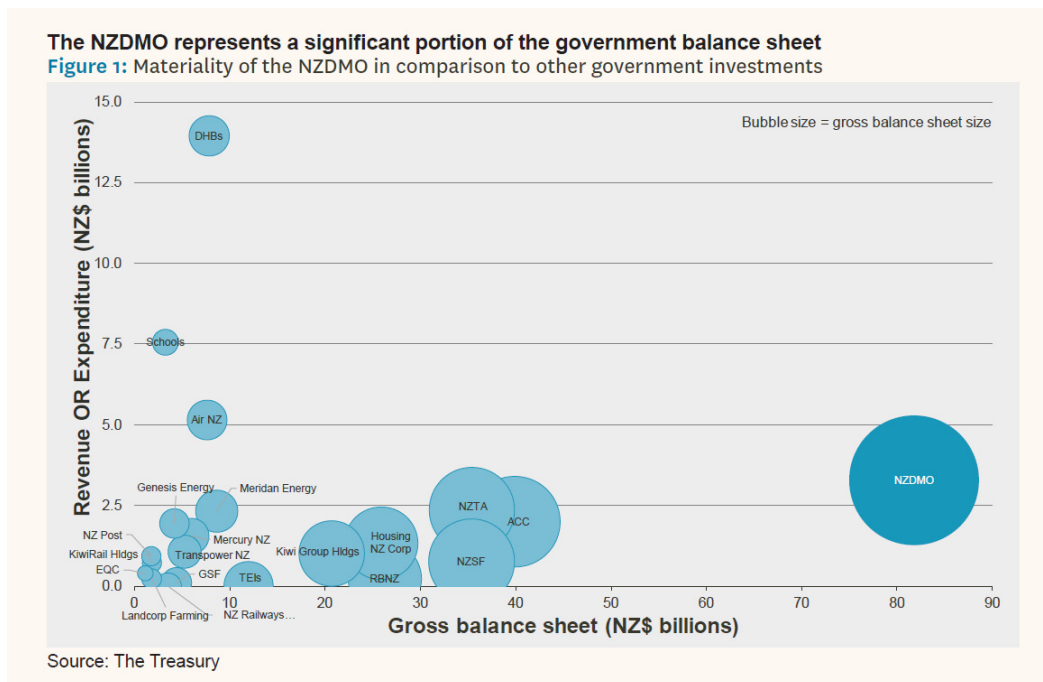


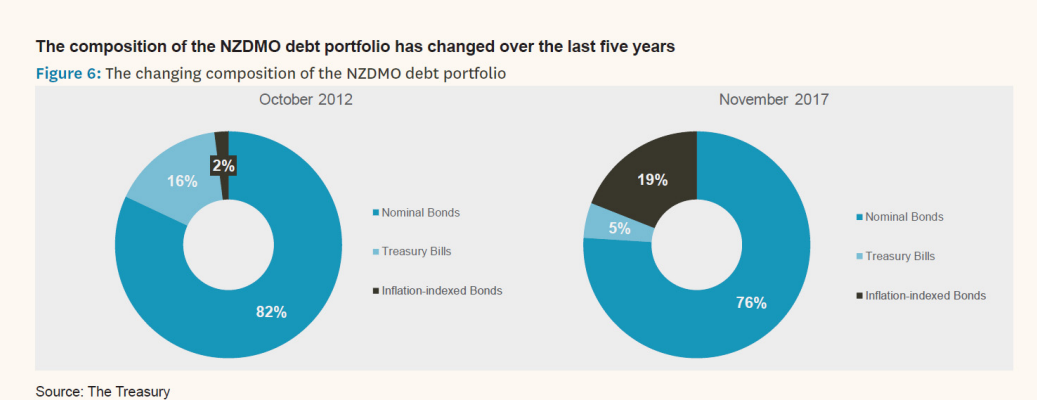
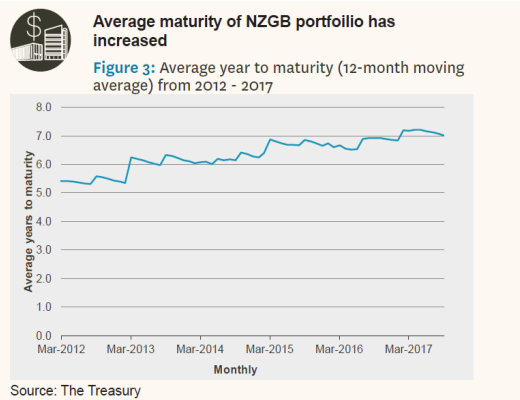
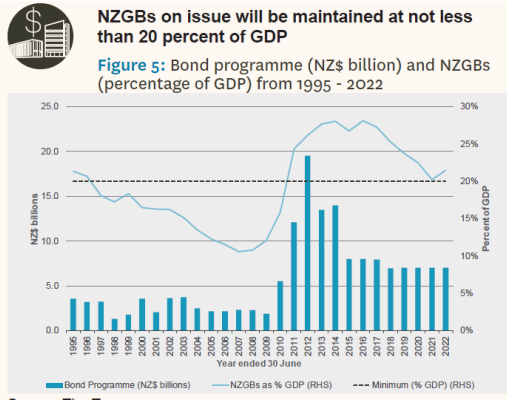
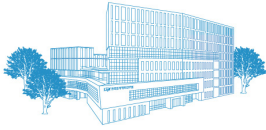
Source: Investment Statement 2018, Chapter 4 Detailed Sector Performance – Accident Compensation Corporation

b) NZDMO

NZDMO oversees core Crown borrowing requirements with the objective to (1) minimise borrowing costs over the long term with due consideration to risk, (2) manage core Crown funding risk and liquidity position, (3) provide financial market risk intermediation and advice to Crown entities, (4) manage the Crown’s core banking relationships, (5) administer loans to Crown entities in accordance with government policy, (6) manage the government’s obligations to the International Monetary Fund, and (7) manage financial market and operational risks (Investment Statement 2018). NZDMO occupies a significant portion of the government balance sheet, mostly in the liability side. In the long run, the New Zealand Government Bonds portfolio will be maintained between 20% to 30% of GDP and at a higher average maturity as below.

Figure 28 New Zealand Debt Management Office





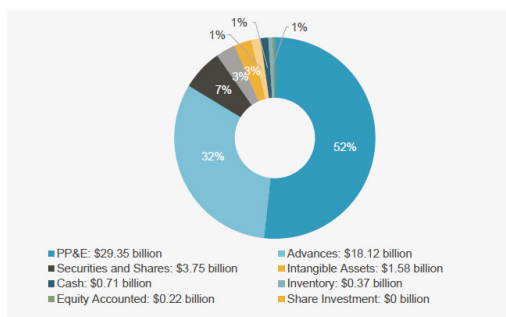
Source: Investment Statement 2018, Chapter 4 Detailed Sector Performance – New Zealand Debt Management Office

C. Commercial Portfolio

New Zealand government’s commercial portfolio is predominantly PP&E assets and interest-bearing liabilities. The commercial assets and liabilities are presented according to their asset/liability categories in the government balance sheet (Investment Statement 2018).

Figure 29

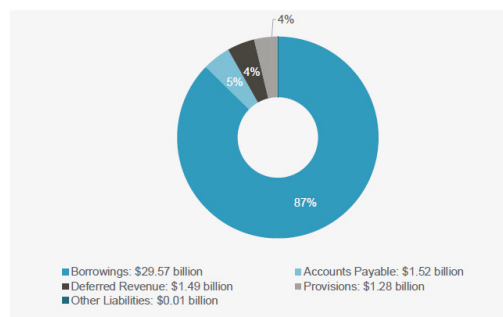
Assets for the Commercial Portfolio as at 30 June 2017



Source: The Treasury

Figure 30

Liabilities for the Commercial Portfolio as at 30 June 2017



Source: The Treasury

Source: Investment Statement 2018, Figure 1.10 – Assets for the Commercial Portfolio as at 30 June 2017 and Figure 1.11 – Liabilities for the Commercial Portfolio as at 30 June 2017

The commercial portfolio includes two sub-portfolios: (1) commercial priority companies, and (2) publicly listed companies. These portfolios are expected to perform as profitably and efficiently compared to those comparable businesses owned by the private sector.

The 2018 review of commercial portfolio documents the following observations:

1. The government realises returns from the portfolio primarily through dividends and the dividend yield is low.
2. Beyond commercial returns, there are few other reasons to own companies.
3. The performance challenges and risks facing commercial priority companies are numerous and diverse.
4. The mixed-ownership model has been financially successful.

(Investment Statement 2018, Chapter 2.3)

The performance assessment of commercial portfolio has been conducted across five dimensions: (1) effectiveness, (2) efficiency, (3) sustainability, (4) resilience, and (5) adaptability.

a) Air New Zealand Limited

Air New Zealand Limited's core business activity is the transportation of passengers and cargo on an integrated network of scheduled airline services to, from and within New



Zealand. Its primary commercial objective is to deliver returns to its shareholders where the government owns 51.9% of the voting shares as at 30 June 2017 (Investment Statement 2018). While Air New Zealand Limited has increased its connectivity domestically and internationally and operating efficiency through cost reduction programmes, it has still faced increased competition, especially in Asia.

Figure 31 Air New Zealand Limited

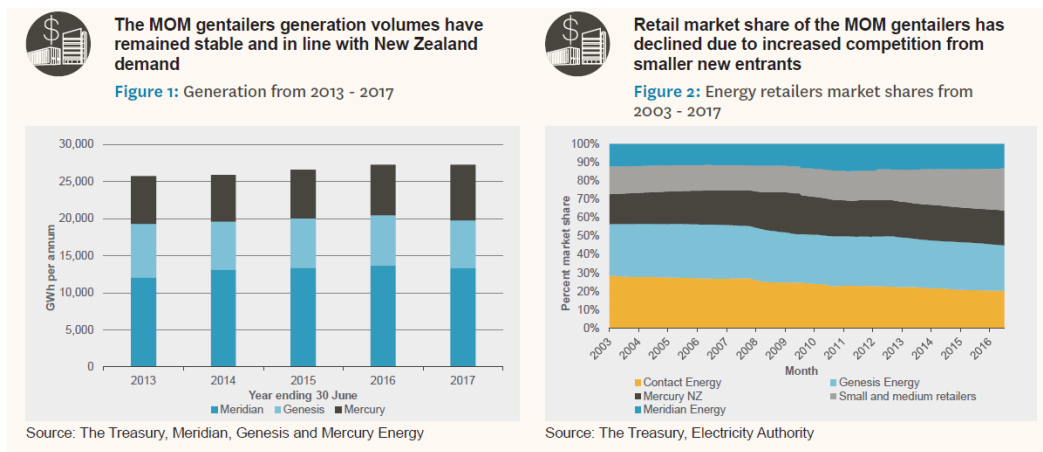


Source: Investment Statement 2018, Chapter 4 Detailed Sector Performance – Air New Zealand Limited

b) Electricity Generator Retailers

Three integrated electricity generators and retailers, including Genesis Energy, Mercury NZ and Meridian Energy, are Mixed Ownership Model where the government is required by legislation to own at least 51% (Investment Statement 2018). While the generation activity has remained stable and in line with New Zealand demand, the retail market share has declined due to increased competition from smaller new entrants as below.

Figure 32 Electricity Generator Retailers



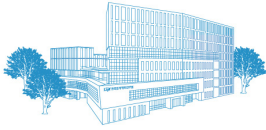
Retail market share of the MOM gentailers has declined due to increased competition from smaller new entrants

Table 2: Relative risk from key system features

Company	HVDC exposure	Emissions trading exposure	Dry-year risk (including hedge contracts)	Marginal cost to generate	Exposure to NZAS closure	Generation diversification
Genesis	Low	Moderate	Low	High	Moderate/High	Moderate
Meridian	High	Low	Moderate	Low	High	Moderate
Mercury	Low	Low	Moderate	Low	Moderate	Moderate

Source: The Treasury

Source: Investment Statement 2018, Chapter 4 Detailed Sector Performance – Electricity Generator Retailers



D. Balance Sheet Resilience Test

One targeted outcome of good balance sheet management is to ensure the sustainability and resilience of the balance sheet so that public services can continued to be delivered in an uncertain future and enable the government to adapt to a range of economic, environmental, social and fiscal pressures (Investment Statement 2018)

Three fiscal stress tests were conducted when preparing the Investment Statement 2018 to provide information to inform fiscal strategy or risk management decisions by the government. These three fiscal stress tests are (1) a severe Wellington earthquake, (2) an outbreak of foot-and-mouth disease, and (3) a major international economic downturn. These tests will provide an overview of potential costs on the government’s fiscal situation in three categories:

1. Balance sheet revaluations – changes in the value of assets and liabilities as a result of the shock e.g. changes in the value of property owned by the government.
2. Direct fiscal costs – actual costs incurred as a result of the shock, e.g. financial support, cost to rebuild infrastructure, triggering of contingent liabilities.
3. Indirect fiscal costs – changes to future government revenue and expenses as a result of the economic impact from the shock.

(Investment Statement 2018)

Table 16 Severe Wellington earthquake stress test results

Cost type	Financial impact	Comment
Balance sheet revaluation	~\$5 billion	Price falls in both New Zealand equity and property markets reduce the values of the government’s equity investments and property assets. Partially offsetting these downward revaluations are gains due to lower real interest rates and currency movements.
Direct fiscal costs	~\$22 billion	Includes response costs, damage to government owned assets, the government’s share of infrastructure rebuild costs, discretionary support for affected residents similar to the Christchurch red-zone package and EQC costs net of reinsurance recoveries.

Cost type	Financial impact	Comment
Indirect fiscal costs (in today's dollars)	~\$38 billion	Driven predominantly by lower future tax revenue from source deduction and goods and services tax (GST), a flow-on effect from lower GDP.
Total financial impact on the Crown	~\$65 billion	In today's dollars.

Impact on net debt

Net core Crown debt increases to 31 percent of GDP five years after the shock, 13 percentage points higher than the HYEPU 2017 forecast.

Table 17 Foot-and-mouth outbreak stress test results

Cost type	Financial impact	Comment
Balance sheet revaluation	~\$9 billion	Driven by falls in the values of the government's New Zealand equity investments and property assets. Partially offsetting these downward revaluations are gains due to lower real interest rates and currency movements.
Direct fiscal costs	~\$6 billion	Includes discretionary support to affected farmers, eradication and compensation costs.
Indirect fiscal costs (in today's dollars)	~\$6 billion	Driven predominantly by higher benefits and welfare expenses as a result of job losses in affected sectors.
Total financial impact on the Crown	~\$22 billion	In today's dollars.

Impact on net debt

Net core Crown debt increases to 22 percent of GDP five years after the outbreak, five percentage points higher than the HYEPU 2017 forecast.



Table 18 International economic downturn stress test results

Cost type	Financial impact	Comment
Balance sheet revaluation	~\$30 billion	Equity assets are most affected. Property assets also fall in value as the property markets weaken.
Direct fiscal costs	None	No direct costs are assumed with the event.
Indirect fiscal costs (in today's dollars)	~\$127 billion	Nominal GDP is lower than the HYEFU 2017 forecast over the entire period. A significant tax revenue fall, along with slightly higher expenses, particularly in welfare and benefits leads to cash deficits over the entire projection period.
Total financial impact on the Crown	~\$157 billion	In today's dollars.

Impact on net debt

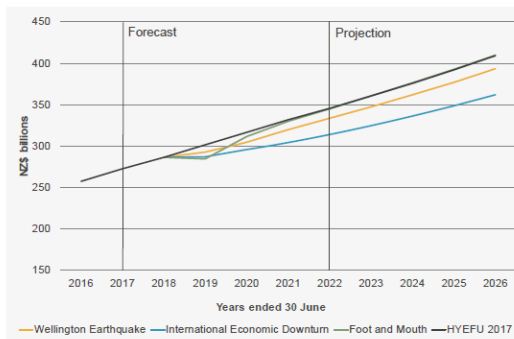
Net core Crown debt rises to 33 percent of GDP five years after the event, 15 percentage points higher than the HYEFU 2017 forecast.

Source: Investment Statement 2018, Tables 1.5 to Tables 1.7 – Resilience test results

These results from these costs will be used to estimate the impact on various fiscal indicators including nominal GDP, OBEGAL and net core Crown debt. (Investment Statement 2018, Chapter 1.3 Testing fiscal resilience).

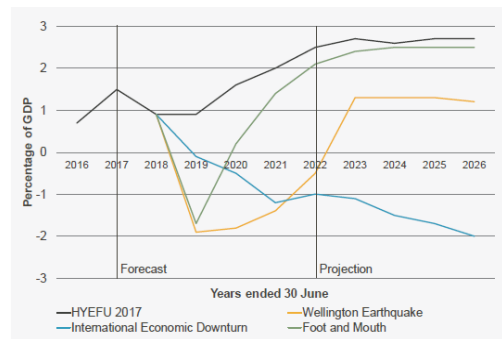
Figure 33 Impacts of stress test on nominal GDP, OBEGAL and net core Crown debt

Figure 1.14: Impacts of stress test on nominal GDP



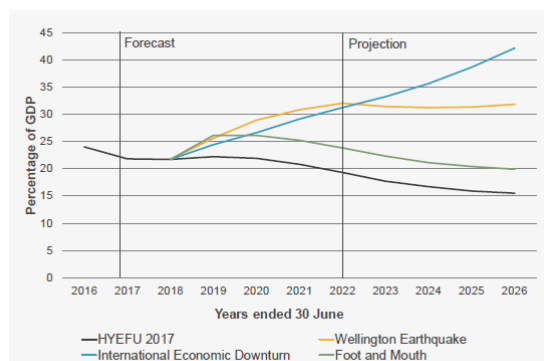
Source: The Treasury

Figure 1.15: Impacts of stress test on OBEGAL



Source: The Treasury

Figure 1.16: Impacts of stress test on net core Crown debt



Source: The Treasury

Source: Investment Statement 2018, Figures 1.14 to 1.16 – Impacts of stress test on nominal GDP, OBEGAL and net core Crown debt

E. Investor Confidence Rating

The investor confidence rating (ICR) is one key characteristics of the balance sheet management approach, arising from the results of the Investment Statement 2014. The ICR is created to (1) reinforce the main objective of the government’s investment system which is to optimise value for New Zealanders, and (2) provide an incentive mechanism that rewards good investment management performance and proactively addresses gaps (Investor Confidence Rating 2021). The ICR process is summarised as below:

What is the ICR?

- The ICR is a Cabinet–approval approach for assessing agency investment performance and thus the level of confidence stakeholders should place in the ability of an agency to manage its assets and investments well.
- The assessment is managed by Treasury on a three yearly cycle. The results are expressed in a range from A (high confidence) to E (very low confidence).
- The ICR works on the hypothesis that there is a strong connection between agency capability and future performance. The ICR takes account of the level of maturity in each agency of key investment management capabilities (lead indicators) and the performance of significant investments and assets against expected targets (lag indicators).



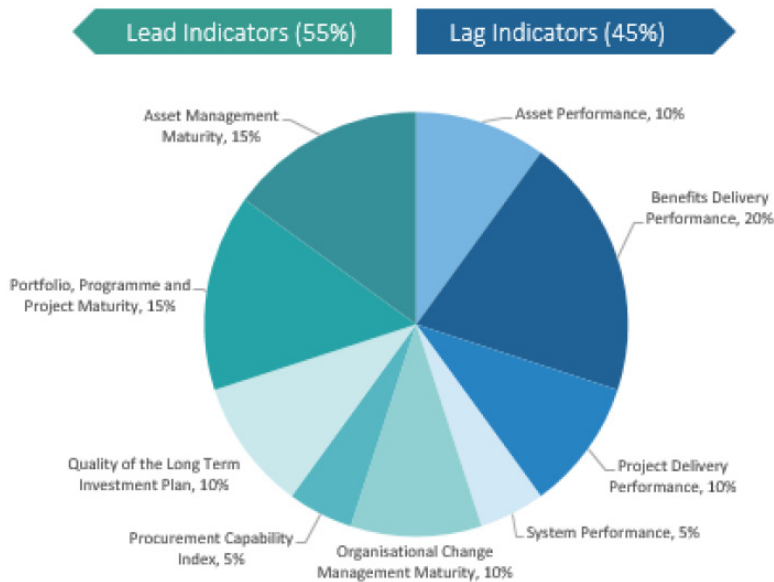
Which agencies are subject to the ICR?

- Cabinet has identified 25 investment-intensive departments and Crown entities that manage investments and assets critical to the delivery of New Zealand Government services. These agencies collectively manage assets worth over \$100 billion, which is around 75 percent of the assets on the Crown's balance sheet.
- Cabinet has set the expectation that all investment-intensive agencies should achieve at least a "B" rating over time.

Source: Investor Confidence Rating (ICR) 2021, Introduction

The ICR process assesses 9 factors or elements, which are (1) asset performance, (2) benefits delivery, (3) project delivery, (4) system performance, (5) organisational change, (6) procurement capability, (7) quality of the long term investment plan, (8) portfolio, programme and project maturity, and (9) asset management maturity, against clear, appropriate targets as below.

Figure 34 The ICR uses 9 elements to assess performance



Source: Investor Confidence Rating (ICR) 2021, How the ICR works

The result of 2021 ICR evaluation is provided as below.

Figure 35 Agency results

Cabinet expects investment-intensive agencies to achieve a minimum of a B rating.

The Treasury considers the ICR assessments in Round 2 to be more robust and therefore more reliable than those in Round 1.

This means that to maintain the same ICR score between rounds agencies will have had to make improvements in several elements compared with what existed at the time of the Round 1 assessment.

ICR Scoring system

Total Score	Rating
81	A
66	B
51	C
26	D
0	E

Agency		Round 1		Round 2	
		Score	Rating	Score	Rating
ACC	Accident Compensation Corporation	77	B	74	B
ADHB	Auckland DHB	71	B	73	B
CCDHB	Capital & Coast DHB	51	C	62	C
CDHB	Canterbury DHB	69	B	75	B
CMDHB	Counties-Manukau DHB	82	A	66	B
Corrections	Department of Corrections	61	C	77	B
Customs	New Zealand Customs Service	77	B	78	B
Defence	Defence Sector (NZDF & MoD)	73	B	79	B
DIA*	Department of Internal Affairs	58	C	56	C
DOC	Department of Conservation	61	C	72	B
HNZC	Housing New Zealand Corporation	87	A	87	A
IRD	Inland Revenue Department	83	A	86	A
MBIE*	Ministry of Business, Innovation, and Employment	70	B	79	B
MFAT	Ministry of Foreign Affairs and Trade	81	A	77	B
MoE	Ministry of Education	63	C	68	B
MoH	Ministry of Health	62	C	40	D
MoJ	Ministry of Justice	68	B	68	B
MSD	Ministry of Social Development			63	C
NDHB	Northland DHB	61	C		
NZTA	New Zealand Transport Agency	72	B	60	C
Otakaro	Otakaro Limited	88	A		
Police	New Zealand Police	56	C	69	B
SDHB	Southern DHB			36	D
WKDHB	Waikato DHB	57	C	52	C
WDHB	Waitemata DHB	72	B	70	B

* Excludes the Government Chief Digital Officer (GCDO) and New Zealand Government Procurement (NZGP) functional leads

Source: Investor Confidence Rating (ICR) 2021, Agency results

F. Capital Charges

The capital charges are a key mechanism to price the use of capital into the cost of producing government services, and to incentivize good asset management within government entities. Capital charges are to be treated as an expense when entities are reporting to Treasury (<https://www.treasury.govt.nz/information-and-services/state-sector-leadership/guidance/financial-reporting-policies-and-guidance/accounting-guidance/capital-charge-financial-instrument-or-expense>). It should be noted that the se capital charges are eliminated during the consolidation process and as a result are not presented in the consolidated financial statements of the government.



The capital charge regime is currently applied to 35 Departments, three Offices of Parliament, and certain statutory Crown entities as provided under the Crown Entities Act 2004 (e.g. 20 District Health Boards and 7 other Crown entities). The capital charge regime applying to agencies whose taxpayers' funds equal around \$33 billion is shown as below.

Table 19

Examining the capital charge regime: current state and potential further work on system settings

Agencies subject to capital charge regime	Estimated Taxpayer's funds (\$m)	Estimated Annual capital charge expense (\$m)
Ministry of Education	14,761	886
NZ Defence Force	5,971	358
DHB sector (20 DHBs)	5,300	318
Department of Corrections	2,357	141
Ministry of Justice	1,139	68
New Zealand Police	797	48
Department of Conservation	605	36
Ministry of Foreign Affairs and Trade	578	35
Ministry of Social Department	327	20
Other departments (30)	1,279	77
Other Crown entities (7)	133	8
Total for all 65 agencies	33,247	1,995

Source: Treasury Report 2018: Examining the capital charge regime: current state and potential further work on system settings

VI. POTENTIAL DIFFICULTIES IN ASSETS AND LIABILITIES MEASUREMENT

As outlined in the Key audit matters section in the Financial Statements of New Zealand Government for the financial year ended 30 June 2020, there are key areas of assets and liabilities that have been subject to high level of uncertainty, thus leading to potential difficulties in the measurement of these assets and liabilities.

1. Assets

A. Personal and corporate tax receivables

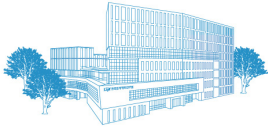
Personal and corporate tax receivables for the year are estimated as the final income tax receivables is only known when the tax return is finalised. The total tax receivables are dependent on how the economy will perform which is currently exposed to greater uncertainty due to the COVID-19 pandemic. Specifically, the estimation of tax receivables is inherently uncertain, and judgment is used to estimate the following:

- The amount of tax to be collected from provisional taxpayers who have not yet filed their final tax return.
- The amount of tax revenue where payments have been received by no provisional or final tax return has been filed.
- The performance of the New Zealand and global economy.

(Financial Statements of the Government of New Zealand 2020)

B. Property, plant, and equipment

Land and buildings: The fair value of land and buildings are largely subject to a range of valuation methods and assumptions. The COVID-19 pandemic has caused increased difficulty in estimating the short-term and long-term effect on the values of land and buildings.



State highways: The valuation of state highways involves significant estimates and assumptions, including assumptions about quantities and rates used to construct the state highways, the remaining useful life of the assets, and the unit costs to apply.

Electricity generation assets: The valuation of electricity generation assets is extremely complicated due to the reliance on significant assumptions about future prices of electricity, generation costs, and how much electricity will be generated. These assumptions are also interdependent on each other (Financial Statements of the Government of New Zealand 2020).

C. Financial assets

Financial assets include loans, investments, and deposits, including student loans and the small business cashflow (loan) scheme. Some financial assets do not have an active quoted market price as below.

- Student loans are measured using actuarial and predictive models, reflecting current student loan policy and macro-economic assumptions. Therefore, the value of student loans assets is sensitive to changes in several assumptions, including future income levels, repayment behaviour, inflation, and discount rates.
- Small business cash flow loan scheme is very new so there is no data available to determine the rates of repayment or default as well as the discount rates.

(Financial Statements of the Government of New Zealand 2020)

2. Liabilities

A. Borrowings – Large Scale Asset Purchase Programme

In response to the COVID-19 pandemic, the Reserve Bank of New Zealand implemented a large-scale asset purchase programme, aiming to purchase up to \$100 billion of bonds with losses. This program has exposed the government to significant interest rate risk (moving from fixed interest rate risk to floating interest rate risk). Up to 30 June 2020, this large-scale asset purchase programme had incurred a loss of \$3.3 billion (Financial Statements of the Government of New Zealand 2020).

B. Insurance liabilities

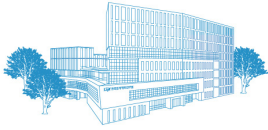
The value of insurance liabilities of the Accident Compensation Corporation is dependent on four closely linked assumptions:

- The discount rate used to get a present value of expected claims payments,
- The risk margin for the inherent uncertainty in the estimate of the present value of expected claims payment,
- The effects of inflation and innovation on future medical costs, and
- The length of the rehabilitation period from injuries.

(Financial Statements of the Government of New Zealand 2020)

C. Superannuation liabilities

The value of the unfunded liability is sensitive to the value of the Fund's assets, expected rates of salary increases for members of the Fund, and estimated inflation and discount rates. The Fund's assets (mainly shares and bonds) are traded on markets and the changes in value of these shares and bonds significantly affect the amount of unfunded liability (Financial Statements of the Government of New Zealand 2020).



D. Veterans' disability entitlements liabilities

The value of veterans' disability entitlements liability is subject to great uncertainty due to (1) possible deficiencies in the underlying data used to make the estimate, (2) the extent to which veterans will take up their full entitlement, (3) the discount rate, (4) the inflation rate, and (5) changes in mortality rates (Financial Statements of the Government of New Zealand 2020).

E. Entitlements under the Holidays Act 2003

The value of the provision for employee entitlements under the Holidays Act 2003 is still ongoing as further work is still needed to finalise the amounts owed to each individual, resulting in uncertainty in the value of the provision. Within certain entities, particularly the district health boards and schools, it is difficult and will take longer to calculate the value of entitlements given the number of employees working in these entities (Financial Statements of the Government of New Zealand 2020).

F. Contingent liabilities

Contingent liabilities are possible costs that have arisen from past events, but the amount of the liability, or whether it will eventuate, will not be confirmed until a particular event occurs; or they are present liabilities that are unable to be measured with sufficient reliability to be recorded in the fiscal forecasts. Contingent liabilities typically consist of guarantees and indemnities, uncalled capital and legal disputes and claims. Contingent liabilities faced by the Crown are a mixture of operating and balance sheet risks and can vary significantly in magnitude and likelihood of realisation (Budget Economic and Fiscal Update 2021). Below is information regarding the quantifiable contingent liabilities faced by the Crown.

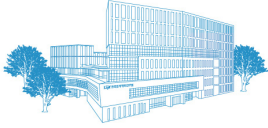
Table 20 Quantifiable contingent liabilities

	Status ¹	31 March 2021 (\$millions)	30 June 2020 (\$millions)
Uncalled capital			
Asian Development Bank	Unchanged	3,140	3,315
International Monetary Fund – promissory notes	Unchanged	1,887	2,058
International Bank for Reconstruction and Development	Unchanged	1,808	1,724
International Monetary Fund – arrangements to borrow	Unchanged	1,358	693
Asian Infrastructure Investment Bank	Unchanged	529	575
Other uncalled capital	Unchanged	18	19
		8,740	8,384
Guarantees and indemnities			
New Zealand Export Credit guarantees	Unchanged	178	127
Other guarantees and indemnities ²	Unchanged	124	136
		302	263
Legal proceedings and disputes			
Inland Revenue – legal tax proceedings	Unchanged	189	189
New Zealand Transport Agency	Unchanged	102	80
Other legal proceedings and disputes	Unchanged	158	222
		449	491
Other quantifiable contingent liabilities			
Unclaimed monies	Unchanged	204	183
Ministry for Primary Industries – Biosecurity Act 1993 compensation	Unchanged	130	132
Other quantifiable contingent liabilities	Unchanged	228	170
		562	485
Total quantifiable contingent liabilities		10,053	9,623

¹ Status of contingent liabilities or assets when compared with the Financial Statements of the Government for the year ended 30 June 2020, (based on the nature of the contingency, not the dollar value of contingencies is updated regularly) published on 24 November 2020

² These include the Business Finance Guarantee Scheme. Note the actual call on the Business Finance Guarantee Scheme is not quantifiable.

Source: Budget Economic and Fiscal Update 2021, Quantifiable contingent liabilities

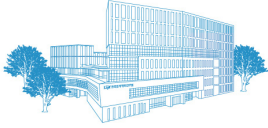


VII. Conclusion

Accrual accounting is used consistently throughout the whole public financial management system in New Zealand, ranging from fiscal policy and budgeting, financial reporting to strategies and plans. Accrual accounting is applied systematically throughout the Central Government, all departments, and agencies as well as local governments. Accrual accounting has been introduced consistently in New Zealand's public financial management system not only because it is better than cash accounting but because it is essential to measure the financial performance and position of the Government and entities within the Government as a whole captured in the Public Finance Act 1989. The public finance modernisation work was undertaken by the Treasury. The adoption of accrual accounting has been considered as fundamental and has not been open for reconsideration. While accrual accounting has played an important role in fiscal risk identification and assets and liabilities management, there do remain certain potential difficulties in its implementation in the preparation of the financial statements. It should also be well noted that some of these difficulties apply equally in the private sector (e.g. asset and liability valuation in general) while others (e.g. the estimation of tax revenue receivables) are more acute in the public sector.

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Author Biography

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Dr Thu Phuong Truong is an Associate Professor of Financial Accounting at Victoria University of Wellington. She teaches financial accounting, financial statement analysis, finance, and research methodology at both undergraduate and postgraduate levels. She facilitates the financial accounting and reporting and capstone courses for the Chartered Accountants Australia and New Zealand pathway programmes. Her research interest is in the fields of financial regulation, corporate governance, corporate disclosure, corporate strategy, and firm valuation. She has published in numerous academic journals, including *Accounting & Finance*, *Pacific-Basin Finance Journal*, *Meditari Accountancy Research*, *Company and Securities Law Journal*, *Australian Journal of Corporate Law*, *Research in International Business and Finance*, *Accounting Research Journal*, and *Pacific Accounting Review*. She serves on the editorial board of *Accounting & Finance*; and is an editor of *Accounting & Finance* and associate editor of *Accounting Research Journal*. She is a member of the management committee of the Quantitative Accounting Research Network, which aims to support and strengthen the environment for quantitative accounting research in New Zealand. She is a member of both Chartered Accountants Australia and New Zealand (CAANZ) and Certified Practising Accountants (CPA) Australia. Given her deep interest in the foreign affairs and international business, she is a member of the Executive Committee of the Asia Forum of Wellington and a member of the Academic Advisory Team of Southeast Asia Centre of Asia-Pacific Excellence. Outside academia, she is a co-founder and CEO of ADEDU, of which mission is to promote and nurture the creative mind in New Zealand and beyond.

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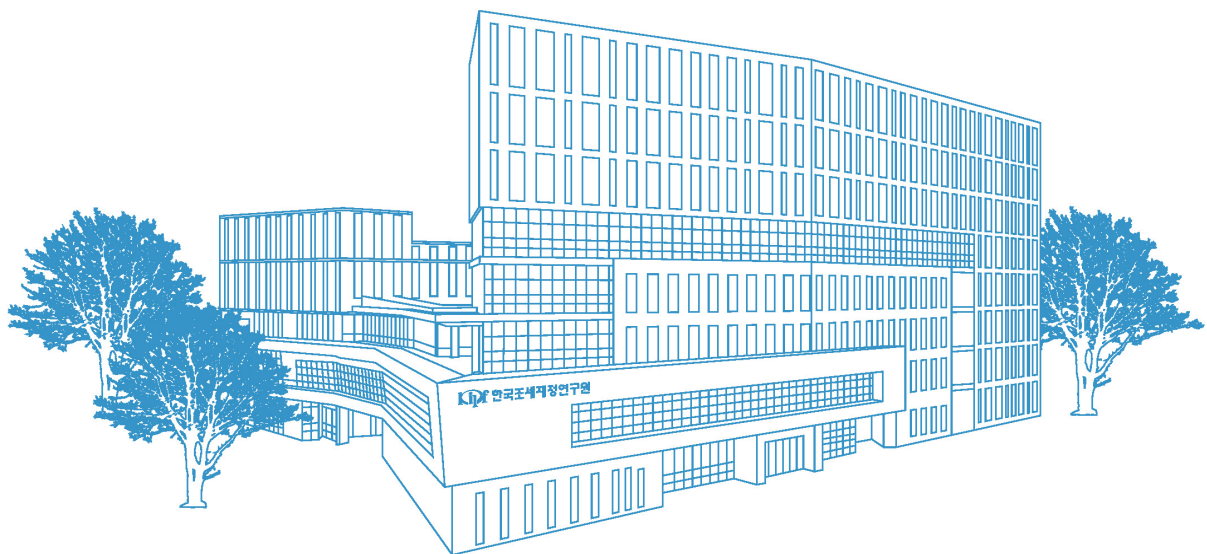
Australia

Use of Accrual Information

Focusing on Fiscal Risk Identification and Assets and
Liabilities Management

2021

Mike Blake





KOREA INSTITUTE OF PUBLIC FINANCE

Government Accounting and Finance Statistics Center

Statement of Submission

The research was undertaken by the agreement for the research project “USE OF ACCRUAL INFORMATION: Focusing on Fiscal Risk Identification and Assets and Liabilities Management” between the Korea Institute of Public Finance (KIPF) and Mr. HM Blake.

Hence, this publication, *Use of Accrual Information focusing on Fiscal Risk Identification and Assets and Liabilities Management*, is a result from the agreement proposed by KIPF with the purpose to conduct an in-depth study on the use of accrual information in Australia.

Date Submitted: September, 2021

Signature:

A handwritten signature in black ink, appearing to read 'H. Blake', is positioned above the signature label.

Author of the report: HM Blake



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Summary

This summary follows the sequence of chapters outlined in the contents page. No explicit recommendations are made.

Conclusions drawn from identifying major reports, their composition and contents

Conclusions regarding legislative requirements as these relate explicitly to identifying fiscal risks and management of assets and liabilities

The Charter of Budget Honesty Act 1998 (especially when read with other legislation) provides a sound and consistent basis under which successive Australian Governments must identify, report on and manage fiscal risks and their management of both assets and liabilities.

No conclusions are drawn as to whether or not application of the legislation results in effective identification and management of fiscal risks or of the management of assets or liabilities. This is for others, such as voters, to judge. However, application of the principles outlined in the legislation should facilitate preparation of reports enabling relevant identification of fiscal risks and comparison of financial performance over time.

Conclusion regarding identified official government reports

The following seven official government reports were identified:

- 1) Federal budget papers (budget papers)
- 2) Mid-year Economic and Fiscal Outlook (MYEFO)
- 3) Final Budget Outcome (FBO) report
- 4) Intergenerational reports (long-term fiscal sustainability reports or equivalent) (IGR) but which is cash, not accrual, based)

- 5) Pre-Election Economic and Fiscal Outlook (PEFO) report¹⁾
- 6) Whole of government consolidated financial statements (CFS) and
- 7) Uniform Presentation Framework.

These reports provide a sound basis for reporting by the Australian Government to the Australian Parliament and people about how it identifies and manages fiscal risks and its management of assets and liabilities. They also facilitate analysis by the international community.

Evident from these reports is the reliance on selected financial measures but which are considered appropriate and consistent with accounting standards and the requirements of Government Financial Statistics (GFS). In addition, the reconciliation of budgeted cash underlying balance and

MYEFO cash underlying balance is a strong accountability mechanism as is the requirement under Australian Accounting Standard AASB 1049 *Whole of Government and General Government Sector Financial Reporting* for inclusion of a reconciliation between AAS and GFS frameworks.

Management of assets and liabilities is comprehensively demonstrated by budgeting for actual, and movements in, net worth, net and gross debt and net financial assets and liabilities.

To assist readers, all measures and aggregates are defined within the official reports and how each is calculated explained or obvious.

No conclusions are drawn as to whether or not these reports demonstrate effective identification or management of fiscal risks or of the management of assets or liabilities by the Australian Government. However, preparation of these reports satisfies legislative requirements and facilitates analysis of Government's

1) reports 1 to 5 are required by the Charter of Budget Honesty Act 1998

performance in identifying and managing fiscal risks and of assets and liabilities over time.

This research concluded that of the various metrics identified, none are more important than others but that, when evaluation fiscal risk or asset and liability management they should be regarded as a package although, depending on the matter being evaluated, some metrics may be of greater relevance. For example, net worth is likely to be relevant when assessing the capacity of a government to withstand future shocks or contingent liabilities.

Conclusions regarding other identified reports

This part of this Report discussed other reports identified when carrying out this research and the following are addressed in the Chapter dealing with major composition and contents:

- Government Finance Statistics
- Assessment of asset impairments and
- Metrics used in the private sector – provided for comparative purposes only.

No conclusions are drawn.

Conclusions drawn when considering cost and expertise input for publication (of official government reports)

Establishing the costs incurred and expertise applied in preparing the various reports referred to previously proved difficult and probably not helpful. It may be better for the Chief Director, Government Accounting and Finance Statistics Center, Korea Institute of Public Finance to make contact with Officials on the Australian Department of Finance to explore costs incurred and expertise involved.

Conclusions drawn on the degree of usage in decision making and its effects on PFM

Conclusions on the degree of usage of identified official reports in decision making were based on my personal experiences which ranges from times when governments in Australia focused on cash-based financial information, moving to accrual-based and then outputs-based with commentary provided in this Chapter on each phase. Each plays a role in effective PFM with none to be considered in isolation of the others.

My own experiences indicate to me there is strong use of budget information, including the MYEFO, FBO, PEFO and IGR by parliamentarians (or equivalent documents at a sub-national level), either in their own right or when part of Estimates processes or committees such as Public Accounts Committees or equivalent. Other users include the media.

However, it is my experience that less attention is given to the CFS by parliamentarians or the media which is, in my view, unfortunate.

Regarding PFM, evident from extracts from the International Public Sector Accounting Standards Board's Strategy and Work Plan 2019-2023 this is that accrual based financial information, prepared based on independently developed accounting standards, from which the non-cash metrics referred to in tables 2 to 4 can be drawn, is essential to better decision making about PFM.

Conclusions drawn from analysis of drivers to success or obstacles to publication of reports and/or implementation of related policies

Commentary in this Chapter is primarily based on personal experiences from which it was noted that, while there may have been obstacles when Australian jurisdictions first moved to accrual reporting and accounting, jurisdictions developed policies and frameworks facilitating the move from cash to accrual and the AASB developed accounting standards which, when adopted and applied, resulted in compliance

with independently approved reporting frameworks. Legislative frameworks referred to earlier locked in the budgeting and financial reporting arrangements that now exist.

Internationally, multiple such frameworks apply with the International Federation of Accountants'/International Public Sector Accounting Standards Board's Study 14 *Transition to the Accrual Basis of Accounting: Guidance for Public Sector Entities* being a useful tool. Study 14 articulates obstacles and stages needing to be followed for successful transition. This includes the need for comprehensive training for staff and users of such reports and identification of systems requirements.

This Chapter articulates my views about success and obstacles identifies in transition from cash to accrual and notes that, based on advice provided, whenever transition to accrual accounting is proposed, it is useful to emphasise the critical success factors, including top level support, appropriate systems and expertise, good planning and communication, gradual implementation rather than a "big bang" approach, and communications with key stakeholders, particularly auditors. Regarding the question as to whether or not, when moving to accrual accounting, a centralised versus a decentralised approach be applied. No conclusions were drawn. Appropriate planning will need to consider which approach works best for individual jurisdictions.

Other than cost or availability of appropriate expertise, there are no obstacles to the publication of the reports referred to in this Report.

Jurisdictions considering a move from cash to accrual, if they have not already done so under either system of accounting, should establish an independent external audit function and may wish to establish an independent budget office.

Use of Accrual Information Focusing on Fiscal Risk Identification and Assets and Liabilities Management

OVERVIEW

Background

The Government Accounting and Finance Statistics Center (hereinafter referred to as “GAFSC”) of the Korea Institute of Public Finance (hereinafter referred to as “KIPF”) is engaged in a project conducting an in-depth study on the use of accrual information. It identified that many OECD countries were using accrual information for the following purposes: identification of fiscal risks, assets and liabilities management, cost policing, and improving financial reporting.

Objective and agreed deliverables

The main objective of this Report was on the identification of fiscal risks, and assets and liabilities management focusing on its effects, current status of operation, level of recognition and acceptance on the usage. In addition, this Report considers Australia’s experience and expertise in incorporating accrual information in the interests of sound public finance. The research outcome is expected to set the directions for the usage of accrual information for public financial management in Korea.

I was engaged to conduct research into the use of accrual information focusing on fiscal risk identification and assets and liabilities management. This report is aimed at providing the agreed deliverables being:

- 1) Review of official government reports regarding identification of fiscal risks, and assets and liabilities management through document review and conducting interviews with



key stakeholders – refer Chapter headed ‘Major composition and contents of the report (focusing on the part specifically incorporating accrual information)’.

2) That this Report address:

- a) Brief overview of the report (background, objective, progress, institution in charge, etc.) – refer this Chapter.
- b) Cost and expertise input for publication – refer Chapter with this heading starting on page 34.
- c) Major composition and contents of the report (focusing on the part specifically incorporating accrual information) – refer Chapter with this heading starting on page 10.
- d) Degree of usage in decision making and its effects on PFM – refer Chapter with this heading starting on page 36.
- e) Analysis on the drivers to success or obstacles – refer Chapter with this heading starting on page 40.

Approach

The approach adopted in carrying out this work included:

- 1) Identification and assessment of official government reports or documents on identification of fiscal risks, and assets and liabilities management by undertaking thorough document review and obtaining written advice from an official at the Department of Finance.
- 2) Identification of legislation relevant to the preparation of official government reports or documents on identification of fiscal risks, and assets and liabilities management.
- 3) Consideration of the drivers to success or obstacles to the publication of such reports / implementation of related policies – this was done based on personal experiences.
- 4) Provision of references (official government reports and relevant laws and regulations), related links, other relevant papers or publications considered relevant.

MAJOR COMPOSITION AND CONTENTS

Introduction

Research was focused on identifying those publicly available reports and/or documents addressing fiscal risks and management of assets and liabilities where such reports/documents were prepared on an accrual basis (unless explicitly stated otherwise). Two categories of reports were identified:

- Identified official Government²⁾ reports; and
- Identified other reports.

With the exception of the intergenerational report referred to later, which is cash-based, all financial budgets or reports reviewed were prepared on an accruals basis.

Before considering available reports however, understanding was needed regarding the term 'fiscal risks'. Research into this identified an International Monetary Fund Fiscal Affairs Department document titled Fiscal Risks – Sources, Disclosures, and Management prepared by Aliona Cebotari, Jeffrey Davis, Lusine Lusinyan, Amine Mati, Paolo Mauro, Murray Petrie, and Ricardo Velloso (IMF document). This document can be located at <https://www.imf.org/external/pubs/ft/dp/2009/dp0901.pdf> and attached at Appendix 1 is a possible assessment tool for completion by GAFSC as to the level of application of the guidelines outlined in this IMF document. Completion should assist GAFSC benchmark how:

- Well fiscal risks are identified and disclosed
- Effectively fiscal policy is developed, and
- Fiscal risks are addressed.

2) Unless otherwise stated, throughout this Report, Government refers to the Australian Federal Government.



In these respects, it is noted from the Guidelines³⁾ that fiscal risks to which a government is exposed should be identified and disclosed, so as to facilitate an effective conduct of fiscal policy – Identification of fiscal risks is a prerequisite for risk disclosure and management. Although risks may be adequately identified in the absence of disclosure, a commitment to making information on fiscal risks publicly available subjects the analysis to additional scrutiny, helping to ensure that risks are fully recognized and properly assessed. Moreover, disclosure may help to manage risks and reduce borrowing costs in the long run. Transparency also strengthens accountability for effective risk management; improves the quality of decisions on whether the government should take on risk in the first place; and promotes earlier and smoother policy responses.

This IMF document is regarded as useful not only because of the concepts outlined, but also because it provides examples of application by various jurisdictions.

Inclusion of reference to this IMF document is not to suggest any conclusion that the Australian Government does or does not, ‘comply’ with the guidelines outlined or that there is any explicit requirement that it should.

Identified Official Government Reports

Official government reports identified that addressed, or reported on, either directly or indirectly, fiscal risks and management of assets and liabilities were⁴⁾:

- 1) Federal budget papers (budget papers)
- 2) Mid-year Economic and Fiscal Outlook (MYEFO)
- 3) Final Budget Outcome (FBO) report
- 4) Intergenerational reports (long-term fiscal sustainability reports or equivalent) (IGR) but which is cash, not accrual, based)

3) Extracted from the first page of the guidelines outlined in Appendix 1.

4) Appendix 4 provides linkages to where these reports can be located.

- 5) Pre-Election Economic and Fiscal Outlook (PEFO) report⁵⁾
- 6) Whole of government consolidated financial statements (CFS) and
- 7) Uniform Presentation Framework.

Although not identified as an Official Government Report, the approach to assessing impairment of assets is also considered in this Chapter.

This review has not had regard to reports that may deal with particular aspects of asset or liability management (for example debt or superannuation/pension funds).

However, before examining these various reports, there is a need to consider the legislative context for each report in particular as these relate, if at all, to fiscal risks and/or management of assets and liabilities.

Legislative requirements

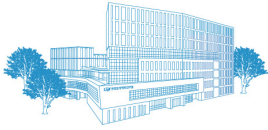
Details of legislative requirements are outlined in Appendix 2 with the most relevant requirements summarised as follows:

Legislative requirement to prepare a Budget

There is no legislation explicitly calling for the preparation of a document called a Budget. However, Section 83 in the Australian Constitution⁶⁾ requires that all expenditure be supported by an appropriation, so unless appropriation bills are passed, which is the core of the budget, no expenditure can take place. Also, the Charter of Budget Honesty Act 1998, referred to below, provides for the “budget papers” to contain specified information.

5) reports 1 to 5 are required by the Charter of Budget Honesty Act 1998

6) https://www.aph.gov.au/About_Parliament/Senate/Powers_practice_n_procedures/Constitution/chapter4#chapter-04_83



Of relevance to the discussion about the need for a budget in the Australian context is Infosheet 10 titled The budget and financial legislation which can be located at https://www.aph.gov.au/About_Parliament/House_of_Representatives/Powers_practice_and_procedure/00_-_Infosheets/Infosheet_10_-_Budget_and_financial_legislation

This Infosheet describes the process for introducing and considering the annual budget in the House of Representatives. It also outlines the different types of financial legislation and special requirements or parliamentary processes for these. The ordinary legislative process is described in Infosheet No. 7 *Making laws* which should be read in conjunction with this Infosheet – refer https://www.aph.gov.au/about_parliament/house_of_representatives/powers_practice_and_procedure/00_-_infosheets/infosheet_7_-_making_laws

Charter of Budget Honesty Act 1998⁷⁾ – this Charter is the legal framework for conducting government budget policy in Australia. The Charter aims to improve budget policy outcomes by establishing a set of rules and principles that guide how the government sets and reports on its budget performance. To facilitate public scrutiny of fiscal policy and performance, the Charter mandates the Government to publicly release the reports referred to in 1 to 5 above, outlines the information that should be included in each of these publications, at a high level only, and what accounting standards to reference when reporting financial information. Importantly, the Charter sets the objective of the Government’s fiscal policy, setting out five principles of sound fiscal management and requires the Government to publish fiscal strategies consistent with these principles. The principles are⁸⁾:

- 1) The principles of sound fiscal management are that the Government is to:
 - a) Manage financial risks faced by the Commonwealth prudently, having regard to economic circumstances, including by maintaining Commonwealth general government debt at prudent levels; and

7) file:///C:/Users/Asus/Downloads/Online%20budget%20glossary-23102020.pdf. Publication issued by the Parliamentary Budget Office.

8) Extracted from the Charter of Budget Honesty Act 1998.

- b) Ensure that its fiscal policy contributes:
 - To achieving adequate national saving; and
 - To moderating cyclical fluctuations in economic activity, as appropriate, taking account of the economic risks facing the nation and the impact of those risks on the Government's fiscal position; and
 - c) Pursue spending and taxing policies that are consistent with a reasonable degree of stability and predictability in the level of the tax burden; and
 - d) Maintain the integrity of the tax system; and
 - e) Ensure that its policy decisions have regard to their financial effects on future generations.
- 2) The financial risks referred to in paragraph (1)(a) include risks such as:
- a) Risks arising from excessive net debt; and
 - b) Commercial risks arising from ownership of public trading enterprises and public financial enterprises; and
 - c) Risks arising from erosion of the tax base; and
 - d) Risks arising from the management of assets and liabilities.

Public Governance, Performance and Accountability Act 2013 – requires preparation of the annual consolidated financial statements discussed later.

Summary of when referred to Official Government reports must be prepared

Table 1 below provides a timeline of preparation and frequency of publication of the six official government reports; details, where known, of the budget cycle including release of the budget, deliberation of the budget and its adoption into law. Also included is whether or not the six reports referred to address fiscal risk identification and assets and liabilities management.



Table 1 Summary of the contents of six Australian Government reports

Report	Frequency of completion/ Budget cycle – date released	Budget cycle – date deliberated/budget adopted	Fiscal risk metrics included	Asset & liability management metrics included
Federal budget papers	Annually	<p>In a normal year, the budget is delivered in early May, discussed in Senate Estimates in late May and Appropriation Bills in late June each year.</p> <p>The details of the expenditure proposed in the Budget are referred by the House of Representatives to the Senate for consideration by the Senate. This enables the Senate to commence its scrutiny of the Budget in the Senate Estimates process, despite the Senate having not yet received the annual Appropriation Bills from the House of Representatives. Additional resources:</p> <p>Department of the Senate, <i>Senate Brief No. 5: Consideration of Estimates by the Senate's Legislation Committees</i>⁹⁾</p>	Yes	Yes
Mid-year Economic and Fiscal Outlook ¹⁰⁾	Must publicly release and table a mid-year economic and fiscal outlook report by the end of January in each year, or within six months after the last budget, whichever is later	N/A	Yes	Yes
Final Budget Outcome ¹¹⁾	Must publicly release and table a final budget outcome report for each financial year no later than 3 months after the end of the financial year	N/A	Yes	Yes

9) https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/rp1718/Quick_Guides/CommonwealthBudget

10) Refer Division 2 – MYEFO report in the Charter of Budget Honesty Act 1998

11) Refer Division 3 FBO report in the Charter of Budget Honesty Act 1998

Report	Frequency of completion/ Budget cycle – date released	Budget cycle – date deliberated/budget adopted	Fiscal risk metrics included	Asset & liability management metrics included
Intergenerational reports ¹²⁾	Once every five years	N/A	Yes	Yes
Pre-Election Economic and Fiscal Outlook ¹³⁾	The responsible Secretaries are, jointly, to publicly release a pre-election economic and fiscal outlook report within 10 days of the issue of the writ for a general election	N/A	Yes	Yes
Whole of government consolidated financial statements ¹⁴⁾	The Finance Minister must prepare annual consolidated financial statements as soon as practicable after the end of each financial year; and give the statements to the Auditor-General as soon as practicable after they are prepared	N/A	Yes	Yes

Conclusions regarding legislative requirements as these relate explicitly to identifying fiscal risks and management of assets and liabilities

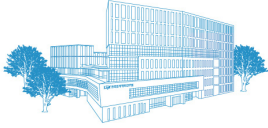
The Charter (especially when read with other legislation) provides a sound and consistent basis under which successive Australian Governments must identify, report on and manage fiscal risks and their management of both assets and liabilities.

No conclusions are drawn as to whether or not application of the legislation results in effective identification and management of fiscal risks or of the management of assets or liabilities. This is for others, such as voters, to judge. However, application of the principles outlined in the legislation should facilitate preparation of reports enabling relevant identification of fiscal risks and comparison of financial performance over time.

12) Refer Part 6 in the Charter of Budget Honesty Act 1998

13) Refer Part 7 in the Charter of Budget Honesty Act 1998

14) Refer Division 7 – Whole of Government financial reporting in the Public Governance, Performance and Accountability Act 2013



Budget Papers

The budget papers comprise various statements with details provided at <https://budget.gov.au/>. The budget sets out the economic and fiscal outlook, and the government's fiscal strategy, with details typically found in Statement 3: Fiscal Strategy and Outlook.

For example, in the 2019–20 Budget the government's medium-term fiscal strategy was to achieve budget surpluses, on average, over the course of the economic cycle. The strategy is underpinned by policy elements, including stabilising and reducing net debt over time and improving net financial worth over time. However, and in response to COVID-19, the 2020–21 Budget showed how Government responded to this pandemic and impacts on various fiscal aggregates. This is demonstrated by the following extract from the Budget Overview (refer <https://budget.gov.au/2021-22/content/overview.htm>):

Rebuilding our economy to repair the budget following COVID-19

Over the next four years, the deficit will nearly halve as a stronger economy improves the bottom line. The underlying cash deficit in 2021–22 is forecast to be \$106.6 billion (5.0 per cent of GDP). This is expected to improve over the forward estimates to a \$57.0 billion deficit (2.4 per cent of GDP) in 2024–25 and to a deficit of 1.3 per cent of GDP by the end of the medium term.

Compared to the 2020–21 Budget, the underlying cash deficit has improved by \$52.7 billion in 2020–21.

Gross debt is expected to be 40.2 per cent of GDP at 30 June 2021, increasing to 50.0 per cent of GDP by the end of the forward estimates. Gross debt is projected to stabilise at around 51 per cent of GDP over the medium term.

Net debt will increase to 30.0 per cent of GDP at 30 June 2021 before peaking at 40.9 per cent of GDP at 30 June 2025, and declining to

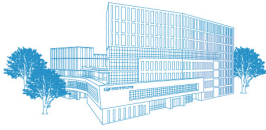
37.0 per cent of GDP at the end of the medium term.

Net debt is lower in every year compared to last year's Budget when it was expected to peak at 43.8 per cent of GDP.

Unless otherwise stated, the various Statements in the Budget are accruals-based. Table 2 below outlines which budget papers address identification of fiscal risks and management of assets and liabilities. The table identifies selected metrics (also referred to as aggregates) included in the various Statements that inform management of fiscal risks and of assets and liabilities.

Table 2 2021–22 Budget papers addressing fiscal risks and management of assets and liabilities

Statement ¹⁵⁾	Selected metrics informing Management of Fiscal Risks	Selected metrics informing Management of assets and liabilities
Statement 1 Budget Overview – This Statement provides an overview addressing the economic outlook, fiscal strategy and outlook and budget priorities (for example, getting Australians through COVID-19).	<p>Underlying cash balance and Net operating balance (both expressed in A\$ and as a percent of GDP)</p> <p>Tax receipts</p> <p>Net debt and Gross debt in A\$ and as a percent of GDP Debt to GDP ratio</p> <p>Real and nominal GDP</p> <p>Employment, unemployment rate, CPI and wage price index</p>	<p>Underlying cash balances (in A\$ and as a percent of GDP)</p> <p>Net debt in A\$ and as a percent of GDP</p> <p>Gross debt in A\$ and as a percent of GDP</p> <p>Debt to GDP ratio</p> <p>Proposed infrastructure investments</p> <p>Digital Economy Strategy (including the NBN upgrade plan)</p> <p>Establishing a national water grid fund</p>
Statement 2 Economic outlook This Statement presents the economic forecasts that underlie the Budget estimates. It includes discussion of the outlook for both the international and domestic economies and medium term projects	Statement 2 is mentioned for completeness but is not evaluated here other than to note that the economic outlook does indirectly inform fiscal risks – e.g. an increase in unemployment would reduce government taxation revenue and increase government social security expenditure, both of which are fiscal risks	Statement 2 is mentioned for completeness but is not evaluated here
Statement 3 Fiscal Strategy and Outlook	<p>Unemployment rates</p> <p>Underlying cash balances</p> <p>Tax receipts (supporting revenue growth)</p> <p>Tax to GDP ratio</p> <p>Controlling expenditure growth</p> <p>Net operating balance</p>	<p>Underlying cash balances (and as a share of GDP)</p> <p>Net and gross debt</p> <p>Using the Government’s balance sheet to support productivity-enhancing investments</p> <p>Net capital investment</p> <p>Fiscal balance</p>



Statement ¹⁵⁾	Selected metrics informing Management of Fiscal Risks	Selected metrics informing Management of assets and liabilities
	<p>Net debt (as a share of the economy – to GDP) Gross debt (as a share of the economy – to GDP) Fiscal balance Cumulative fiscal improvements and underlying cash balances over > 10 years</p> <p>Movements in budgeted operating balance compared to prior MYEFO</p> <p>Parameter variations¹⁶⁾</p>	<p>Capital spending and impact of capital spending on the borrowing requirement</p> <p>Impact of recurrent spending on the borrowing requirement Government borrowing</p> <p>Public debt interest as a percent of GDP</p> <p>Net financial worth (and as a percent of GDP) Net worth (and as a percent of GDP)</p>
<p>Statement 4 The labour market through COVID- 19 Statement 5 Revenue Statement 6 Expenses and Net Capital investment</p>	<p>These Statement are mentioned for completeness but were not evaluated here</p>	<p>These Statements are mentioned for completeness but were not evaluated here although it is worth noting that the Net Capital Investment part of Statement 6 shows how Government manages net assets. Net capital investment is broadly defined as the sale and acquisition of non-financial assets less depreciation expenses. It provides a measure of the overall growth in capital assets (including buildings and infrastructure, specialist military equipment and computer software) after taking into account depreciation and amortisation as previously acquired assets age. Relevant measures include:</p> <p>Total net capital investment in A\$ and as a percent of GDP</p> <p>Net capital investment by function in A\$</p>
<p>Statement 7 Debt Statement</p>		<p>Australian Government Securities (AGS) issuance strategy and changes therein (and as a percent of GDP)</p> <p>Net debt and Gross debt Interest on AGS</p>
<p>Statement 8 Forecasting performance and sensitivity analysis</p>	<p>Statement 8 is mentioned for completeness but is not evaluated here</p>	<p>Statement 8 is mentioned for completeness but is not evaluated here</p>

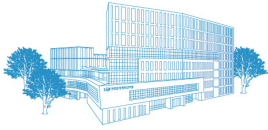
Statement ¹⁵⁾	Selected metrics informing Management of Fiscal Risks	Selected metrics informing Management of assets and liabilities
Statement 9 Statement of Risks	Outlines general fiscal risks, specific contingent liabilities and specific contingent assets that may affect budget balances at the entity level – further information is provided below Table 2	Outlines general fiscal risks, specific contingent liabilities and specific contingent assets that may affect budget balances at the entity level – further information is provided below Table 2
Statement 10 Australian Budget financial statements ¹⁷⁾ These comprise budgeted financial statements for the Australian Government general government sector (GGS), the public non-financial corporations (PNFC) sector, the total non-financial public sector (NFPS) and the public financial corporations (PFC) sector. These budget financial statements comply with both the Australian Bureau of Statistics' (ABS) accrual Government Finance Statistics (GFS) and Australian Accounting Standards (AAS), with departures disclosed.	Statement 10 is mentioned for completeness but is not evaluated here	Statement 10 is mentioned for completeness but is not evaluated here
Appendix A Financial reporting standards and budget concepts	Appendix A is mentioned for completeness but is not evaluated here	Appendix A is mentioned for completeness but is not evaluated here
Appendix B Assets and Liabilities	N/A	Outlines Government's major assets and liabilities
Statement 11 Historical Australian Government data ¹⁸⁾	Statement 11 is mentioned for completeness but is not evaluated here	Statement 11 is mentioned for completeness but is not evaluated here

15) Unless otherwise stated, the metrics noted in table 1 relate to the General Government Sector

16) Parameter variations are due to variations in underlying assumptions, rather than as a result of new government policy.

17) Statement 10 Budget financial statements are the end product of all the other budget activities discussed in statements 1-9.

18) This Statement is not directly related to current fiscal risks, but does put the current budget/fiscal situation into historical context.



Further information regarding Statement 9 Statement of Risks

The question that needs answering here is whether or not Statement 9 provides metrics facilitating assessment of the identification and management of fiscal risk and or asset and liabilities management. Information provided here is taken, or summarized from Statement 9 in the 2021–22 budget papers¹⁹).

Statement 9 commences by noting that a range of factors may influence the actual budget outcome in future years. The *Charter of Budget Honesty Act 1998* requires these factors to be disclosed in a statement of risks in each Budget and Mid-Year Economic and Fiscal Outlook. This Statement outlines general fiscal risks, specific contingent liabilities and specific contingent assets that may affect the budget balances.

In overview the Statement notes that the forward estimates of revenue and expenses in the 2021–22 Budget incorporate assumptions and judgments based on the best information available at the time of publication, together with a range of economic assumptions and other forecasts and projections. It goes on to note events that could affect fiscal outcomes and that these include:

- Changes in economic and other parameters, including the path of recovery from the COVID–19 pandemic in both Australia and overseas, as well as other global economic developments more broadly;
- Matters not included in the fiscal forecasts because of uncertainty about their timing, magnitude or likelihood; and
- The realisation of contingent liabilities or assets.

The Statement then makes clear to readers that revenue and expense estimates and projections published in the 2021–22 Budget Papers are based on a range of economic and other parameters, that there are still significant international and domestic risks, including those associated with the COVID–19 pandemic, and the outlook remains highly

¹⁹) <https://budget.gov.au/2021-22/content/bp1/index.htm>

uncertain. Statement 9 should therefore be read with Statement 8 which examines the impact on receipts and payments of altering some of the key economic assumptions underlying the Budget estimates.

Clear from Statement 9 is that it also discusses specific risks to the Budget including identified contingent liabilities a large number of which reflect indemnities, guarantees, uncalled capital subscriptions and credit facilities to international financial institutions and legal cases concerning the Australian Government and that the Government has robust and conservative strategies in place to reduce its potential exposure to these contingent liabilities.

Table 9.1 in Statement 9 outlines how fiscal risks, assets and liabilities and contingent assets and liabilities are disclosed in the Budget and Table outlines at the entity level, the Department of Education, Skills and Employment for example, a summary of contingent assets and liabilities.

In conclusion, therefore, no explicit metrics measuring fiscal risks or asset and liability management are noted with this not being the intent of the analysis in Statement 9.

MYEFO

The Mid-Year Economic and Fiscal Outlook (MYEFO) provides updated information on the government's fiscal performance that can be assessed against the fiscal strategy set out in the Budget papers. The MYEFO must be published by the end of January in each year, or within six months after the latest budget. The most recent MYEFO was issued in December 2020 covering 2020–21 and can be found at <https://budget.gov.au/2021-22/content/myefo/index.htm>. It is not audited and the precise format is not defined.

Table 3 below outlines which aspects of the 2020–21 MYEFO addresses fiscal risks and management of assets and liabilities. The table identifies selected metrics (also referred to as aggregates) included in the MYEFO that inform management of fiscal risks and of assets and liabilities.

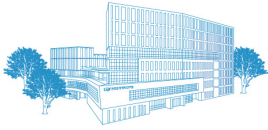
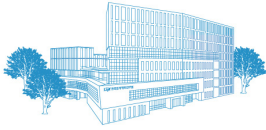


Table 3 2020–21 MYEFO addressing fiscal risks and management of assets and liabilities

December 2020 ²⁰	Selected metrics informing Management of Fiscal Risks	Selected metrics informing Management of assets and liabilities
<p>Part 1: Overview – contains summary information on the key fiscal and economic indicators and outlook and an outline of the key policy decisions taken since the 2020–21 Budget</p>	<p>Underlying cash balances (in A\$ and as a percent of GDP) Net operating balance (in A\$ and as a percent of GDP) Gross and Net debt Commentary on various budget and economic measures, objectives and initiatives announced</p> <p>Relevant economic parameters including real GDP, employment, unemployment rate, CPI, wage price index and normal GDP</p>	<p>Underlying cash balances (in A\$ and as a percent of GDP) Net operating balance (in A\$ and as a percent of GDP) Gross and Net debt</p>
<p>Part 2: Economic outlook – discusses the domestic and international economic forecasts and projections that underpin the budget estimates</p>	<p>Outlines key assumptions expected to impact fiscal performance and discussion of both the international and domestic economic outlooks. Domestically, measures of relevance here are discussion of real GDP levels, unemployment rates. Other measures, both actual and forecast, all of which can inform fiscal risks, are comprehensive – refer page 19 of MYEFO.</p>	<p>None explicitly mentioned relevant to the management of assets and or liabilities although economic outcomes and resulting policy choices arising from assessing economic circumstances will have an impact. Discussed in Part 3 below.</p>
<p>Part 3: Fiscal strategy and outlook – provides a discussion of the fiscal strategy and outlook, in addition to a summary of the factors explaining variations in the cash flow statement, the operating statement and the balance sheet since the 2020–21 Budget</p>	<p>Underlying cash deficit (in A\$ and as a percent of GDP) Net operating balance (in A\$ and as a percent of GDP) Fiscal balance²¹ (in A\$ and as a percent of GDP) GGS cash flows (in A\$ and as a percent of GDP) and headline cash balances</p> <p>Reconciliation between Budgeted underlying cash balances and MYEFO underlying cash balance and explanation for variances in receipts, revenues, payments and expenditures</p> <p>Reconciliation between GGS underlying and headline cash balance estimates – relevant because</p>	<p>Movements in underlying and headline cash balances reconciled</p> <p>Reconciliation of GGS Net capital investments estimates Financial assets, Non-financial assets Net financial worth, Net worth Gross and Net debt Total liabilities Net interest payments</p>

December 2020 ²⁰⁾	Selected metrics informing Management of Fiscal Risks	Selected metrics informing Management of assets and liabilities
	<p>addresses movements investments in financial assets for policy purposes</p> <p>Gross and net debt</p> <p>Projections in total payments, receipts and underlying cash balances as a percent of GDP</p> <p>Gross and net debt, net financial worth projections as a percent of GDP</p>	
<p>Part 4: Debt statement – provides information on current and estimated Government debt</p>	<p>This Statement provides information on current and estimated Government gross debt on issue, estimated Government net debt and interest costs related to Australian Government Securities (AGS). It discusses changes in AGS on issue since the previous Budget and provides a breakdown of the face and market values of AGS on issue at a point of time (8 Dec 2020).</p> <p>Changes in, and reconciliation of, net debt</p> <p>Interest, both accrual and cash, on AGS</p> <p>Interest receipts and interest income</p>	<p>Gross debt Net debt</p>
<p>Part 5: Statement of risks – provides details of general developments or specific events that may have an impact on the fiscal position, and contingent liabilities which are costs the government may possibly face, some of which are quantified</p>	<p>Addresses which events could affect fiscal outcomes</p> <p>Discussion of risks to the Budget and, importantly, provides a summary of material changes to the Statement of risks provided in the most recent previous budget</p>	<p>All events discussed will have implications for assets and liabilities</p> <p>Explicit discussion about loans provided by Government (for example, higher education and VET student loan programs)</p>
<p>Part 6: Australian Government Budget Financial Statements – provides financial statements for the general government sector, the public non– financial corporations sector, the total non– financial public sector, the public financial corporations</p>	<p>Provides updated budget for the current financial period and forward periods to 2023–24 with the format comprising an operating statement, balance sheet and cash flow statement and related notes for each of the Sectors.</p>	<p>Change in net worth Fiscal balance Net acquisition of non–financial assets Net worth Net financial liabilities Net debt Net cash from operating, investment and financing activities</p> <p>Net financial worth</p>



December 2020 ²⁰⁾	Selected metrics informing Management of Fiscal Risks	Selected metrics informing Management of assets and liabilities
sector and notes to the general government sector financial statements. Differences between reporting frameworks (AAS and GFS for example, are explained	<p>Presentation complies with AAS, GFS and with the agreed UPF.</p> <p>From a fiscal risk perspective, metrics again include, for each Sector, but are not limited to, the following:</p> <p>Net operating balance Net acquisition of non-financial assets Fiscal balance</p>	
MYEFO also contains four appendices which are not discussed here		

FBO

The Final Budget Outcome (FBO) provides the final fiscal outcomes for the year, and must be published within three months of the end of each financial year. Commentary in Table 4 below focusses on the FBO 2019–20 issued in September 2020. It is not audited and the precise format is not defined.

Table 4 2019–20 FBO addressing fiscal risks and management of assets and liabilities

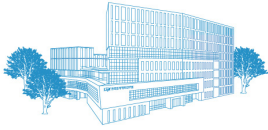
September 2020 ²²⁾	Selected metrics informing Management of Fiscal Risks	Selected metrics informing Management of assets and liabilities
<p>Preface –</p> <p>The FBO has been prepared in a manner consistent with the Charter which, in this case, requires the Government to provide a final budget outcome report no later than three months after the end of the financial year. Consistent with these requirements, this report</p>	<p>The FBO reports for each Sector, for the 2019–20 financial period, the MYEFO estimate, the outcome and the movement between the two. Once again, it is clear which standards have been complied with and departures or differences where relevant are outlined. Key terms are defined. The FBO articulates in Part 3 details of payments, including</p>	<p>Underlying cash balances (in A\$ and as a percent of GDP) Net operating balance (in A\$ and as a percent of GDP) Gross and Net debt</p>

20) Unless otherwise stated, the metrics noted in table 3 relate to the General Government Sector

21) Fiscal balance is net operating balance plus the impact of net capital investment.

September 2020 ²²⁾	Selected metrics informing Management of Fiscal Risks	Selected metrics informing Management of assets and liabilities
<p>encompasses Australian Government general government sector fiscal outcomes for the 2019–20 financial year and is based on external reporting standards</p>	<p>payments by function made by the Australian Government to the Australian States and Territories and the nature and purpose of those payments.</p> <p>Appendix A of the FBO provides, for the GGS, expenses data on a functional and sub-functional basis reporting prior year outcomes, MYEFO estimates and current year outcome. This information facilitates comparison with expenditure reported by nature in the Operating statement.</p> <p>Also helpful was inclusion of Appendix B which reports historical data (for varying periods some as far back as since 1970–71) of various fiscal aggregates including – receipts, payments, net Future Fund earnings, underlying cash balances, net cash flows from investments in financial assets for policy purposes, headline cash balances, taxation receipts, non-taxation receipts and total receipts, net debt and net interest payments, face value of AGS on issue and interest paid, revenue, expenses, net operating balance, net capital investment and fiscal balances, net worth and net financial worth.</p>	

22) Unless otherwise stated, the metrics noted in table 4 relate to the General Government Sector



Pre-election Economic and Fiscal Outlook (PEFO)

The most recent PEFO was issued in April 2019. Its Preface notes that the Charter provides for the Secretary to the Treasury and the Secretary of the Department of Finance to release publicly a PEFO report within 10 days of the issue of the writs for a general election. Such writs were issued on 11 April 2019.

The purpose of the PEFO is to provide updated information on the economic and fiscal outlook. The information in the report takes into account, to the fullest extent possible, all Government decisions and all other circumstances that may have a material effect on the economic and fiscal outlook that were in existence before the issue of the writs for the election.

The Charter provides that, where there is information unchanged from that set out in full in an earlier budget report, the PEFO may summarise and state this information is unchanged.

Consistent with the requirements of the Charter, the PEFO includes:

- Fiscal estimates and projections for the current financial year (2018–19) and the following four financial years (2019–20, 2020–21, 2021–22 and 2022–23);
- Economic and other assumptions for the current financial year and the following four financial years used in preparing these updated fiscal estimates;
- Discussion of the sensitivity of updated fiscal estimates to changes in those economic and other assumptions and refers to the detailed analysis in the 2019–20 Budget that remains unchanged;
- An updated set of financial statements and summary of the external reporting standards used in the preparation of the PEFO;
- A list of policy decisions taken by the Government since the 2019–20 Budget and decisions that were taken but not announced at that time; and
- An updated statement of the risks that may have a material effect on the fiscal outlook.

The PEFO does not include the impact of commitments made in the context of the current election campaign. Further context to election commitments is that not all election commitments are made by the time PEFO is issued; and some commitments will be made by parties that ultimately do not form government and so will not be implemented. Some, but not all, costings of election commitments are published, which may inform those that are interested. For example, refer 2019 Election Costings | Election Costings, or at <https://www.electioncostings.gov.au/>.

No further information is provided here other than to note that information provided in the PEFO, as this relates to managing fiscal risks and management of assets and liabilities, is broadly in line, although abbreviated, with the reports referenced above.

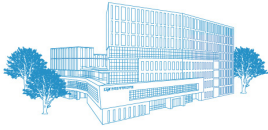
Intergenerational Report (IGR)

The Charter requires preparation of the IGR with sections 20 and 21 being relevant:

1) Public release and tabling of intergenerational reports

- a) The Treasurer is to publicly release and table intergenerational reports as follows:
 - An intergenerational report is to be publicly released and tabled on or before 30 June 2021²³⁾;
 - Subsequent intergenerational reports are to be publicly released and tabled within 5 years of the public release of the preceding report.
- a) If:
 - An intergenerational report is publicly released within the period specified in subclause (1); but
 - A House of the Parliament is not sitting when the report is released; the report does not have to be tabled in that House until it next sits (or as soon as practicable after then), even if that is after the end of the specified period.

23) The reference to 2021 was a recent amendment to the legislation designed to allow for a six-year period, due to COVID. The original legislation provided for the first report within 5 years of the commencement of the legislation, so reports have been prepared for about two decades now.



2) Contents of intergenerational report

An intergenerational report is to assess the long term sustainability of current Government policies over the 40 years following the release of the report, including by taking account of the financial implications of demographic change.

The most recent IGR was issued in June 2021, titled '2021 Intergenerational Report'. As noted earlier, it is cash based. This is considered reasonable in view of the many assumptions that would need to be made under an accrual model, especially having regard to it needing to require forecasting over a forty-year period. Notes below were prepared based on review of the 2015 Intergenerational Report.

Of relevance to fiscal management and management of assets and liabilities are that the IGR addresses, through to 2054–55, in today's dollars (and as a % of GDP in some cases):

- Fiscal aggregates such as projections in underlying cash balances, net financial worth, government expenditure (for example expenditures on health, aged care, aged pension, services to the disabled, defence), revenue, superannuation (or employee pensions), gross debt, net debt, anticipated movements in defined benefit superannuation obligations and management of assets such as the Future Fund and higher education loans;
- Discussion about policy settings needed to build jobs, growth, identify opportunity aimed at Australians enjoying higher living standards. In these respects, commentary focusses on matters such as annual real growth in GDP, measures needed to boost productivity and encourage higher workforce participation, changes to tax systems, investment in critical infrastructure, provision of efficient service provision reducing compliance and entering into new free trade agreements.

Understandably, the IGR explores demographic changes and their impacts on productivity, resulting living standards and Government's ability to continue to afford to provide services and deliver community support into the future. Managing the environment and related factors (for example managing water and land) are discussed as is the budgetary

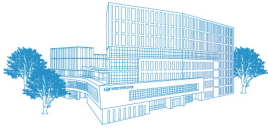
impacts of managing these factors.

Also relevant to managing fiscal risk is a discussion in section 2.1.2 of the 2015 IGR concerning what is referred to as the ‘primary balance’, expressed as an important measure of fiscal sustainability. The primary balance includes the same expenditure and receipts as the underlying cash balance, but excludes net interest payments and earnings from the Future Fund – that is, balance sheet impacts from prior year surpluses and deficits. In doing so, the primary balance reveals underlying spending pressures in a particular year.

Consolidated financial statements

For purposes of this review, the Commonwealth of Australia’s Consolidated Financial Statements for the year ended 30 June 2020 (the CFS) issued in December 2020 were accessed. The CFS comprise the following:

- Preface – no comments are provided here about the contents of the Preface.
- Commentary on the CFS from which, as this relates to management of fiscal risks and of assets and liabilities the following are noted:
 - The Commentary is unaudited with results focused on comparing actual 2019–20 outcomes against those for 2018–19 and where relevant comparative GDP percentages.
 - Consistent with budgeted information noted early in this Report, metrics focus on the net operating balance, fiscal balance, net worth, cash surplus/(deficit), revenue (both taxation and non–taxation revenue) and expenses, net capital investments, net financial worth, net debt, financial assets, non–financial assets, provisions and payables, interest bearing liabilities and net interest payments.
 - Information is reported in amounts and graphical trends facilitating easy understanding of movements in the key metrics referred to over a 10–year period.
 - In addition, information is provided on categories of revenue (for example composition of taxation revenue), expenditure (for example composition of expenditure by



nature and by function), assets (for example composition of assets), liabilities (for example, composition of liabilities) and receipts and payments although for the current year only.

- Appendix 4 outlining linkages to other publications, for example the 2019–20 FBO.
- The audited CFS, from which, as this relates to management of fiscal risks and of assets and liabilities, the following are noted:
 - Preparation is required by *Public Governance, Performance and Accountability Act 2013*.
 - They are prepared in accordance with Australian Accounting Standard 1049 *Whole of Government and General Government Sector Financial Reporting* (AASB 1049).
 - The CFS comprise, for both the current and previous financial years, the key statements being the Operating Statement, Balance Sheet, Cash Flow Statement, Statement of Changes in Equity, Sector Statements (GGS, PNFCs, PFCs eliminations and totals) and notes to the Statements. These notes outline the basis on which the CFS are prepared including that they are prepared in accordance with relevant standards.
 - Of particular relevance is that the notes include reconciliations and explanations for differences from ABS GFS measures and a budget reconciliation as this relates to the GGS while noting that the budget itself was not audited which is expected (refer Note 12 series in the CFS). However, these reconciliations are no longer as detailed as in prior years following a recent amendment to AASB 1049 arising, for example, as a result of a new accounting standard dealing with leases the issue being that GFS did not change its accounting for leases, and keeping two sets of records on leases is onerous.

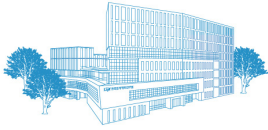
Preparation of the CFS is required by section 48 of the *Public Governance, Performance and Accountability Act 2013*. The CFS are general purpose financial statements that have been prepared for the whole of government and the GGS in accordance with Australian Accounting Standards (AAS), including AASB 1049). As a result, the CFS do not necessarily focus on metrics outlined in tables 2 to 4 above although many can be

determined from the CFS. The CFS are an accountability document outlining historical financial performance and financial position at a point in time. It should not be inferred from their inclusion in the CFS that some metrics are more important than others when having regard to identifying or managing fiscal risks or managing assets and liabilities. Instead, the various measures reported, and included in tables 2 to 4, should be used as a package of measures helpful in this respect. Also relevant is that particular metrics may be more useful than others when assessing a particular matter. For example, if a report user wanted to consider the capacity of a government to withstand future shocks (perhaps climate change or pandemic impacts, contingent liabilities for example), then Net Worth may be the most useful metric to consider.

Uniform Presentation Framework

The Uniform Presentation Framework (UPF) is a framework applied in Australia for the presentation of uniform financial Information by the Commonwealth, State and Territory Governments. Details of the framework are noted in a report outlining a revised framework for presenting data in accordance with the objectives of the uniform presentation agreement reached at the May 1991 Premiers' Conference in Australia. The Australian Loan Council agreed, in March 1997, to the implementation of this revised framework. Development of the revised framework arose from a review of what aggregate budgetary and fiscal information Commonwealth, State and Territory governments should publish for external purposes. The report referred to can be located at https://books.google.com.au/books/about/Uniform_Presentation_Framework.html?id=3HB1AAAACAAJ&source=kp_book_description&redir_esc=y

The framework was updated in 2019 and can be located at https://treasury.gov.au/sites/default/files/2019-06/190618_Uniform_Presentation_Frameworkor_2.pdf



The link at <https://treasury.gov.au/publication/p2019-t365789> notes that:

“The May 1991 Premiers’ Conference agreed to the introduction of the Uniform Presentation Framework (UPF). The primary objective of the UPF is to ensure that Commonwealth, state and territory governments provide a common ‘core’ of financial information in their budget papers. There have been subsequent revisions to the UPF agreed by the Australian Loan Council in 1997, March 2000 and March 2008. Administrative responsibility of the UPF transferred from the Australian Loan Council to the Council on Federal Financial Relations in January 2018.

This revised publication incorporates revisions to the UPF agreed by the Council on Federal Financial Relations in February 2019. The revisions to the framework are primarily a result of the 2015 update to the Australian System of Government Financial Statistics (GFS) framework. The update of the Australian GFS aims to better align with the International Monetary Fund’s GFS 2014 framework and the System of National Accounts 2008. The revised UPF also removes the Loan Council Allocation reporting requirements.”

Evident from this summary is that the framework requires these jurisdictions to report common information in respective budget papers. While not explicitly aimed at managing fiscal risks or assets and liabilities, the fiscal measures required to be reported are the same as, or similar to, those outlined in the tables in this Chapter. That is, the net operating balance, net lending/borrowing (fiscal balance), change in net worth, net worth, net debt, net financial worth, net financial liabilities, cash surplus/deficit and use of the underlying budget results. It can be reasonably concluded from this that the UPF assists comparative assessment of how fiscal risks and assets and liabilities are managed.

Conclusion regarding identified official government reports

Reports discussed above provide a sound basis for reporting by the Australian Government to the Australian Parliament and people about how it identifies and manages fiscal risks and its management of assets and liabilities. They also facilitate analysis by the international community.

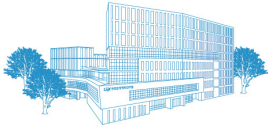
Evident from these reports is the reliance on selected financial measures but which are considered appropriate and consistent with accounting and GFS standards (discussed below). In addition, the reconciliation of budgeted cash underlying balance and MYEFO cash underlying balance is a strong accountability mechanism as is the requirement under AASB 1049 for inclusion of a reconciliation between AAS and GFS frameworks.

Management of assets and liabilities is comprehensively demonstrated by budgeting for actual, and movements in, net worth, net and gross debt and net financial assets and liabilities.

To assist readers, all measures and aggregates are defined within the official reports and how each is calculated explained or obvious.

No conclusions are drawn as to whether or not these reports demonstrate effective identification or management of fiscal risks or of the management of assets or liabilities by the Australian Government. However, preparation of these reports satisfies legislative requirements and facilitates analysis of Government's performance in identifying and managing fiscal risks and of assets and liabilities over time.

This research concluded that of the various metrics identified, none are more important than others but that, when evaluation fiscal risk or asset and liability management they should be regarded as a package although, depending on the matter being evaluated, some metrics may be of greater relevance. For example, net worth is likely to be relevant when assessing the capacity of a government to withstand future shocks or contingent liabilities.



Identified other reports

This part of this Report discussed other reports identified when carrying out this research and the following are addressed here:

- Government Finance Statistics
- Assessment of asset impairments and
- Metrics used in the private sector – provided for comparative purposes only.

Government Finance Statistics

This research identified compliance with reporting against the Government Finance Statistics (GFS) framework as an ‘other identified report’ the need for which is addressed here.

The GFS framework reports key fiscal aggregates that measure the financial activities of each government and the impacts of those activities on other sectors of the economy²⁴). In Australia, the GFS framework is set out in the Australian Bureau of Statistics (ABS) GFS Manual. The main convergence differences between the key fiscal aggregates reported in the CFS under AASB 1049 and the corresponding fiscal aggregates reported under the ABS GFS Manual are outlined in Note 12 of the 2019–20 audited CFS referred to earlier.

Research indicated that the major fiscal aggregates identified in the GFS Framework are those outlined in Appendix 5 which are similar to those applied in the various budget documents and CFS referred to earlier.

The latest release of the Australian Bureau of Statistics (ABS) GFS Annual methodology is available at the following link –

<https://www.abs.gov.au/methodologies/government-finance-statistics-annual-methodology/2019-20>. No further information is provided here.

²⁴) Refer note 12A in the 2019–20 audited CFS.

Discussions with the ABS have not been held the view being that Australia's approach to its GFS responsibilities are clear from the ABS website especially when read alongside the reconciliation and explanations referred to earlier and the common use of fiscal aggregates.

Assessment of asset impairments

The need for consideration of indicators suggesting consideration needs to be given by reporting entities, including governments in Australia, is addressed by applying Australian Accounting Standard AASB 136 *Impairment of Assets* –

https://www.aasb.gov.au/admin/file/content105/c9/AASB136_07-04_COMPapr07_07-07.pdf

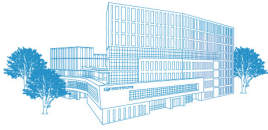
Guidance on the application of this standard comes in the following identified forms:

- By the Australian Securities and Investments Commission (ASIC) in its INFO 203 – refer – <https://asic.gov.au/regulatory-resources/financial-reporting-and-audit/directors-and-financial-reporting/impairment-of-non-financial-assets-materials-for-directors/>

While this guidance applies to directors of companies, the steps to follow to assure compliance with AASB 136 are helpful for all entities.

By the Australian Government in its guidance on Commonwealth Entities Financial Statements Guide (RMG 125) which can be located at <https://www.finance.gov.au/publications/resource-management-guides/commonwealth-entities-financial-statements-guide-rmg-125>

- Some States in Australia also provide guidance, for example the State of Victoria issued FRD 106B Impairment of Assets in May 2018.
- Guidance developed by the Staff of the AASB on impairment of non-financial assets as a result of the Coronavirus pandemic can be located at – [https://aasb.gov.au/admin/file/content102/c3/FAQ_ImpairmentOfNonFinancialAssets_07-20%20\(002\).pdf](https://aasb.gov.au/admin/file/content102/c3/FAQ_ImpairmentOfNonFinancialAssets_07-20%20(002).pdf)



Comparison with measures used by entities in the private sector

For comprehensiveness, comparison was made with measures and aggregates used by private entities. This is considered in table 5 below.

Table 5 Comparison with private sector measures

Private sector measures (ratios)	Addressed by measures or aggregates used by the Australian Government
Liquidity (acid test) ratio Current ratio	Net debt, net financial assets, net financial liabilities are more relevant in the GGS. Perhaps more relevant to entities in the PFC and or NPFC sectors where, it is understood, such ratios are computed at the entity level where relevant
Activity ratios such as debtor or creditor turnover, inventory turnover	Not applicable to the GGS or whole of government financial circumstances but may have some relevance to entities in the PFC or NPFC sectors depending on whether or not they are trading entities. However, it is understood that in the GGS there is a tendency to report aging data, rather than turnover ratios, because it is important for Government to know that outstanding receivables are being managed and collected
Return on investment Return on total assets	Not applicable to the GGS or whole of government. Perhaps more relevant to entities in the PFC and or NPFC sectors. However, when making comparisons, it is important to note that returns by public corporations can be affected by some factors not present in the private sector e.g. presence of substantial community service obligations within a public corporation.
Leverage or gearing ratios Debt equity Times interest earned ratio, fixed charge coverage ratio	Not applicable to the GGS or whole of government financial circumstances but may have some relevance to entities in the PFC or NPFC sectors depending on how they are financed. In the public sector net debt, net financial assets, net financial liabilities, net worth, net financial worth, gross interest paid, net interest paid and interest to GDP are more relevant.
Survival and growth ratios	Not applicable to the GGS or whole of government. Perhaps more relevant to entities in the PFC and or NPFC sectors
Breakeven analysis	Not applicable to the GGS or whole of government. Perhaps more relevant to entities in the PFC and or NPFC sectors

Conclusions regarding identified other reports

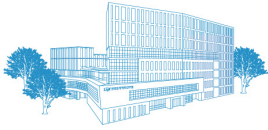
No conclusions are drawn regarding identified other reports.

COST AND EXPERTISE INPUT FOR PUBLICATION (of official government reports)

Introduction

Establishing the costs incurred and expertise applied in preparing the various reports referred to previously proved difficult and probably not helpful for the following reasons:

- Compilation of the Budget papers is mostly spread over the departments of Treasury and Finance (Finance tends to look after expenditure, non-tax revenue and Treasury tends to look after economic matters and taxation revenue).
- Resources required is unknown, but they vary depending on the time of year and workload. Additional people will be added to teams at busy times, rather than having a rigidly fixed workforce. Also, difficult to quantify is support provided by an accounting firm which supports budget financial statement preparation.
- Information – the Budget information is derived from the Department of Finance’s Central Budget Management System, which is accrual based (and derives cash information from the accrual information). Input to the CBMS is done by entities and managed by small teams in Finance, so the Finance role in preparation of accrual-based information is mostly about policy and management rather than detailed budget compilation.
- Period – preparation of next year’s budget commences in the latter half of the calendar year. Most of the intensive work related to budget preparation occurs in the three months before the May budget (i.e. February–April).
- Expertise – staff at senior levels in the central agencies usually have extensive experience. Where they have specialist roles, they will have formal qualifications (e.g. economists and accountants).
- Budget papers are submitted to Parliament for them to consider in budget deliberations and in specific role entities such as the Parliamentary Budget Office (PBO) (discussed below) and Senate Estimates Committees.



- Drivers to success include completion on time, a well-defined and managed process and compliance with legislation.

As far as standard setting is concerned, preparation of the CFS is in line with AAS 1049 *Whole of Government and General Government Sector Financial Reporting* issued by the Australian Accounting Standards Board. Details concerning the costs to run the AASB are best obtained from review of its annual report the most recent of which can be found at https://aasb.gov.au/admin/file/content102/c3/2019-20_AASB-AUASB_AnnualReport.pdf from which it was noted that:

- Total costs incurred in 2019-20 were \$4,441,440 and
- Total full time equivalent staffing at 30 June 2020 was 16.1

Persons/organisations contacted to date

Contact to date focused on one individual at the Australian Government's Department of Finance and email exchanges with two representatives from the Australian National Audit Office. Consideration was given to making contact with representatives from the Australian Bureau of Statistics and the Parliamentary Budget Office but rejected on the basis that information sought was available from respective websites.

Also, inquiries were made with Treasury Departments (or equivalent) at the State Governments of Victoria and Tasmania which resulted in the provision of access to various documents or links to material relevant to the identification of fiscal risks and management of assets and liabilities. However, these were not evaluated and no further commentary is provided here.

Other countries that have recently or in the process of moving to accrual

While not requested as part of this assignment, membership of the IPSASB has resulted in knowing that at least the following two countries are engaging in implementing or researching a move to accrual-based reporting:

- Portugal
- Saudi Arabia.

Conclusions drawn regarding cost and expertise input for publication (of official government reports)

Establishing the costs incurred and expertise applied in preparing the various reports referred to previously proved difficult and probably not helpful. It may be better for the Chief Director, Government Accounting and Finance Statistics Center, Korea Institute of Public Finance to make contact with Officials on the Australian Department of Finance to explore costs incurred and expertise involved.



DEGREE OF USAGE IN DECISION MAKING AND ITS EFFECTS ON PUBLIC FINANCIAL MANAGEMENT

Introduction

This section of this Report is limited to my personal experience of working with parliamentarians and other users of public sector, excluding local government, financial reports but at a sub-national level. But, first some general context – my experience ranges from times when governments in Australia focused on cash-based financial information, moving to accrual-based and then outputs-based and I comment on each phase below. Each plays a role in effective PFM with none to be considered in isolation of the others:

- Cash-based – financial information about cash, or cash equivalents, continues to be essential for effective PFM and in the management of assets and liabilities. While not only based on cash or cash equivalents, aggregates such as financial assets, financial liabilities and net financial assets are similarly essential pieces of financial information. In any event, the cash flow statement, read alongside the operating cash to operating result reconciliation, provides essential information to users of public financial reports about cash management both during and at the end of a financial reporting period. However, financial information based only on cash provides insufficient decision-making attention to, for example, the management of debt and non-financial assets.
- Accrual-based financial information enhances PFM by providing information to users of a government's assets and liabilities and contingent assets and contingent liabilities. These financial reports facilitate assessment of aggregates such as net debt, liabilities, assets and gross and net worth. What perhaps such reports do not do, is to provide an explicit assessment of a government's ability to withstand future shocks or unanticipated contingencies although it is noted that the Australian Government's budget papers provide commentary on how it manages known contingencies including those arising locally and internationally.
- Inputs – a particular personal view is that, despite the move to outputs-based budgeting and reporting, there continues to be a focus by users of budgets and

financial reports on detailed information about inputs, such as wages, consulting costs and amounts paid to senior executives, for example, rather than the outputs or outcomes delivered by expenditure on such inputs.

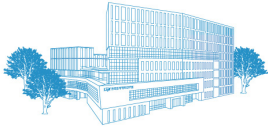
- Outputs-based information – such information enhances PFM by reporting how well inputs were applied and outputs delivered and outcomes achieved. Another personal view is that the focus on inputs seems not to address how well allocated funds were spent with there being a need to focus during budget approval stages of debates on proposed outputs and outcomes. Connected to this is another personal observation that parliamentarians focus too much on the budget and too little on the outcomes delivered – in other words, there seems too little attention given to annual reports at the entity level. In saying this, it is acknowledged that reporting outputs at a whole of government level is problematic and probably unrealistic and perhaps mechanisms for doing so need to be developed.

Usage of financial reports

Again, observations here are based on my personal experiences.

There is strong use of budget information, including the MYEFO, FBO, PEFO and IGR by parliamentarians (or equivalent documents at a sub-national level), either in their own right or when part of Estimates processes or committees such as Public Accounts Committees or equivalent. Other users include the media.

Less attention is given to CFS by parliamentarians or the media which, as noted earlier, is in my view unfortunate. In my jurisdiction, an important accountability focus by parliamentarians and the media is on entities in the Government Business Sector (PFCs and PNFCs) by way of annual scrutiny of annual reports issued by these entities by 31 October each year with scrutiny occurring in late November/early December each year. However, these entities do not, and are not required to, report budget information. Principles underpinning such scrutiny is essential for agencies in the GGS sector but, as noted earlier does not in my experience happen to any organized or legislated extent.



Research by Staff of the AASB

As part of completing research into this subject, the following Discussion Paper is referenced – AASB Discussion Paper: Improving Financial Reporting for Australian Public Sector https://www.aasb.gov.au/admin/file/content102/c3/DP_IFRPS_06-18.pdf from which it was noted under the heading “What users need”

The users of public sector financial statements vary from parliamentarians, parliamentary accounts committees, taxpayers, and lenders to those receiving government services. Governments need to be accountable to their stakeholders for the management of resources and financial reports are a key part of this process. However, unlike the for-profit sector, in the public sector, financial reporting is too extensive and not targeted enough to enable public sector entities to be held to account. Government departments are effectively administrative constructs (i.e. branches) and requiring Tier 1 financial reports for all such departments when they are also included in WoG²⁵⁾ reports, means that users are not directed to the key budget versus actual and service performance (outcome) reporting that would enable genuine accountability.

Public Financial Management²⁶⁾

Public Financial Management (PFM), in its broadest sense, is the system by which financial resources are planned, directed and controlled, both externally to and internally within the public sector entity, to enable and influence the efficient and effective delivery of public service outcomes.

The IPSASB’s work plan notes the importance of accrual-based, and audited, financial reports in holding governments to account and informing decision making. The work plan goes on to note that:

25) Whole of Government

26) Commentary on PFM is summarised from pages 3 and 4 of the International Public Sector Accounting Standards Board’s Strategy and Work Plan 2019-2023 (the work plan).

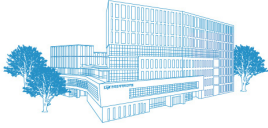
- Accounting standards help improve the quality of financial reporting, which have the potential to improve decision making in the public sector.
- The increasing complexity of public sector finances, together with a greater focus on the quality of PFM, has increased demand for high-quality standards and guidance on how to adopt and implement such standards.
- Adoption and implementation of International Public Sector Accounting Standards (IPSAS) are fundamental steps that governments can take to improve financial reporting and PFM because IPSAS-based information provides a comprehensive picture of their financial performance and position.
- Such information can also enable progress on key government development initiatives such as those related to the United Nations sustainable development goals²⁷).

Evident from this is that accrual based financial information, prepared based on independently developed accounting standards, from which the non-cash metrics referred to in tables 2 to 4 can be drawn, is essential to better decision making about PFM.

Conclusions drawn on the degree of usage in decision making and its effects on PFM

Conclusions on the degree of usage of identified official reports in decision making were based on my personal experiences which ranges from times when governments in Australia focused on cash-based financial information, moving to accrual-based and then outputs-based with commentary provided in this Chapter on each phase. Each plays a role in effective PFM with none to be considered in isolation of the others.

27) Accountability and transparency by governments and public sector entities on the use of their resources, enables through high-quality financial reporting, such as IPSAS can lead to improved decision making. Further, this can be seen as an important step in achieving improvements on the United Nations sustainable development goals; a key initiative to better society for future generations around the world.



My own experiences indicate to me there is strong use of budget information, including the MYEFO, FBO, PEFO and IGR by parliamentarians (or equivalent documents at a sub-national level), either in their own right or when part of Estimates processes or committees such as Public Accounts Committees or equivalent. Other users include the media.

However, it is my experience that less attention is given to the CFS by parliamentarians or the media which is, in my view, unfortunate.

Regarding PFM, evident from extracts from the International Public Sector Accounting Standards Board's Strategy and Work Plan 2019–2023 this is that accrual based financial information, prepared based on independently developed accounting standards, from which the non-cash metrics referred to in tables 2 to 4 can be drawn, is essential to better decision making about PFM.

ANALYSIS OF THE DRIVERS TO SUCCESS OR OBSTACLES TO THE PUBLICATION OF REPORTS AND/OR IMPLEMENTATION OF RELATED POLICIES

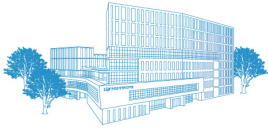
Introduction

Analysis here is based on personal experiences and references to types of financial information mentioned in the immediately preceding chapter are relevant but are not repeated here.

Drivers to success or obstacles of the publication of reports

While there may have been obstacles when Australian jurisdictions first moved to accrual reporting and accounting, jurisdictions developed policies and frameworks facilitating the move from cash to accrual and the AASB developed accounting standards which, when adopted and applied, resulted in compliance with independently approved reporting frameworks. Legislative frameworks referred to earlier locked in the budgeting and financial reporting arrangements that now exist.

Internationally, multiple such frameworks apply with the International Federation of Accountants'/International Public Sector Accounting Standards Board's Study 14 *Transition to the Accrual Basis of Accounting: Guidance for Public Sector Entities* being a useful tool. Study 14 articulates obstacles and stages needing to be followed for successful transition. This includes the need for comprehensive training for staff and users of such reports and identification of systems requirements. This transition facilitated the movement of experienced accountants from the private sector into the public sector and, for example and improved identification and management of assets and liabilities. Other successes included:



- Enhanced accountability
- Better comparability
- Improved financial analysis
- Sounder understanding of all liabilities, including pension obligations, and state of assets especially by requiring the development of long-term asset management plans
- Improved management of obligations to employees
- Identification of the full cost of providing public services

Difficulties identified were:

- Ensuring effective comparability by requiring budgets to be prepared on an accrual basis
- Whether or not to include capital charges associated with funding asset replacement
- Sensitive management of public servants familiar with cash-based reporting unable or unwilling to transition to accrual and
- Moving from accrual reporting to accrual management on a day-to-day basis. It was my experience that at the entity level, at least initially, monthly reporting continued to be on a cash basis. At a whole of government level this is now accrual
- Cost of transition. This should not be underestimated nor should the time needed to transition
- Difficulties by parliamentarians in understanding accrual information – in this respect preparation of explanatory financial information in budget papers and the introductory pages to the CFS is helpful. Even better might be application of frameworks such as application by governments at the whole of government or entity level, of the IPSASB's Recommended Practice Guide 2 Financial Statement Discussion and Analysis is encouraged.

Other than cost or availability of appropriate expertise, there are no obstacles to the publication of the reports referred to in this Report.

Another resource that may be helpful is the article by Jon R Blondal titled *Accrual Accounting and Budgeting: Key Issues and Recent Developments* published in the *OSCD Journal on Budgeting* – Vol 3, No 1 in 2003 – <https://www.oecd.org/gov/budgeting/42187847.pdf>.

Other perhaps useful resources might be the following:

- *Accrual Budgeting Framework* issued by the Tasmanian Government in 2003 – https://www.treasury.tas.gov.au/Documents/Accrual_Budgeting_Framework.pdf and
- *Accrual Budgeting Project* (archive.org).

Critical success factors and centralised v decentralised approaches

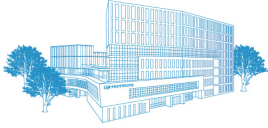
Advice provided to me indicated that, whenever transition to accrual accounting is proposed, it is useful to emphasise the critical success factors, including top level support, appropriate systems and expertise (which may be partly from consultants and training where necessary), good planning and communication, gradual implementation rather than a “big bang” approach, and communications with key stakeholders, particularly auditors.

Also, it is an open question whether the move to accrual accounting is very centralised or less centralised – I was informed that, in Australia there was less reliance on centralisation, with the agencies heavily involved in developing their own accrual numbers whereas other jurisdictions may apply a more centralised control. No conclusion is drawn. Appropriate planning will need to consider which approach works best for individual jurisdictions.

Roles of the Parliamentary Budget Office and Auditor-General

Parliamentary Budget Office

The Parliamentary Budget Office (PBO) was established in 2012 to ‘inform the Parliament by providing independent and non-partisan analysis of the budget cycle, fiscal policy and the financial implications of proposals’. It was established under Division 2 of the of the



Parliamentary Service Act 1999 – <https://www.legislation.gov.au/Details/C2016C00405>, and https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/About_the_PBO.

The PBO improves transparency around fiscal and budget policy issues, provides confidential costing services to all parliamentarians, and publishes a report after every election that shows the fiscal implications of major parties' election commitments. Its website references a number of publications aimed at fulfilling its objectives of informing parliamentarians about the budget, finances and fiscal information –

https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office. Information about costs associated with running the PBO²⁸⁾ can be found at 202122 PBO Portfolio Budget Statements PBS PDF.pdf

Or at –

https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/About_the_PBO/Corporate_information/Portfolio_budget_statements/Portfolio_Budget_Statements_2021-22

Commonwealth Auditor-General and the Australian National Audit Office

The Auditor-General is appointed under the Auditor-General Act 1997 – refer Appendix 2, and forms part of the accountability arrangements outlined in Australian Federal legislation. Their role includes auditing the CFS utilising relevant auditing standards. Their functions also include conduct of performance audits the outcomes from some of which are referred to in Appendix 4.

28) Understood to be budgeted at about \$13m for 2012-22

Conclusions drawn from analysis of drivers to success or obstacles to publication of reports and/or implementation of related policies

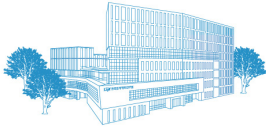
Commentary in this Chapter is primarily based on personal experiences from which it was noted that, while there may have been obstacles when Australian jurisdictions first moved to accrual reporting and accounting, jurisdictions developed policies and frameworks facilitating the move from cash to accrual and the AASB developed accounting standards which, when adopted and applied, resulted in compliance with independently approved reporting frameworks. Legislative frameworks referred to earlier locked in the budgeting and financial reporting arrangements that now exist.

Internationally, multiple such frameworks apply with the International Federation of Accountants'/International Public Sector Accounting Standards Board's Study 14 *Transition to the Accrual Basis of Accounting: Guidance for Public Sector Entities* being a useful tool. Study 14 articulates obstacles and stages needing to be followed for successful transition. This includes the need for comprehensive training for staff and users of such reports and identification of systems requirements.

This Chapter articulates my views about success and obstacles identifies in transition from cash to accrual and notes that, based on advice provided, whenever transition to accrual accounting is proposed, it is useful to emphasise the critical success factors, including top level support, appropriate systems and expertise, good planning and communication, gradual implementation rather than a “big bang” approach, and communications with key stakeholders, particularly auditors. Regarding the question as to whether or not, when moving to accrual accounting, a centralised versus a decentralised approach be applied. No conclusions were drawn. Appropriate planning will need to consider which approach works best for individual jurisdictions.

Other than cost or availability of appropriate expertise, there are no obstacles to the publication of the reports referred to in this Report.

Jurisdictions considering a move from cash to accrual, if they have not already done so under either system of accounting, should establish an independent external audit function and may wish to establish an independent budget office.



Appendix 1. IMF guidelines for disclosing and managing fiscal risks

The table below is included for possible completion by GAFSC should it wish to assess the extent of compliance with the Guidelines provided by the International Monetary Fund Fiscal Affairs Department document as outlined in the Introduction on page 3 of this Report.

Table outlining assessment by GAFSC with its compliance with the IMF guidelines for disclosing and managing fiscal risks

Box 7 Guidelines²⁹⁾

Fiscal risks to which the government is exposed should be identified and disclosed, so as to facilitate an effective conduct of fiscal policy – *Identification of fiscal risks is a prerequisite for risk disclosure and management. Although risks may be adequately identified in the absence of disclosure, a commitment to making information on fiscal risks publicly available subjects the analysis to additional scrutiny, helping to ensure that risks are fully recognized and properly assessed. Moreover, disclosure may help to manage risks and reduce borrowing costs in the long run. Transparency also strengthens accountability for effective risk management; improves the quality of decisions on whether the government should take on risk in the first place; and promotes earlier and smoother policy responses.*

Availability of information on fiscal risks

A list of all material fiscal risks to which the government is exposed should be compiled, together with an indication of their relative importance; whenever possible, risks should be quantified in terms of amounts (point estimate and range) and probability of occurrence.

Procedures should be in place to provide independent assurance of the integrity and robustness of the assumptions underlying the budget, including the government's macroeconomic forecasts.

Legal/accounting framework regarding the disclosure of fiscal risks

There should be a presumption that information on fiscal risks should be published, with exceptions based on clearly defined criteria relating mainly to the materiality of fiscal risk exposure and the

29) Box 7. Guidelines for Fiscal Risk Disclosure and Management from the IMF Fiscal Affairs Department document titled Fiscal Risks – Sources, Disclosures, and Management(2009, IMF)

Box 7 Guidelines

possibility that disclosure might engender moral hazard (e.g., through perceived blanket guarantees in the banking system) or prejudice the national interest (e.g., in wage negotiations or legal disputes). It would be desirable for the timely publication of information on fiscal risks to be a legal obligation of the government. The government's accounting policies should be reviewed to ensure that, to the extent possible, they provide relevant information on fiscal risks, consistent with international accounting standards. Notably, the government's accounting standards should require disclosure of information on contingent liabilities.

Disclosure practices

The budget documentation should include:

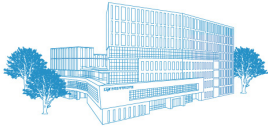
- An assessment of fiscal sustainability;
- Discussion of overall fiscal risk management strategy, including priority areas for risk mitigation
- Alternative macroeconomic scenarios or sensitivities of the fiscal aggregates to changes in assumptions;
- Statements describing the nature and fiscal significance of quasi-fiscal activities, together with related fiscal risks;
- Discussion of public debt management strategy, risks in the portfolio, and risk mitigation;
- Information on contingent liabilities, including (see *Manual on Fiscal Transparency*):

(i) a classification of outstanding contingent liabilities by major category; (ii) a description for each category of why and how the government takes on such risks; (iii) the fiscal significance of outstanding contingent liabilities by major category (quantification should include the total exposure under the liability and, where feasible, the expected value); (iv) information on major individual contingent liabilities, including a description of their nature, scope, and quantification; (v) past calls on the government to meet contingent liabilities; (vi) for each new contingent liability, its public policy purpose, duration, and the intended beneficiaries; and (vii) information about any assets set aside against specific contingencies.

Budget documentation could also include information on (i) PPPs (perhaps as a separate report in countries where the size of the PPP program warrants it), indicating for each project the government's contingent liabilities and future contract payments; (ii) stateowned enterprises and subnational governments; and (iii) the objectives and operations of extrabudgetary funds—including any revenue or expenditure stabilization funds.

The government should publish information on realized risks, including annual ex post reviews of budget macroeconomic and fiscal forecasts against outcomes, with analysis of reasons for deviations.

Information on fiscal risks presented in the annual budget documents could usefully be compiled into a single Statement of Fiscal Risks.



Box 7 Guidelines

Fiscal risks should be mitigated in a cost-effective manner – Efficient risk *mitigation—efforts to address or reduce potential fiscal risks before they are taken on or before they materialize—involves a combination of:*

modifying the activity to reduce risk; taking up insurance or otherwise transferring the risk to, or sharing the risk with, other parties, particularly those that are able to influence risk outcomes;

allocating risks based on an assessment of which economic agents have the best ability and incentives to bear and manage risks.

A clear policy framework on fiscal risk mitigation helps assess the justification for proposals to take on new risks; independent expert review is also helpful in this area.

A clear policy framework should be in place for assessing whether the government should take on a fiscal risk. The government's priorities for mitigating fiscal risks should consider the expected net benefits from risk reduction while paying attention to: the possibility of extreme realizations imposing unacceptably large fiscal costs; the interactions between different risks; and scenarios in which a number of risks materialize at the same time. The specific rationale for taking on a risk (e.g., issuing a guarantee) should be documented and available for subsequent review.

Fiscal risks should be allocated based on which economic actor has the best ability and incentives to manage them, and who is best placed to bear them. For example, in PPP contracts or guarantees, the government should bear the risk of future changes to the policy or regulatory environment; private sector agents should bear risks over which they have some control, either in terms of reducing the probability of loss (e.g., construction risk) or their exposure to loss (e.g., foreign exchange risk).

The state should consider issuing contingent liability instruments only in cases of externalities/market failure (e.g., where markets are unable to take on large risks even though it is socially desirable to do so), or where the government is better placed than other parties to manage risks it finds necessary to take.

Economic actors that influence the government's fiscal risk exposure could pay a charge for their reduced risk exposure, or bear at least some risk at the margin.

There may be policy justification for imposing ex ante controls on the risk-taking activities of economic actors that have weak incentives or impose costs on others through their actions (for example, limits on borrowing or on the issuance of guarantees by subnational governments, to minimize the macro/fiscal risk involved in their potential bailout).

When a risk materializes and the central government intervenes to absorb costs incurred by other entities, this should be done in a way that preserves or strengthens incentives for future risk management.

Box 7 Guidelines

Guarantee proposals should be subject to scrutiny and appropriately designed prioritization, to balance insurance and incentive considerations. This could be attained, for example, through guarantee fees; partial guarantees; quantitative ceilings; termination clauses; or requirements for collateral.

There should be a clear legal and administrative framework to regulate overall fiscal management and the government's exposure to fiscal risks – *Effective management of fiscal risks that remain after mitigation efforts hinges on a clear allocation of roles and responsibilities—notably between the central government and the rest of the public sector (including subnational governments)—with respect to the collection, investment, commitment, and use of public funds.*

Fiscal risk management may be facilitated by a central unit of government with the necessary authority and accountability for monitoring the overall level of fiscal risk and coordinating its management, taking into account possible interactions among different sources of risk. To ensure that fiscal risk management is an integral part of overall fiscal management, such a unit could be within the ministry of finance. At the same time, it may be desirable (subject to capacity constraints) for line ministries and agencies to have some clearly specified responsibilities for prudently managing fiscal risks to which they are exposed.

Relationships among different levels of government

The entity with primary interest in managing the fiscal position (typically the ministry of finance) should be responsible for overall monitoring and management of fiscal risks and have the necessary authority to do so.

Fiscal risk responsibilities of different levels of government, and the relationships among them, should be clearly specified. In particular, the legal framework should be clear as to who may authorize borrowing, investment, and issuance of contingent obligations.

There should be a centralized technical capability for analysis and advice to government, and for technical support to line ministries and other public sector entities, on specific aspects of fiscal risk management (e.g., on PPPs, and in a PPP unit).

The government should fully and timely compensate public enterprises, the central bank, and public financial institutions, from the central government budget, for noncommercial obligations it requires them to undertake.

Risk management

To the extent that departments/agencies are allowed to take on risks, each department/agency head should be responsible for the prudent management of such entity's fiscal risks, and should be required to have a risk management strategy in place.

An assessment of fiscal risks should be conducted before the government enters into contractual arrangements with public or private entities, including resource companies and operators of government concessions. Such arrangements should be: clear about the apportionment of fiscal risk; appropriately reflected in government accounts; and publicly accessible, to the extent possible.



Box 7 Guidelines

The responsibility for taking on risks should be separate from the responsibility for estimating their potential fiscal costs: for example, line ministries responsible for issuing guarantees should not be tasked with assessing the expected cost of such guarantees without outside supervision; guidelines should be in place on how to “price” risks.

It is desirable to subject fiscal activities that create risk (including those undertaken off-budget) to internal audit as well as audit by the supreme auditing institution.

Fiscal risks should be systematically incorporated into fiscal analysis and the budget process – *When determining fiscal targets, allowance needs to be made for the possibility that some risks will materialize. In the case of government guarantees and other contingent liabilities, a close integration of fiscal risk management and budget process calls for incorporating decisions over such liabilities to be into the annual budget cycle, and for analyzing the fiscal sustainability implications of the medium- or long-term nature of many contingent liabilities.*

Incorporating risk analysis into the macroeconomic policy framework

The government’s exposure to fiscal risks should be incorporated into fiscal sustainability analysis.

The government should have in place a fiscal policy strategy for unexpected changes in revenues or expenditures. For example, in situations of high revenue volatility, mechanisms (e.g., binding expenditure ceilings) should be in place to ensure that temporary revenue increases do not automatically result in excessive spending.

The general risk of uncertain expenditures in the budget year may be handled through a limited annual centralized contingency appropriation, whose magnitude reflects country-specific circumstances (e.g., the frequency and cost of natural disasters). This may provide adequate flexibility to manage risks that materialize during budget implementation, while preserving the integrity of the original budget.

Guarantees and contingent obligations

Decisions over issuance of guarantees and other contingent obligations should be integrated with the annual budget cycle so that proposals are considered alongside competing instruments and programs intended to achieve similar objectives.

A framework should be in place to require parliamentary approval of guarantees to be issued, whether through an overall ceiling on guarantees, a ceiling on broad categories of guarantees, or approval of individual guarantees.

An annual budget appropriation could be included to cover expected calls on guarantees in the fiscal year, either in a general contingency appropriation or, where the likely costs are significant and can be estimated, in separate appropriations for anticipated calls on individual guarantee programs (e.g., a housing loan guarantee program).

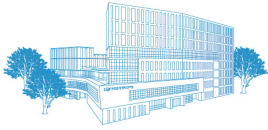
Appendix 2. Relevant legislation and reasoning

*Charter of Budget Honesty Act 1998*³⁰⁾ this Charter is the legal framework for conducting government budget policy in Australia. The Charter aims to improve budget policy outcomes by establishing a set of rules and principles that guide how the government sets and reports on its budget performance. To facilitate public scrutiny of fiscal policy and performance, the Charter mandates the government to publicly release the following reports:

- A budget that sets out the economic and fiscal outlook, and the government's fiscal strategy
- A Mid-Year Economic and Fiscal Outlook (MYEFO) that provides updated information on the government's fiscal performance that can be assessed against the fiscal strategy set out in the budget. The MYEFO must be published by the end of January in each year, or within six months after the latest budget
- A Final Budget Outcome that provides the final fiscal outcomes for the year, and must be published within three months of the end of each financial year
- A Pre-Election Economic and Fiscal Outlook (PEFO) report if a general election is called
- An Intergenerational Report at least once every five years, which assesses the long-term sustainability of current government policies over the next 40 years.

The Charter outlines the information that should be included in each of these publications and what accounting standards to use when reporting financial information. Importantly, the Charter sets the objective of the government's fiscal policy, which is to maintain ongoing economic prosperity and the welfare of Australians. It sets out five principles of fiscal management and requires the government to publish fiscal strategies consistent with these principles. The principles include ensuring policy decisions have taken account

30) file:///C:/Users/Asus/Downloads/Online%20budget%20glossary-23102020.pdf



of the financial effects on future generations, and managing financial risks carefully, including by maintaining government debt at prudent levels.

Fiscal strategy statements are typically found in Statement 3: Fiscal Strategy and Outlook of Budget Paper No. 1. For example, in the 2019–20 Budget the government’s medium–term fiscal strategy was to achieve budget surpluses, on average, over the course of the economic cycle. The strategy is underpinned by policy elements, including stabilising and reducing net debt over time and improving net financial worth over time.

The Charter outlines arrangements under which the Treasury, the Department of Finance and the Parliamentary Budget Office (PBO) may be requested to cost election commitments during the caretaker period prior to a general election. The caretaker period begins at the time the House of Representatives is dissolved and continues until the election result is clear or, if there is a change of government, until the new government is appointed. During the caretaker period, a party can request a costing from the Department of Finance, the Treasury or the Parliamentary Budget Office, but not from more than one of these.

Relevant extracts from the Charter are from Part 3 which spell out the principles of sound financial management the Australian Government must adhere to which are outlined in sections 4 and 5 as follows:

Section 4. Formulation of Government fiscal policy

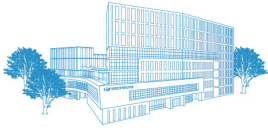
- 1) The Government’s fiscal policy is to be directed at maintaining the on–going economic prosperity and welfare of the people of Australia and is therefore to be set in a sustainable medium–term framework.
- 2) To meet this objective, the Government’s fiscal strategy is to be based on the principles of sound fiscal management.

Section 5. The principles of sound fiscal management

- 1) The principles of sound fiscal management are that the Government is to:
 - a) Manage financial risks faced by the Commonwealth prudently, having regard to economic circumstances, including by maintaining Commonwealth general government debt at prudent levels; and
 - a) Ensure that its fiscal policy contributes:
 - To achieving adequate national saving; and
 - To moderating cyclical fluctuations in economic activity, as appropriate, taking account of the economic risks facing the nation and the impact of those risks on the Government's fiscal position; and
 - c) Pursue spending and taxing policies that are consistent with a reasonable degree of stability and predictability in the level of the tax burden; and
 - d) Maintain the integrity of the tax system; and
 - e) Ensure that its policy decisions have regard to their financial effects on future generations.
- 2) The financial risks referred to in paragraph (1)(a) include risks such as:
 - a) Risks arising from excessive net debt; and
 - b) Commercial risks arising from ownership of public trading enterprises and public financial enterprises; and
 - c) Risks arising from erosion of the tax base; and
 - d) Risks arising from the management of assets and liabilities.

Reasoning:

This Report does not set out to assess compliance or otherwise with these policies and other requirements of the Charter. The material above is provided to assist in providing context for fiscal decisions made, how assets and liabilities are managed as a result including selected financial metrics and subsequent reporting in either budget documents or financial reports.



Public Governance, Performance and Accountability Act 2013

An Act about the governance, performance and accountability of, and the use and management of public resources by, the Commonwealth of Australia, Commonwealth entities and Commonwealth companies, and for related purposes. The objectives of this Act are set out in Section 5 as being:

- a) To establish a coherent system of governance and accountability across Commonwealth entities; and
- b) To establish a performance framework across Commonwealth entities; and
- c) To require the Commonwealth and Commonwealth entities:
 - To meet high standards of governance, performance and accountability; and
 - To provide meaningful information to the Parliament and the public; and
 - To use and manage public resources properly; and
 - To work cooperatively with others to achieve common objectives, where practicable; and
- d) To require Commonwealth companies to meet high standards of governance, performance and accountability.

Reasoning:

Included because this Act spells out how the Government and Government entities must account for the resources allocated to them. This includes preparation by them of annual performance statements (which may be audited) and annual financial statements (which must be audited).

Division 7 of the Act requires the Finance Minister to prepare (which must be audited):

- Monthly consolidated financial statements which must be in a form that is consistent with the budget estimates for the financial year and
- Annual consolidated financial statements which must comply with the accounting standards and any other requirements prescribed by the rules; and present fairly the consolidated financial position, financial performance and cash flows.

Division 2 of the of the Parliamentary Service Act 1999 which establishes the Parliamentary Budget Office

Division 2 – Parliamentary Budget Office Subdivision A–Establishment, functions etc.

64A Department of the Parliamentary Budget Office

1) The Department of the Parliamentary Budget Office is established as a Department of the Parliament by this subsection.

* Note: The Department of the Parliamentary Budget Office is referred to in this Act as the *Parliamentary Budget Office* (see section 7).

2) The Parliamentary Budget Office consists of the Parliamentary Budget Officer, together with Parliamentary Service employees assisting the Parliamentary Budget Officer.

64B Purpose of Parliamentary Budget Office

The purpose of the Parliamentary Budget Office is to inform the Parliament by providing, in accordance with this Division, independent and non-partisan analysis of the budget cycle, fiscal policy and the financial implications of proposals.

Refer <https://www.legislation.gov.au/Details/C2016C00405> for the full legislation

Reasoning:

The purpose of the PBO provides suitable reasoning for inclusion in this Report of reference to it. Relevant references to the PBO's work are included in Appendix 3.

Auditor General Act 1997

The full legislation relating to the appointment of the Federal Auditor-General and establishment of the Australian National Audit Office can be found at <https://www.legislation.gov.au/Details/C2018C00036>.



Reasoning:

Reference to the Auditor-General was included because it spells out this person's independent role in auditing the CFS and the annual financial statements of Australian public entities and his/her ability to carry out other functions including the performance audits referred to in Appendix 4.

Appendix 3. Definitions

The definitions were obtained from the Parliamentary Budget Office ONLINE BUDGET GLOSSARY, Release 1.1, October 2020³¹⁾ the Overview to which notes that:

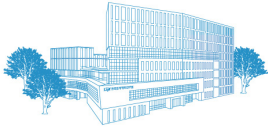
“The Parliamentary Budget Office (PBO) Online budget glossary explains key terms related to the Commonwealth Government budget in a non-technical way. Terms in the glossary include those used in the Commonwealth budget papers as well as some related terms that are important for understanding the budget in the context of the broader economy”.

Accrual accounting records income when it is earned, and records costs when they are incurred, regardless of when the related cash is received or paid. Under accrual accounting, government income is called ‘revenue’ and costs are generally called ‘expenses’. As an example, under accrual accounting, goods and services tax revenue is recorded in the financial year that the goods and services are purchased, even though the government may not receive the related tax amounts until the following financial year.

Alternative³²⁾ financing refers to when governments fund policies or projects using alternatives to the typical approach of paying for them directly with cash (sometimes known as ‘direct funding’). Alternative financing often involves the government providing money to another entity, like a company or individual, in exchange for a financial return in the future. In contrast, under direct funding, the funds are not expected to be repaid. Examples of alternative financing include loans and examples of direct funding include income support payments like the age pension.

31) file:///C:/Users/Asus/Downloads/Online%20budget%20glossary-23102020.pdf

32) Because in preparing this report I have chosen to use definitions independently applied by the PBO, this definition has been retained. However, use of the word ‘alternative’, should not, and does not, imply that funding activities by means other than ‘direct funding’, such as loans or even equity, are new. They have, in fact, been applied for some time.



Automatic stabilisers are parts of government policy that adjust automatically to work against changes in economic conditions such as recessions. Two commonly cited examples are unemployment benefits and taxation revenues. (Related terms include fiscal policy and fiscal stimulus.)

The budget is the Commonwealth Government's main annual financial report that outlines the economic and fiscal outlook for Australia. It is comprised of a series of documents, including the budget papers, the budget speech, the budget overview, and information on each government Minister's area of responsibility (their 'portfolio'). The budget provides an estimate of money coming in (revenue), money going out (expenses), and how much is owed (net debt). The budget is also a policy statement on the government's priority areas of focus and how they intend to meet their objectives.

Budget aggregates are summary indicators that provide information on the government's financial position. Some widely cited budget aggregates are the underlying cash balance, the net operating balance, the fiscal balance, and net debt. A single budget aggregate can only present a partial picture but combined they provide a good summary of the government's financial situation and its impact on the broader economy. 'Aggregate' refers to the fact that these indicators look at total impacts, such as total government cash flows.

The budget papers are four key documents produced as part of every budget that outline the economic and fiscal outlook of the Commonwealth Government. Together, they provide a large amount of information about the government's current and projected financial position (including revenue, expenses and the level of net debt), details of the government's fiscal strategy, new government decisions, and funding provided to the states and territories.

Capital comprises assets, some of which can be used to directly produce goods or services. Capital includes financial assets such as cash and loans, and non-financial assets such as buildings and machinery. Some economic theories also define other types of capital, for example human capital (such as the stock of knowledge and skills), and

natural capital (the stock of natural assets that support life). Non-financial assets, like land, buildings and machinery, are combined with labour inputs to produce goods and services. For example, a farm uses farm machinery, land and the effort of farm labourers to produce crops. Looking across the economy as a whole, the total value of all of these goods and services is called gross domestic product.

Cash accounting records income when cash is received, and records costs when cash is paid out, regardless of when those amounts are earned or incurred. For example, under cash accounting, goods and services tax receipts are recorded in the financial year they are received, even though those tax amounts may relate to goods and services purchased in the previous financial year. Under cash accounting, government income is called 'receipts' and costs are called 'payments'.

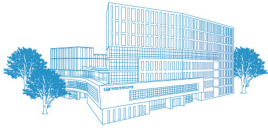
The Charter of Budget Honesty Act 1998 (the Charter) is the legal framework for conducting government budget policy in Australia. The Charter aims to improve budget policy outcomes by establishing a set of rules and principles that guide how the government sets and reports on its budget performance.

Consumer price index (CPI) is one of the most frequently used indicators of inflation, which measures the price changes facing households Net debt.

Government debt refers to the amount of money that the government owes its lenders at a particular point in time. In broad terms, it measures how much successive governments have spent over the receipts they have collected. Going into debt allows the government to fund activities that it could not otherwise afford.

There are two main measures of government debt, gross debt and net debt, and the numbers for each are often very different from each other.

In the budget papers, **gross debt** is the sum of Australian Government Securities on issue, based on their value when the securities were issued (their 'face value'). While gross debt reflects the total amount of Commonwealth Government debt, it does not include any of the government's financial assets that partly offset that debt, or any smaller debts that are



not Australian Government Securities. For this reason, only looking at gross debt without net debt could give an incomplete picture of the government's financial position.

Net debt is the sum of selected financial liabilities (including government securities, loans, deposits held, and other borrowings) minus the sum of selected financial assets (including cash and deposits, advances paid, and investments). In the net debt calculation, Australian Government Securities are valued as the price they are currently trading at (their 'market value') rather than their face value.

Compared to gross debt, net debt is a better indicator of the strength of the government's financial position. While net debt is a widely used indicator of the financial health of a government, it has its own limitations. Within the budget papers:

- Statement 6: Debt Statement, Assets and Liabilities of Budget Paper No. 1 provides information on current and projected government debt, including the assumed interest rates on future borrowings and the share of bonds held by non-resident investors.
- Statement 9: Australian Government Budget Financial Statements of Budget Paper No. 1 provides complete projections of the government's fiscal position, including projections of net debt.

An **equity investment** is a payment in exchange for an ownership stake in a business and a share of any profits. The money invested is called an 'equity injection' and the profits paid back are called dividends. In the Commonwealth Government budget context, examples of equity investments include:

- Direct government ownership of shares in companies through Commonwealth Government investment funds
- The government's sole ownership of NBN Co Limited to finance the delivery of the National Broadband Network.

Final Budget Outcome (FBO) provides the Commonwealth Government's fiscal outcomes over the past financial year. It shows how much the government actually spent or received rather than how much it expected to spend or receive, and whether a projected budget surplus or deficit actually occurred.

Financial assets³³⁾ represent a financial claim that entitles the owner to receive funds or other resources from another entity. An equity investment is one example of a financial asset.

Fiscal balance (FB) is one of several indicators known as 'budget aggregates' that measure the impact of the government's budget on the economy³⁴⁾. Along with the underlying cash balance, or sometimes the net operating balance, the fiscal balance is one of the budget aggregates that may be referred to in discussions of whether the budget is in a surplus or a deficit position.

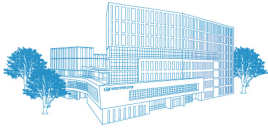
Fiscal policy refers to the government's financial operations and management, including how much the government spends and on what, how much income the government has and from what sources, and how much the government borrows. 'Fiscal' means relating to government money.

Examples of fiscal policy include policies related to:

- Revenue, such as the rates and scope of taxes like income tax and company tax
- Expenses, such as the level of income support payments like the age pension and who is eligible for them
- The size and role of the government as a whole, such as how much the government should seek to redistribute income, and whether there should be restrictions on tax as a share of the total economy (a 'tax cap'), or on how much the government can borrow (a 'debt ceiling').

33) From PBO report Alternative financing of government policies page 28.

34) From PBO report Alternative financing of government policies table 2-2 on page 10.



Fiscal policy can:

- Influence the economy directly or indirectly. For example, fiscal policy has a direct influence when the government purchases equipment, and an indirect one when the government provides payments to, or taxes, households and businesses, changing their spending or saving behaviour.
- Be expansionary or contractionary. That is, influencing the economy to grow faster or slower, respectively, than it would have without the government's actions.
- Work over the short term and long term. For example, fiscal stimulus policies seek to avoid or reduce the severity or duration of a recession, while governments implement a range of other fiscal policies to achieve longer-term objectives, such as preparing the economy for the changes associated with an ageing population.
- Be counter cyclical or pro cyclical. If the economy was heading into a downturn and fiscal policy was reducing the severity of the downturn, policy would be counter cyclical; if fiscal policy was intended to offset the downturn but actually reinforced it, it would be pro cyclical.

Fiscal policy can be distinguished from monetary policy. In Australia, monetary policy is set independently by the Reserve Bank of Australia (RBA), which sets official interest rates³⁵). For example, if it thinks inflation is above its target, the Reserve Bank can raise official interest rates to help bring it back down. Together, fiscal and monetary policy are aspects of 'macroeconomic policy', or policies to do with the operation of the economy as a whole. Different economists have different views about these two arms of policy, including about the relative effectiveness of monetary policy versus discretionary fiscal policy.

In Australia, the Charter of Budget Honesty Act 1998 sets the legal framework for Commonwealth Government fiscal policy. The Charter sets out that the objective of fiscal policy is to maintain ongoing economic prosperity and the welfare of Australians. It

35) The official rates set by the RBA are the rate of interest it pays commercial banks on their deposits with the RBA. The RBA may also undertake market operations to influence the yields on Commonwealth bonds. Both of these influence interest rates in the economy, but the RBA does not regulate general interest rates in the economy, such as those charged by banks.

includes obligations for the contents and frequency of budget documents, and requires governments to set out and report against a medium-term fiscal strategy based on principles of sound fiscal management.

Fiscal stimulus refers to government policies that aim to avoid or reduce the severity or duration of an economic downturn, such as a recession. Paying income support recipients, such as pensioners, a one-off top-up payment during a recession is an example of fiscal stimulus.

General government sector primarily provides public services and benefits for free or at subsidised prices, funded mainly through taxes. These include goods and services for collective rather than individual consumption, such as defence, and others, such as health, that are provided to individuals at significantly subsidised prices. The sector includes Commonwealth Government departments such as the Department of Health and non-departmental bodies such as the Australian Aged Care Quality Agency, the Bureau of Meteorology, and the Australian Broadcasting Corporation.

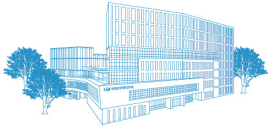
Gross refers to a whole or total economic impact before offsetting adjustments have been made. This is distinct from net, which refers to the economic impact that remains after offsetting adjustments have been made.

Gross debt is the total amount of Commonwealth Government debt before considering the government's financial assets that partly offset that debt. Only looking at gross debt without net debt could give an incomplete picture of the government's financial position³⁶.

Gross domestic product (GDP) is the total value of all goods and services produced within an economy over a given period of time, usually three months or one year. Growth in GDP measures the change in the total value produced from one period to the next.

Mid-Year Economic and Fiscal Outlook (MYEFO) provides updated information on the government's fiscal position and outlines any information that has changed since the most recent budget.

36) The determination of gross and net debt now includes lease liabilities because they are considered 'borrowings'. This change arose from the introduction of a new accounting standard for leases.



Net refers to the economic impact that remains after any offsetting adjustments have been made. This is distinct from gross, which refers to a whole or total economic impact before any offsetting adjustments have been made.

Where gross and net impacts are presented, it is often important to look at both to get a complete picture. For example:

- Net income typically refers to gross (total) income minus taxes and deductions, so gives a better indication of how much of a person's income is available for them to spend.
- Net debt adjusts gross debt, and other similar financial liabilities, for selected financial assets, so gives a better picture of the government's financial position than looking only at gross debt. It is a relatively narrow measure of the strength of the government's balance sheet but it is widely used.
- Net financial worth is equal to the gross (total) value of financial assets minus the gross (total) value of liabilities on the Commonwealth Government balance sheet. It is a broader measure of the strength of the government's balance sheet than net debt.

Net capital investment (also referred to as net acquisition of non-financial assets) measures the change in non-financial assets (such as infrastructure, land or equipment) over a period of time (usually a financial year). Net capital investment is calculated by deducting the value of any sales of non-financial assets from the value of non-financial assets purchased and adjusting for changes in the value of non-financial assets such as depreciation.

Net Debt. Broadly speaking, **net debt** adjusts the gross value of financial liabilities for the value of (selected³⁷⁾) financial assets. It gives a better picture of the government's financial position than looking only at gross debt.

37) Added by Blake - from PBO report Alternative financing of government policies page 32 where selected financial assets are cash and deposits, advances paid and investments, loans and placements (therefore not including other receivables, or equity investments).

Net debt is the sum of selected financial liabilities (including government securities, loans, deposits held, and other borrowings) minus the sum of selected financial assets (including cash and deposits, advances paid, and investments). In the net debt calculation, Australian Government Securities are valued as the price they are currently trading at (their ‘market value’) rather than their value when the securities were issued (their ‘face value’).

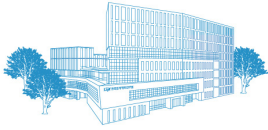
While net debt is a widely used indicator of the government’s financial position, it has its own limitations. First, not all government assets or liabilities are included in the measurement of net debt. For example, the value of any equity investments is not included. **Net financial worth** is a broader measure that includes all of the government’s financial assets and liabilities. Second, excluding some types of assets and liabilities means that the calculation of net debt is sensitive to the particular investment structures and strategies adopted by government investment funds such as the Future Fund.

The Parliamentary Budget Office (PBO) publishes an alternative measure of net debt that adjusts for this factor, which is higher than the standard measure. See the PBO report No. 01/2019: Net debt and investment funds – Trends and balance sheet implications for further information.

Net financial worth measures the total financial assets (such as cash or shares in a company) held by a person or organisation at a fixed point in time, minus the value of any liabilities, such as outstanding debts.

For the Commonwealth Government, net financial worth is one of several indicators known as ‘budget aggregates’ that provide information on the government’s financial position. The Commonwealth Government’s main financial assets are investments and loans, and its main liabilities include debt and superannuation entitlements for public servants and military personnel. Compared to some other indicators, net financial worth is:

- A broader measure of the government’s financial position than net debt, which only includes some of the government’s financial assets and liabilities
- A narrower measure than net worth, which includes all of the government’s assets (both financial assets and non-financial assets such as buildings).



Net operating balance (NOB) is one of several indicators known as ‘budget aggregates’ that measure the impact of a government’s budget on the economy. The net operating balance measures the net costs of providing government services excluding costs related to revaluation, such as the write down of assets. (or, the change in net worth due to transactions³⁸⁾)

Non-financial assets – assets provide benefits to their owner and can be either non-financial assets, such as buildings or equipment, or financial assets, such as cash or shares in a company. Non-financial assets can be tangible, such as land, buildings or roads, or intangible, such as some computer software.

Net financial liabilities – not

Defined Net liabilities – not defined

Net financial worth measures the government’s net holdings of financial assets. It is calculated as financial assets less liabilities. It is one of the broader balance sheet indicators reported in the budget. It includes unfunded superannuation liabilities and holdings of equity, and excludes non-financial assets such as land, buildings, equipment and infrastructure³⁹⁾.

Net worth shows the government’s overall wealth, calculated as total assets (both financial and non-financial) less total liabilities⁴⁰⁾.

Parameters are elements that affect the price, cost, or amount of government activities. Parameters can relate to the general economy, such as the rate of employment growth or inflation, or be activity-specific, such as the number of people receiving a welfare payment like the age pension.

38) From PBO report Alternative financing of government policies table 2-2 on page 10.

39) From PBO report Alternative financing of government policies table 2-2 on page 10.

40) From PBO report Alternative financing of government policies page 28.

Pre-Election Economic and Fiscal Outlook (PEFO) provides an up-to-date picture of the economic and fiscal outlook in the lead-up to a general election. It takes account of government policy decisions and all other circumstances (such as changes in economic conditions) that may have a material effect on the economic and fiscal outlook and were in existence before the issue of the writs for the general election.

Public debt interest (PDI) is the borrowing costs of the government, mainly incurred through issuing and servicing government debt, and recorded as a cost to government in the budget. In 2018–19, public debt interest expenses were around \$17 billion, about the same size as expenditure on the Family Tax Benefit.

The government funds its programs through receipts or borrowings. For example, suppose the budget is in cash deficit (receipts are smaller than payments) and the government wants to increase the age pension payment. There are three options available:

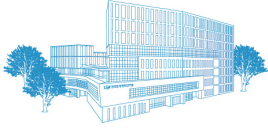
- Reduce other spending to find savings to pay for the pension increase
- Increase receipts, for example by raising taxes
- Borrow money from investors to fund the additional payments. These borrowed amounts would incur interest, which increase the government's public debt interest costs.

An increase in estimated public debt interest could mean one or a combination of the following:

- Actual interest rates are higher than previously predicted
- The amount of expected future borrowings has increased.

Public non-financial corporations are government-controlled corporations that produce and charge for goods and services at market prices⁴¹). Examples include Australia Post,

41) Blake added 'at market prices', which is relevant because some government companies are GGS.



which sells postal services, and NBN Co Limited, which sells broadband network access to internet service providers.

Underlying cash balance (UCB) is the difference between the government's receipts and its payments⁴²). It is one of several indicators known as 'budget aggregates' that measure the impact of the government's budget on the economy. When the government or the media say the budget is in surplus or deficit, they are generally referring to the underlying cash balance, or sometimes the net operating balance or fiscal balance.

42) But not including the financing function which means that the underlying cash balance is close to net operating receipts/payments and net outlay on non-financial assets. In this respect it is very close to, although not identical to, the GFS net cash surplus/deficit.

Appendix 4. Reports referenced

The documents or papers are referred to in the order in which they are mentioned in this Report.

IMF Fiscal Affairs Department document titled Fiscal Risks – Sources, Disclosures, and Management prepared by Aliona Cebotari, Jeffrey Davis, Lusine Lusinyan, Amine Mati, Paolo Mauro, Murray Petrie, and Ricardo Velloso (IMF document). This document can be located at <https://www.imf.org/external/pubs/ft/dp/2009/dp0901.pdf> Budget papers – the budget papers comprise various statements with details provided at <https://budget.gov.au/>

Infosheet 10 The budget and financial legislation –
https://www.aph.gov.au/About_Parliament/House_of_Representatives/Powers_practice_and_procedure/00_-_Infosheets/Infosheet_10_-_Budget_and_financial_legislation

Infosheet No. 7 Making laws –
https://www.aph.gov.au/about_parliament/house_of_representatives/powers_practice_and_procedure/00_-_infosheets/infosheet_7_-_making_laws

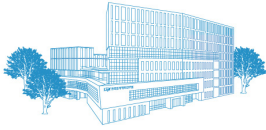
Mid-year Economic and Fiscal outlook (MYEFO) – the most recent MYEFO was issued in December 2020 covering 2020–21 and can be found at <https://budget.gov.au/2021-22/content/myefo/index.htm>

Final Budget Outcome (FBO) – the most recent FBO is for 2019–20 and can be located at <https://archive.budget.gov.au/2019-20/fbo/download/FBO-2019-20.pdf>

Pre-election Economic and Fiscal Outlook (PEFO) – the most recent PEFO was issued in April 2019 and can be located at <https://www.finance.gov.au/publications/pre-election-economic-and-fiscal-outlook>

Intergenerational report (IGR) – the most recent IGR was issued in June 2021 and can be located at <https://treasury.gov.au/publication/2021-intergenerational-report>

Commonwealth of Australia's Consolidated Financial Statements (CFS) – the most recent CFS are for the year ended 30 June 2020 which were issued in December 2020 and can be located at <https://www.finance.gov.au/publications/commonwealth-consolidated-financial-statements>



Uniform Presentation Framework

Book outlining details of the Uniform Presentation Framework applied in Australia – https://books.google.com.au/books/about/Uniform_Presentation_Framework.html?id=3HB1AAAACAAJ&source=kp_book_description&redir_esc=y and

The framework was updated in 2019 and can be located at https://treasury.gov.au/sites/default/files/2019-06/190618_Uniform_Presentation_Framework_2.pdf

The link at <https://treasury.gov.au/publication/p2019-t365789> provides further information about the UPF Impairment of assets guidance:

https://www.aasb.gov.au/admin/file/content105/c9/AASB136_07-04_COMPapr07_07-07.pdf

<https://asic.gov.au/regulatory-resources/financial-reporting-and-audit/directors-and-financial-reporting/impairment-of-non-financial-assets-materials-for-directors/>

<https://www.finance.gov.au/publications/resource-management-guides/commonwealth-entities-financial-statements-guide-rmg-125>

[https://aasb.gov.au/admin/file/content102/c3/FAQ_ImpairmentOfNonFinancialAssets_07-20%20\(002\).pdf](https://aasb.gov.au/admin/file/content102/c3/FAQ_ImpairmentOfNonFinancialAssets_07-20%20(002).pdf)

Australian Bureau of Statistics (ABS) GFS Annual methodology – the latest release of this is available at the following link –

<https://www.abs.gov.au/methodologies/government-finance-statistics-annual-methodology/2019-20>

ABS website as this relates to its GFS methodology –

<https://www.abs.gov.au/ausstats/abs@.nsf/mf/5514.0>

Australian Accounting Standards Board – 2019–20 annual report can be found at

https://aasb.gov.au/admin/file/content102/c3/2019-20_AASB-AUASB_AnnualReport.pdf.

IFAC's/IPSASB's Study 14 –

<https://www.ifac.org/system/files/publications/files/IPSASB-study-14-3e.pdf>

IPSASB's RPG 2 – <https://www.ipsasb.org/publications/recommended-practice-guideline-2>

AASB Discussion Paper: Improving Financial Reporting for Australian Public Sector
https://www.aasb.gov.au/admin/file/content102/c3/DP_IFRPS_06-18.pdf

Article by Jon R Blondal titled Accrual Accounting and Budgeting: Key Issues and Recent Developments published in the OSCD Journal on Budgeting – Vol 3, No 1 in 2003 –
<https://www.oecd.org/gov/budgeting/42187847.pdf>

Accrual Budgeting Framework issued by the Tasmanian Government in 2003 –
https://www.treasury.tas.gov.au/Documents/Accrual_Budgeting_Framework.pdf

General resource on the move to accrual – Accrual Budgeting Project (archive.org)

Parliamentary Budget Office websites –
https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/About_the_PBO

and

https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office. Costs associated with running the PBO – 202122 PBO Portfolio Budget Statements PBS PDF.pdf

Or at –

https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Budget_Office/About_the_PBO/Corporate_information/Portfolio_budget_statements/Portfolio_Budget_Statements_2021-22

Australian National Audit Office (ANAO) – Reports and observations provided by the ANAO who noted that, currently, accrual accounting is the centre piece of the commonwealth financial reporting framework and now embedded in the sustainability measures of financial statements.

The ANAO has carried out performance audits that have some relevance to management of fiscal risk and assets/liabilities at the entity level, but which have not been analysed, including:

Implementation of the Commonwealth Scientific and Industrial Research Organisation (CSIRO) Property Investment Strategy <https://www.anao.gov.au/work/performance-audit/implementation-the-csiro-property-investment-strategy>



Management of the National Collections

<https://www.anao.gov.au/work/performance-audit/management-the-national-collections>
<https://www.anao.gov.au/work/performance-audit/management-the-national-collections-follow>

Defence's Management of Materiel Sustainment

<https://www.anao.gov.au/work/performance-audit/defence-management-materiel-sustainment>

Veterans' affairs compensation schemes

<https://www.anao.gov.au/work/performance-audit/compensating-f-111-fuel-tank-workers>.

GFS publications - refer to Appendix 5

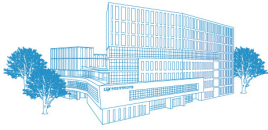
Appendix 5. Major (GFS) fiscal aggregates⁴³⁾

Based on the GFS framework, the major fiscal aggregates presented in the Australian Government's financial reports include:

- **Net operating balance** – is an accrual measure that shows whether the Government has to borrow from financial markets to cover its operating activities.
- **Fiscal balance** – is an accrual measure that shows whether the Government has to borrow from financial markets to cover its operating activities and net investments in non-financial assets used in the provision of goods and services.
- **Underlying cash balance** – is a cash measure that shows whether the Government has to borrow from financial markets to cover its operating activities and net investments in non-financial assets used in the provision of goods and services.
- **Headline cash balance** – is a cash measure that shows whether the Government has to borrow from financial markets to cover its operating activities, net investments in non-financial assets used in the provision of goods and services, and net investment in financial assets for policy purposes.
- **Net debt** – a common measure of the strength of the Government's financial position comprising liquid financial assets and interest bearing liabilities.
- **Net worth** – is equal to assets minus liabilities and is a measure of the strength of the government's financial position. It is a broader measure than net debt.
- **Net financial worth** – is equal to financial assets minus liabilities and is a measure of the strength of the Government's financial position but avoids valuation issues with non-financial assets in the net worth measure.

See Finance Advice Paper – General Principles for Recognition of Expenditure in Budget Aggregates for the principles used in the presentation of government expenditure in the

43) <https://www.finance.gov.au/government/financial-reporting-and-accounting-policy/overview-common-wealth-financial-reporting/major-fiscal-aggregates>



Australian Government's budget financial statements and the consolidated financial statements. Further information on equity investments and concessional loans are provided in the following documents which are presented in a Q&A format:

- Finance Advice Paper – Questions and Answers – Equity Investments
- Finance Advice Paper – Questions and Answers – Concessional Loans

Net operating balance

Net operating balance (NOB) is an accrual measure that shows whether the Government has to borrow from financial markets to cover operating activities. If this measure is in surplus, this indicates that the Government's revenue (mainly taxation) is sufficient to fund operating expenses, which is a measure of the sustainability of the existing level of government goods and services. GFS revenue and expenses excludes changes in assets and liabilities that the Government can't control, such as:

- Net write-downs of assets;
- Assets recognised for the first time;
- Actuarial revaluations;
- Net foreign exchange gains;
- Net swap interest received; and
- Market valuation adjustment for issued securities

Fiscal balance

The fiscal balance is an accrual measure that shows whether the Government has to borrow from financial markets to cover operating activities and net investments in non-financial assets used in the provision of goods and services. If this measure is in deficit, this indicates that the Government is drawing on resources of other sectors in the economy to finance its provision of goods and services. This is sustainable if NOB is in balance/surplus as the government is only seeking the financing of investments in

productive non-financial assets.

Fiscal balance is calculated as NOB less net investment in non-financial assets. The capital adjustment is net purchases less sales of fixed assets such as equipment and intangible assets such as spectrum. It also removes depreciation included in NOB to avoid any double counting.

Underlying cash balance

The underlying cash balance (UCB) is a cash measure that shows whether the Government has to borrow from financial markets to cover its operating activities and net investments in non-financial assets used in the provision of goods and services. If this measure is in deficit, this indicates that the Government is drawing on resources of other sectors in the economy to finance its provision of goods and services.

The UCB is calculated as net AAS cash receipts from operations (excluding net Future Fund earnings until 2019–20), plus financing adjustments (to remove cash flows more appropriately viewed as financing in GFS), plus capital adjustments (net investment in non-financial assets).

Financing adjustments include:

- Principal payments on lease liabilities
- Net interest on swap transactions; and
- Certain public debt interest (PDI) transactions.

Headline Cash Balance

The headline cash balance is a cash measure that shows whether the Government has to borrow from financial markets to cover its operating activities, net investments in non-financial assets used in the provision of goods and services and net investment in financial assets for policy purposes. If this measure is in deficit, this indicates that the



Government is drawing on resources of other sectors in the economy to finance its provision of goods and services and public policy investments.

The Government can provide equity and loan funding for public policy reasons rather than for cash management. This includes net equity and loan payments to government economic corporations (such as NBN) and other economic sectors. This funding results in higher government borrowing and is therefore included in the headline cash balance. The Future Fund and the Australian Office of Financial Management invest for cash management purposes and their investments are not included in the headline cash balance.

Author Biography

Mike Blake

Mike Blake was Tasmanian Auditor-General from 10 May 2004 to 29 March 2016 and is now focussing on board positions. Prior to accepting the position as Tasmania's Auditor-General, he was Auditor-General for the Northern Territory. His career has involved working in both the private and public sectors, firstly with Deloitte Ross Tohmatsu for 16 years starting in Zimbabwe and ending in Western Australia, where he joined the Audit Office of Western Australia rising to the position of Deputy Auditor-General. Mike was a partner with Deloitte Zimbabwe for 8 years.

Mike has been active in standard setting in Australia being a member of the Consultative Committee to the former Public Sector Accounting Standards Board from 1994 to 1998 and he was a Board member in 1999, a member of the Australian Accounting Standards Board's Urgent Issues Group representing Auditors-General from 2003 to 2005 and was appointed to the Auditing and Assurance Standards Board on 1 January 2006. While with this Board, Mike played a key role in developing standards for performance and compliance auditing in the public sector and, until stepping down from the Board on 31 December 2011, he was joint chair of a project group developing an assurance standard for general purpose water accounting reports.

Mike chaired the Advisory Board to the University of Tasmania's Faculty of Business for three years, Regional Chair of the Institute of Chartered Accountants in Tasmania from 2007 and 2008 and he was a Board member of Chartered Accountants Australia and New Zealand from 2011 to 2018 where he chaired its audit and risk committee. In 2015 he was appointed to the Australian Accounting Standards Board (retired in December 2020) and is a member of the International Public Sector Accounting Standards Board (deputy chair of both boards although his term as deputy of the IPSASB concluded at the end of 2020).



He also chairs Tasmania's Electoral Commission and TasTAFE, Tasmania's public provider of vocational educational training, and is a member of the Financial Statements of the Government of New Zealand Audit Committee.

Mike has a BCom from the University of Natal, Durban, is a Fellow of the Institute of Public Administration Australia, CA ANZ Australia, and CPA Australia, an Honorary member of the Institute of Public Accountants and a graduate of the Australian Institute of Company Directors.

He is married to Jenny. They have three children and two grandchildren and three fostered grandchildren. Mike and Jenny love living in Tasmania.

International
Cooperative
Research

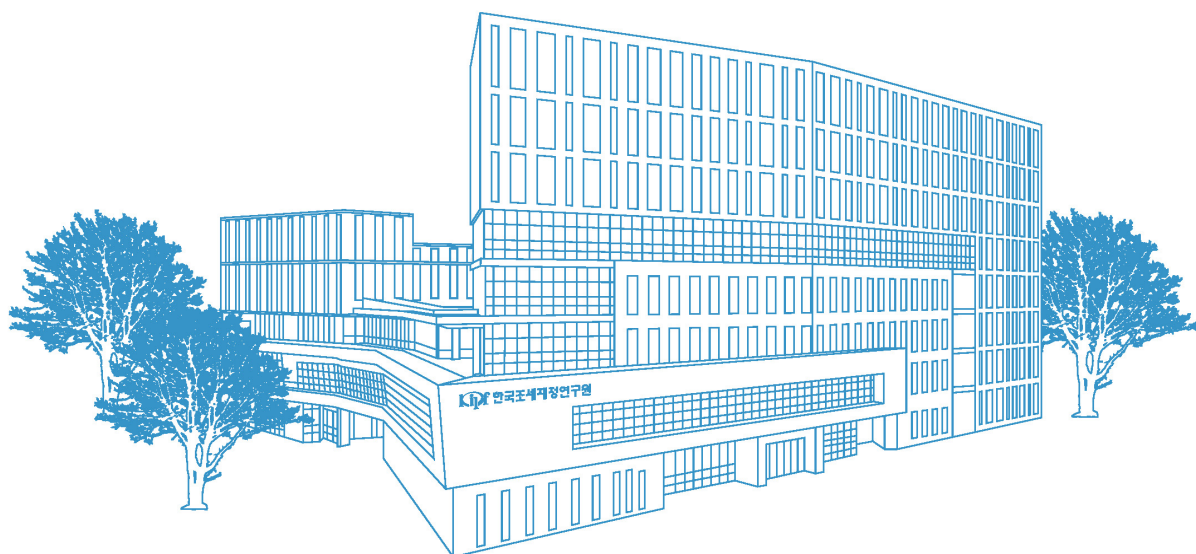
Canada

Using Accrual Information

to Manage Fiscal Risk, Assets and Liabilities
in the Government of Canada

2021

Brian Pagan, Marcia Santiago





KOREA INSTITUTE OF PUBLIC FINANCE

Government Accounting and Finance Statistics Center

Statement of Submission

The research was undertaken by the agreement for the research project “USE OF ACCRUAL INFORMATION: Focusing on Fiscal Risk Identification and Assets and Liabilities Management” between the Korea Institute of Public Finance (KIPF) and the Capital Perspectives.

Hence, this publication, *Using Accrual Information to Manage Fiscal Risk, Assets and Liabilities in the Government of Canada*, is a result from the agreement proposed by KIPF with the purpose to conduct an in-depth study on the use of accrual information in Canada.

Date Submitted: September, 2021

Signature:

Two handwritten signatures in black ink are shown. The first signature, on the left, appears to read 'B. Pagan'. The second signature, on the right, appears to read 'M. Santiago'.

Authors of the report: Brian Pagan & Marcia Santiago



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Figure 1. Sources of Mandate and Information for Key Government Financial Reports 2



Executive Summary

Since the 1990s, Canada has implemented a series of changes to its management of public finance and the fiscal framework, incorporating roles for both accrual and cash accounting methods. The strategy recognizes the utility of each method in providing an information and analytical base, and in the planning and control of public spending. This paper focuses on the use of accrual information in the federal Budget and the Public Accounts of Canada as the basis for identifying and managing financial risk, managing assets and liabilities, and influencing the information and analysis that supports fiscal decision-making.

Based on a policy commitment in 1995, the federal government has been preparing the Budget on an accrual basis since 2003. As its principal fiscal policy document, the Budget is the vehicle for communicating the Government's overall direction and high-level decisions on program spending, as well as key considerations and risks to the economic and fiscal outlook. The Budget also presents historical and forecasted aggregate results for the government's finances, including total revenues, expenses, and the budgetary balance.

On the other side of the planning horizon, the Public Accounts of Canada present the actual financial results achieved during the fiscal year, using both accrual information in volume I, corresponding to the accrual-based forecast set out in the federal Budget, and cash information in volume II, corresponding to the cash-based expenditure authorities set out in the Estimates and the appropriation acts.

The direct resourcing requirements to produce these two key government financial reports amount to roughly 100 fulltime equivalent employees – mainly economists, accountants, and managers – and CAD 21 million annually. Three principal ministries are involved in gathering and consolidating information, publishing, and presenting the documents to Parliament – Finance Canada, the Treasury Board Secretariat, and Public Services and Procurement Canada (Receiver General function) – with data provided by all line departments.

The move to full accrual for managing the fiscal framework was motivated by the Government's desire to provide a more complete and current picture of its financial position, and to better reflect the impact of recent economic events and policy decisions in the budgetary balance. These objectives have been achieved in the key financial reports presented to Parliament in the form of the Budget and Public Accounts. In the process, additional information has become available to financial decision-making, for example, by introducing the concept of depreciation to the management of physical assets, and better reflecting the implementation of tax measures and recognition of liabilities the costing of program proposals.

The evolution of accrual-based planning in the Canadian federal government originated in a political commitment and has been sustained over nearly three decades by active capacity building and resource commitments. As a result, Canada has developed systems and processes to produce and analyze accrual information, allowing it to take further steps into active usage for financial management in key program areas.

Using Accrual Information to Manage Fiscal Risk, Assets and Liabilities in the Government of Canada

I . Introduction

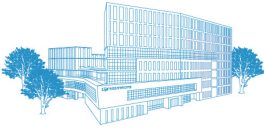
Public Finance is an inherently complex topic that requires among other things, an understanding of economics and public policy; a knowledge of government expenditure and taxation objectives and their underlying accounting basis; and an appreciation of country-specific institutional dynamics, such as the role of bureaucrats in developing – and of executives and legislatures in reviewing and approving – detailed spending plans and proposals.

While jurisdictions around the world will each have their own unique economic, political, and institutional contexts, the underlying accounting processes across jurisdictions are remarkably similar, owing in large part to the existence of national and international accounting standards. For example, the International Public Sector Accounting Standards Board seeks to improve the consistency and comparability of financial information across jurisdictions by developing international standards for both the cash basis and the accrual basis of accounting¹).

The defining difference between accrual and cash accounting methods is in the timing of the recognition and recording of financial events. In cash accounting, revenues and expenditures are recorded when payment is exchanged, i.e., money enters or leaves a bank account. However, in accrual accounting, revenues and expenses are recognized when the financial transaction or event occurs, i.e., when an invoice is received or sent.

Each of these accounting systems has certain advantages and disadvantages with respect to information for decision-making and the control of public expenditure. The Government of Canada uses both accounting methods in managing different aspects of its fiscal framework.

1) See, for example, The Handbook of International Public Accounting Pronouncements (2021 edition, volume I). https://www.ifac.org/system/files/publications/files/IPSASB-HandBook-2021-Volume-1_0.pdf



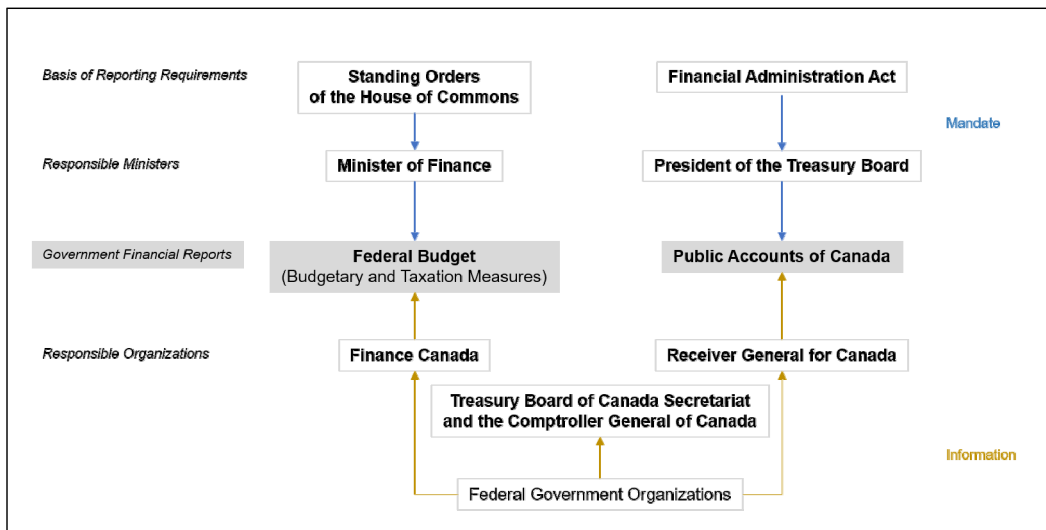
While Canada has prepared both the federal Budget and the financial statements in volume I of the Public Accounts on an accrual basis since 2003, movement in this direction began eight years prior, with a political commitment made in the 1995 federal Budget to address escalating debt levels through broad fiscal reforms.

Separately from the Budget process, the Estimates and annual appropriations to support departmental programs and services are voted through a supply bill and are managed on a modified cash basis, which is reflected in volume II of the Public Accounts. The Debt Management Strategy and Debt Management Report are additional reporting tools that provide detail on the cash operations of the Government.

Thus, the federal Budget and the Public Accounts of Canada are among the government's most important financial reports and represent the most significant uses of accrual information.

Figure 1 presents these documents, along with the sources of their mandate, the ministers responsible for tabling them in Parliament, and the organizations responsible for providing and consolidating information, and publishing the reports.

Figure 1 Sources of Mandate and Information for Key Government Financial Reports



Three principal ministries are at the forefront of the financial management and reporting process – Finance Canada, the Treasury Board Secretariat, and Public Services and Procurement Canada (Receiver General function). Each of these ministries exercises its unique authorities and responsibilities set out in legislation to work with line departments to collect and consolidate both cash and accrual financial information and data, using both independent and common information systems.

The three ministries approach their mandates independently, with well-defined spheres of responsibility for fiscal policy (Finance), accounting policy and expenditure management (TBS) and banking operations (Receiver General). They effectively coordinate activity by using common information systems and extensive inter-departmental communication and coordination in order to integrate material into publications and documents for presentation to Parliament.

Current usage reflects the original driving forces towards accrual budgeting, with the overall economic and fiscal policy direction established by the Minister of Finance in the federal Budget, and financial results reported to Parliament with the commentary provided by the Auditor General through the financial statements and the Public Accounts.

Overall, the implementation of accrual accounting in the budgeting process has improved the government's capacity to adopt a longer-term horizon in fiscal planning and to manage fiscal risks, assets, and liabilities. For the Budget, the accrual method allows the Government to reflect the forecast impact of planned or likely events in calculating a bottom-line surplus or deficit. For government accounting, making the costs of significant events visible when they occur increases the likelihood that the direct costs and related future liabilities will be managed actively in fiscal decision making.



II. Identification and Management of Financial Risk

1. The Federal Budget

A. Overview of the Federal Budget

The Budget is the federal government's principal fiscal policy document, reflecting its economic agenda, the program and policy priorities for the year ahead, the aggregate forecast of revenues and expenditures, and the budgetary balance.

The Budget is normally tabled in Parliament between February and April, having usually been preceded in the fall by an Economic and Fiscal Update. The latter presents the economic and fiscal information that form the basis of policy consideration and public debate, leading up to the next formal tabling of a federal Budget.

Although the Government is not obliged to present a Budget each year, the Standing Orders of the House of Commons prescribe the “ways and means” through which budgetary policy and the supporting revenue generation (taxation) are to be presented and approved in Parliament. These procedures are based on the constitutional principle that legislation for taxation measures should originate in the House of Commons²⁾.

As shown in Figure 1, it is the Minister of Finance who leads this exercise for the Government. Each year, the Budget process unfolds within a specific economic and political context, but the underlying process is remarkably similar year after year. This process includes the establishment of high-level priorities, for example, through election platforms, a Speech from the Throne, or within ministerial mandate letters. In addition to these overarching priorities, the Minister of Finance actively seeks input from his or her ministerial colleagues through a Budget call letter that invites Ministers to identify high priority program or policy objectives that should be funded through the Budget

2) Robert Marleau and Camille Montpetit. House of Commons Procedure and Practice (2000).
<https://www.ourcommons.ca/marleaumontpetit/DocumentViewer.aspx?DocId=1001&Language=E&Sec=Ch18&Seq=6>

prioritization and allocation process.

Officials within Finance Canada work through the Budget call letters and assign a unique identifier to each Budget request and then develop an analysis document known as a “Budget Two-Pager” to support decision-making by the Minister of Finance and the Prime Minister. The Budget Two-Pager provides a summary of the Budget proposal; accrual and cash profiles of financial impact over five fiscal years, and ongoing costs if applicable; detailed analysis of the proposal by Finance Canada officials and a recommendation to accept, reject or modify the proposal. All decisions are the exclusive prerogatives of the Minister of Finance and the Prime Minister, and funding decisions are based on and reflected in accrual profiles.

B. Major Composition and Contents of the Federal Budget

While the structure of the published document can vary, the federal Budget typically presents a high-level narrative on the underlying macroeconomic context and fiscal risks confronting the Government, and then sets out the overall strategic direction and related policy proposals, along with some of the supporting technical information.

Budget 2021³⁾, tabled in the House of Commons on April 19, 2021, contained the following major elements:

- An overview of the policy direction and framework, including the approach to resolving and recovering from the impact of COVID-19, and an explanation of its basis in the Gender Results Framework and the process of factoring gender and diversity considerations into decision making.
- Policy measures by thematic area, including proposed tax and direct spending measures to address public finance risks and objectives, as well as funding sources and requirements presented on an accrual basis.

3) A Recovery Plan for Jobs, Growth and Resilience: Budget 2021. (April, 2021)



- The economic context, including significant past and anticipated economic events to consider in assessing risk to public finances and setting the fiscal direction, along with the composite results of private sector economic projections commissioned during the formulation of the budget plan.
- Other Parliamentary requirements, including the Government's debt management strategy; and notices of tax and non-tax measures proposed to be implemented through legislation. In these cases, accrual considerations are relevant to the extent that Parliament is presented with forecasts of revenue impacts based on the fiscal years in which tax measures would apply, rather than the year in which they are approved or transacted, as in the cases where the approval is retroactive to the prior year. Similarly, on the expense side, there are some situations in which transfer payments, for example, could be charged to the year prior to when the agreement is actually executed.

The Budget is the primary means by which the Government can articulate its economic and fiscal priorities, but many of these priorities are at a high level, representing an aspiration of what the Government intends to do, rather than a detailed plan of how it will do it. These plans often take many months to develop before programs finally receive all approvals and are operationalized.

Consequently, while the Budget does attract a considerable amount of attention for what it may signal in terms of program spending priorities, many observers are more interested in the aggregate results – and particularly in the headline numbers of total spending, total revenues, and the resulting budgetary balance.

In this respect, the Debt Management Strategy offers important information about how the Government will manage budgetary cash shortfalls by providing details on the Government's sources and uses of planned borrowings, including the duration of bond issuances, and setting out its approach to ensure that it always has cash on hand to finance operations⁴). The Debt Management Strategy is predicated on the cash needs of

4) Budget 2021, Annex 2. Debt Management Strategy.
<https://www.budget.gc.ca/2021/report-rapport/anx2-en.html>

the government, as determined by the difference and timing of cash receipts vs cash payments.

The authority to manage public debt, as determined by the difference between the government's assets and liabilities, is governed by Part IV of the *Financial Administration Act* and the *Borrowing Authority Act* which provide the Minister of Finance authority to borrow money up to a maximum amount established by Parliament.

The *Financial Administration Act* requires that the Minister of Finance provide an annual report to Parliament on planned borrowings within 30 parliamentary sitting days of the start of the fiscal year, and this report, in the form of the Debt Management Strategy is typically provided as an Annex to the Budget.

The Debt Management Strategy for 2021 continues the approach established in 2020 to issue long-term debt to finance the emergency support to Canadians and Canadian businesses through the Covid pandemic. As a result of these actions, and the path forward outlined in this year's strategy, the government has a plan to more than double, compared to 2019, the share of its annual bond issuance dedicated to long-term debt.

Post-Budget, the Department of Finance monitors financial risk, tracks progress against the Budget forecast, and provides updates on its cash liquidity position through a monthly report known as the Fiscal Monitor⁵). The Fiscal Monitor provides monthly and year-to-date financial highlights on a comparative basis.

C. Cost and Expertise Required to Prepare the Federal Budget

The Economic and Fiscal Policy Branch, within Finance Canada, has the primary responsibility for producing and publishing the federal Budget.

5) See for example,

<https://www.canada.ca/en/department-finance/services/publications/fiscal-monitor/2021/01.html>



The branch is comprised of roughly 84 economists and managers, who work with both policy and program areas within the department, as well as with their fiscal and expenditure management counterparts in the other two central agencies, i.e., the Privy Council Office and the Treasury Board of Canada Secretariat.

The team supports the Minister of Finance, as they engage their colleagues to collect, assess and consolidate budgetary proposals and develop recommendations for the Minister of Finance. They also engage private sector economists to develop independent forecasts, the average of which is incorporated into the Government's economic and fiscal outlook, as a measure towards greater objectivity and transparency.

The direct cost of producing the federal Budget is roughly CAD 10 million, representing primarily the salary and operating costs of the Economic and Fiscal Policy Branch at Finance Canada.

All staff involved in preparing the federal Budget are classified in the economic and social services group, or as executives, including some with a professional accounting designation. While familiarity with accounting concepts is a definite asset, the officials driving the Budget process are known for their knowledge and expertise in economic analysis and public policy.

III. Management of Assets and Liabilities

1. The Public Accounts of Canada

A. Overview of the Public Accounts of Canada

The Public Accounts of Canada (the Public Accounts) are the primary document by which the Government “closes the loop” with Parliament and provides a detailed accounting of approved funding. The Public Accounts include the Government’s audited consolidated financial statements, setting out assets and liabilities, using information reported by departments, agencies, Crown corporations and other federal government organizations.

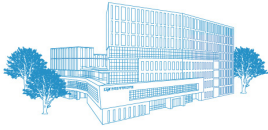
The Public Accounts are an instrument of the Government’s financial accountability to Parliament and Canadians, based on two constitutional principles: that all tax and non-tax revenue form one Consolidated Revenue Fund, and that, after meeting expenses, the balance of the Fund is appropriated by Parliament for the public service to use in operations and program delivery⁶).

As shown in Figure 1, the Financial Administration Act establishes the mandate for the Public Accounts of Canada. Specifically, section 64 (1) requires the President of the Treasury Board to table in Parliament, by December 31, the report for the fiscal year that ended on the preceding March 31; or if the House is not sitting at that time, within the next 15 sitting days of the House of Commons.

B. Major Composition and Contents of the Public Accounts of Canada

The Public Accounts of Canada present all expenses charged to the fiscal framework, revenues collected, and payments into and out of the Consolidated Revenue Fund, as

6) Robert Marleau and Camille Montpetit. House of Commons Procedure and Practice (2000).
<https://www.ourcommons.ca/marleaumontpetit/DocumentViewer.aspx?DocId=1001&Language=E&Sec=Ch18&Seq=6>



authorized by Parliament through statutory (ongoing) and voted (annual) appropriations.

The financial statements reflect information from two sources: the detailed transactional records maintained by government organizations, and the summarized financial transactions reported by these organizations to the Receiver General and maintained in the accounts of Canada.

The 2020 Public Accounts tabled in the House of Common on November 30, 2020, contain three volumes⁷⁾:

- Volume I – the audited consolidated financial statements of the government, and additional financial information and analysis, on an accrual basis, corresponding to the federal Budget;
- Volume II – information on the financial operations of the government, by ministry and organization, on a modified cash basis, corresponding to the Estimates and the related appropriation acts; and,
- Volume III – supplementary information and analysis, including details on the acquisition of land, buildings, machinery and public debt charges, amongst other information.

The federal government’s chart of accounts sets out and defines key accrual concepts for the purpose of recording and monitoring financial transactions. This paper considers three: assets, liabilities, and net assets/equity.

Assets are financial (e.g., cash, accounts receivable, and loans, investments and advances) or non-financial (e.g., inventories, buildings, machinery and equipment, capital leases, and work in progress) resources that are controlled by a government entity and which may generate future economic benefits.

Liabilities are financial obligations to outside organizations and individuals, resulting from

7) The Public Accounts of Canada 2020, (November 2020).

<https://www.tpsgc-pwgsc.gc.ca/recgen/cpc-pac/2020/index-eng.html>

contracts, agreements, and legislation that require the government to repay borrowings or to pay for goods and services required or provided (e.g., accounts payable, accrued interest payable, accrued salaries and wages, superannuation, and public debt).

Net assets/liabilities represent the difference between total assets and liabilities, depending on whether assets exceed liabilities (net assets) or vice versa (net liabilities).

Data, analysis and discussion pertaining to these and other key concepts are presented in Volume I of the Public Accounts, along with 10 years of comparative financial information and detailed consolidated statements of the government's operations and accumulated deficit, financial position, change in net debt, cash flow, non-budgetary transactions and non-financial assets, and foreign exchange, unmatured debt and cash transactions.

In addition to this information, section 49.2 of The FAA also requires that the Minister of Finance provide a full annual report to Parliament within 30 sitting days of the tabling of the Public Accounts, in the form of the Debt Management Report detailing bond issuances and cash management activity to manage government debt⁸⁾.

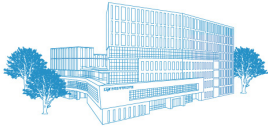
C. Cost and Expertise Required to Prepare the Public Accounts of Canada

The Government Accounting Policy and Reporting (GAPR) team, within the Office of the Comptroller General (OCG) at the Treasury Board of Canada Secretariat, has the primary responsibility for producing and publishing the Public Accounts of Canada.

The GAPR team is comprised of roughly 15 to 17 accountants and managers, who work with the staff of the Office of the Receiver General for Canada at Public Services and Procurement Canada, and financial administration staff in other government organizations⁹⁾. The team develops and applies accounting policy, and provides direction as needed on the

8) <https://laws-lois.justice.gc.ca/eng/acts/f-11/fulltext.html>

9) In total, there are approximately 5,000 financial officers and auditors employed by the Government of Canada to manage all aspects of the finance function. Unionized employees are represented by the Association of Canadian Financial Officers, North America's largest union exclusively representing accountants, comptrollers, auditors, and financial professionals.



accounting treatment of financial transactions. They also lead the government-wide process of developing financial statements for the Public Accounts of Canada, in close collaboration with all partners and the Office of the Auditor General, in accordance with standards established by the Public Sector Accounting Board.

The direct cost of producing the Public Accounts of Canada is roughly CAD 11 million, including salary and operating costs of the GAPR (CAD 1 million), and related costs for the Receiver General function (CAD 10 million).

All staff involved in preparing financial statements are classified as financial officers or executives with a professional accounting designation. As postsecondary education programs are short of content on public sector accounting standards, the OCG works with the national association of Chartered Professional Accounts Canada, the Public Sector Accounting Board and the Canada School of Public Service to develop and customize training for federal government financial professionals.

The Canada School of Public Service is a federal department that works closely with the functional authorities across government to address specific training needs. In the area of finance, the Canada School offers a number of courses including Risk Management for Finance Professionals and Financial Management Control Frameworks¹⁰.

10) Online and classroom-based training, job aids and other resources are available through GCcampus, the online delivery platform of the Canada School of Public Service.
<https://www.csps-efpc.gc.ca/index-eng.aspx>

IV. Usage and Impact in Fiscal Decision-Making

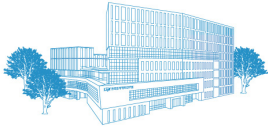
1. Information, Analysis and Usage

Accrual accounting is a standard endorsed by the Public Sector Accounting Board of the Canadian Institute of Chartered Accountants. It has the support of the Canadian Parliament, as represented by the House of Commons Standing Committees on Public Accounts, and on Government Operations and Estimates. It is also seen as a leading practice by credit rating and investor agencies and by the Auditor General of Canada.

The move to full accrual for managing the fiscal framework in 2003 was motivated by a desire to provide a more complete and current picture of the Government's financial position that supported better analysis and decision-making. Specifically, this was meant to have the balance sheet provide a more comprehensive picture of assets and liabilities, and to have the annual budgetary balance – Canada's prime fiscal aggregate – better reflect the impact of economic events and policy decisions taken by the Government during the year.

For the executive branch of government, full accrual also provided new information to support decision-making by introducing the concept of depreciation through the consumption or use of physical assets (e.g., buildings and equipment, amortization of infrastructure). In this way, accrual information more accurately represented the full cost of owning and operating capital equipment and provided more complete coverage and reporting of assets and liabilities. A leading example of the operational use of accrual information for financial management is the National Defence capital portfolio, where a funding envelope was established for the department to manage – in consultation with the central agencies – the acquisition, maintenance, and renewal of its capital assets.

Such information is summarized at the end of each fiscal year in volume I of the Public Accounts of Canada. For example, in relation to the fiscal year that ended on March 31, 2021, the government reported on a net increase of CAD 4.1 billion on a total CAD 163.8



billion in accounts payable and accrued liabilities, reflecting movements such as:

- An increase of CAD 9.1 billion in amounts for the Canada Emergency Response Benefit (CERB) payable to individuals in respect of the period from March 15 to March 31, 2020. This program was announced around March 25 and the online application process was launched in early April.
- A decrease of CAD 5.0 billion in tax amounts payable, reflecting changes in the timing of processing refunds and lower refund amounts owing at yearend, based on process changes announced in the Government's Economic Response Plan to the COVID-19 emergency.
- An increase of CAD 2.1 billion in accrued salaries and benefits for the public administration.
- An increase of CAD 1.5 billion in environmental liabilities and asset retirement obligations, reflecting revised estimates net of remediation activities undertaken during the fiscal year. Many of these environmental liabilities are managed through the Federal Contaminated Sites Action Plan, whose core mandate is to manage human and environmental risks, and the related financial liabilities, associated with federal contaminated sites. Originally established with a 15-year profile in 2005 and subsequently renewed in 2019, the funding envelope for this program is centrally managed on an accrual basis, alongside the cash appropriations to custodian departments.
- A decrease of CAD 1.5 billion in provisions for contingent liabilities, related to the settlement of various claims and pending and threatened litigation. Cash appropriations for most of the related payments were reflected in the 2020-21 Estimates. A substantial portion of these liabilities are related to claims and litigation in the Indigenous portfolio; therefore, central agencies work closely with the key responsible departments, in a process like that for contaminated sites, to monitor changes in the inventory and status of claims, adjusting provisions as necessary, along with funding envelopes and appropriations.

In all these cases, accrual information at a detailed level was used intensively for

management and operational decision making at the officials' level, while also feeding into the government-wide information reported in the Budget and Public Accounts. At that higher level, these changes have meant that key fiscal aggregates – such as the accumulated deficit, the value of federal debt and the annual budgetary balance – came to become more accurate reflections of the Government's fiscal position than would be possible using a cash basis of accounting.

These benefits on the budgeting side have sustained a level of interest in extending the accrual-based management framework to cover Estimates and voted appropriations, with recommendations from parliamentary Standing Committees in 2006, 2012 and 2019^{11), 12), 13)}.

However, the Government continues to opt instead to maintain its mixed approach of using both cash and accrual concepts in financial management, citing the advantage of keeping track separately of the expenses for capital depreciation and the cash outlays for acquiring and building capital assets and developing options to reconcile Budget and Estimates documents¹⁴⁾.

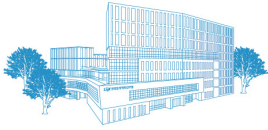
At the legislative level, there are three principal committees for the review of Government finances. Within the House of Commons, the Government Operations and Estimates Committee reviews departmental Estimates in support of annual appropriations and specific Budget proposals, and the Public Accounts Committee reviews and reports on

11) "Accrual Budgeting and Appropriations in the Federal Government". Report of the Standing Committee on Government Operations and Estimates, December 2006
<https://www.ourcommons.ca/Content/Committee/391/OGGO/Reports/RP2600186/Oggorp06/Oggorp06-e.pdf>

12) "Strengthening Parliamentary Scrutiny of Estimates and Supply". Report of the Standing Committee on Government Operations and Estimates, June 2012
<https://www.ourcommons.ca/DocumentViewer/en/41-1/OGGO/report-7>.

13) "Improving Transparency and Parliamentary Oversight of the Government's Spending Plans". Report of the Standing Committee on Government Operations and Estimates, January 2019.
<https://www.ourcommons.ca/DocumentViewer/en/42-1/OGGO/report-16/>

14) "Empowering Parliamentarians through Better Information: The Government's Vision for Estimates Reform. October 2016
<https://www.canada.ca/en/treasury-board-secretariat/services/planned-government-spending/empowering-parliamentarians-better-information.html>



the Public Accounts and reports of the Auditor General. In the Senate, the Standing Committee on National Finance examines Budget, Estimates and Public Accounts material.

The Committee review process tends to cover a wide range of topics from high level headline issues such as net debt to department-specific programs and services such as information technology platforms, new infrastructure programs and services to the elderly, or to indigenous Canadians. Ministers will often appear before Committee to address policy issues, and then turn to senior officials to discuss technical program details and funding requirements.

A. Improvements

Interviews and parliamentary reports indicate that the implementation of accrual frameworks is seen as a “net positive”. Senior officials, Ministers and other Parliamentarians regularly make use of the more complete picture of budgeting decisions that they provide. Where cash accounting only shows the cash inflows and outflows for a single year, accrual accounting presents the full impact of decisions over time. This is useful in situations like capital investments in infrastructure, which is treated as an asset and added to the balance sheet, and the related depreciation expense is deducted over time from the income statement.

Accrual concepts are also used to identify and quantify contingent liabilities related, for example, to environmentally contaminated sites and indigenous claims and litigation, and to reflect these liabilities in the balance sheet. In principle, this practice allows for improved decision-making by providing a better sense of the total scope of the Government’s anticipated obligations, risks, and costs – and how these liabilities can grow over time.

On the asset side, the introduction of accrual accounting has been a key driver in informing investments in infrastructure and identifying challenges related to asset management and inventories. For example, in implementing accrual concepts, the

Department of National Defence has been required to improve their inventory tracking processes and systems, leading to the identification of inventories that are obsolete, such as World War II-era tank covers, or materiel that should be depreciated.

B. Challenges

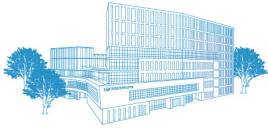
While there are strong supporting arguments for the use of accrual concepts in terms of accounting policy and practice, there are some challenges to be addressed in terms of budgeting. The timing of events, for example, can be difficult to determine, as in the case of a when a contingent liability for environmental contamination could or should be recognized as an actual liability. Other challenges include the continuing adjustment of assumptions and methods, and evolving policy opinions and interpretations.

For example, a pressing challenge within the Government of Canada has been the application of appropriate discount rates for liabilities and obligations. Fixing appropriate discount rates, which are acceptable to both accountants and auditors can pose a significant technical and political hurdle, as they are driven by a range of assumptions about inflation and economic growth, amongst other factors. Regardless of how it is determined – e.g., using current market rates or a historical average – a discount rate is required to establish the present value of a future cash flow, which in many cases is also difficult to determine completely or reliably.

In June 2017, the Government of Canada committed in its response to the Twenty-Eighth Report of the Standing Committee on Public Accounts to review, in consultation with the Auditor General of Canada, how it selected and updated its discount rate methodologies in the valuation of various assets and liabilities in the government's consolidated financial statements¹⁵).

Prior to the 2018 Public Accounts, a variety of methodologies had been used to select discount rates for different benefit plans and liabilities. However, as a result of the

15) Government Response to the Twenty-Eighth Report of the Standing Committee on Public Accounts (June, 2017). <https://www.ourcommons.ca/DocumentViewer/en/42-1/PACP/report-28/response-8512-421-234>



discount rate review completed in 2018, a standard methodology was established for the valuation of¹⁶⁾:

- Liabilities for unfunded pension and other employee future benefits
- Liabilities for contaminated sites
- Asset retirement obligations
- Liabilities for comprehensive land claims
- Capital lease obligations
- The concessionary portion of long-term loans receivable

This new standard discount rate methodology is based on the rates on the actual zero-coupon yield curve for Government of Canada bonds, published by the Bank of Canada, which reflect the timing of expected future cash flows for financial statement items that are discounted to their present values based on the government's cost of borrowing. The methodology to select the discount rates used in measuring funded pension benefits is based on the expected rates of return on plan assets, through consultation with the Department of Finance, the Treasury Board Secretariat and the Government of Canada's Chief Actuary and remains unchanged.

When applied to an issue on the scale of the Government's pension obligations, even minute changes in discount rates or cash flow assumptions have the potential to introduce considerable variability in year-to-year fiscal outcomes, creating sizeable and variable gains and losses. For the Government of Canada, the effects of implementing the new discount methodology resulted in an increase of CAD 19.6 billion to the accumulated deficit reflected in the 2018 Public Accounts.

The Government of Canada opted to mitigate this variability by adopting the New Zealand model of reflecting core revenues and expenses in the income statement, before

16) Review of Methodologies to Determine Discount Rates (2018).

<https://www.canada.ca/en/treasury-board-secretariat/corporate/reports/review-methodologies-determine-discount-rates.html>

accounting for the impact of depreciation, interest rate adjustments and unrecognized accrual gains and losses. It is reported as “the accumulated deficit before actuarial gains and losses”.

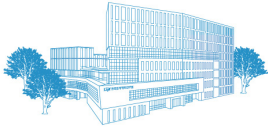
2. Critical Success Factors

Almost 20 years of experience in Canada demonstrate that the introduction of accrual concepts in public financial management requires an alignment of policy direction with decision-making processes, dedicated training and supporting information systems, and consistent communication and education.

The extent to which accrual accounting is currently embedded in the decisionmaking processes of the Government resulted from clear policy direction, primarily from the Office of the Comptroller General, supported by incremental development of organizational capacity, both within policy centres and within government departments.

Responding to concerns expressed by the Auditor General of Canada, Budget 1995 committed the Government to implementing full accrual accounting in reporting on its financial results. In moving closer to private sector practice, the Government intended mainly to capitalize physical assets over their useful life and to account for tax revenues in the year to which they relate, instead of the year in which they are received. These changes in accounting approach coincided with and supported the fundamental changes in fiscal direction taken by the Government of that era: the move towards smaller government; tax relief; and, for the first time in nearly 30 years; debt reduction through balanced budgets¹⁷⁾. After several years of work on building systems and professional capacity throughout the government, the 1995 commitment was fulfilled in the 2003 Budget and Public Accounts.

17) “Executive Summary”, The Budget that Changed Canada: Essays on the 25th Anniversary of the 1995 Budget (2020). <https://www.fraserinstitute.org/sites/default/files/budget-that-changed-canada.pdf>



The Office of the Comptroller General has served since then as both a policy centre and the functional lead of the finance and accounting community, as it is well positioned to direct policy development and implementation, communication, and training. The OCG has played an important advisory and liaison role in terms of integrating accrual information into decision-making documents and forums. For example, key decision documents including Memoranda to Cabinet, Budget briefings and submissions to the Treasury Board, where approvals of policy, program and expenditure authority are sought by federal organizations now all require detailed financial tables presenting cost profiles on both cash and accrual bases. This shows decision makers the expected stream of payments over time alongside the fiscal impact. While these usually coincide, in the situations where they may not – as in debt write-offs or settlements of claims against the Crown, for example – having both sets of information in one place helps decision makers, who often do not have specialized training or experience in financial management, to understand the financial flows and consequences of the proposals they are considering.

At the same time, there remains, in the current context, some scope to develop organizational capacity in this area. One example is in capital planning, where federal organizations continue to struggle with maintaining the parallel tracks of managing appropriations on a cash basis and managing fiscal impact on an accrual basis. This is a long-standing capacity challenge for the finance community – the financial professionals involved with managing cashbased program and operational budgets at the fund centre level, including the Chief Financial Officers as well as the deputy heads in their role as departmental accounting officer – as they work with program managers in their own organizations and fiscal planners at the central agencies, to provide for and manage accrual-based sources of funds. This capacity issue was flagged by the Auditor General in a 2006 report as a barrier to the full and effective integration of accrual information into financial management operations and decision-making¹⁸).

A more fundamental challenge is the ongoing requirement for communication and education of public finance processes and documents. In practice, the relative unfamiliarity

18) “Managing Government: Financial Information,” Chapter 3, 2006 May Status Report of the Auditor General of Canada. https://www.oag-bvg.gc.ca/internet/English/parl_oag_200605_01_e_14958.html

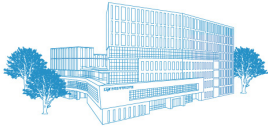
with the accrual framework by both senior decision makers in the executive branch and parliamentarians can be a barrier to their engagement in financial discussions. Simply put, the concepts and mechanics of accounting policy – be it cash basis or accrual – can be difficult for non-specialists to understand and are often too far removed from their immediate concerns and interests.

Individual parliamentarians and the Standing Committees can be quite engaged on headline concepts such as budgetary balance, accumulated deficit, national debt, and debt deletions. However, their interest is driven as much by partisan political or constituency interests than by the accounting basis of the underlying information.

Similarly, on the revenue side, when parliamentarians pose questions to Ministers and senior officials, they tend to be around the nature of the revenue or the intended recipient groups or regions, rather than technical accounting concepts or the policy basis of the forecast. Parliamentarians are most interested in detailed, readily accessible, and user-friendly information about their ridings, regional industries or firms, and other aspects of government activity and spending that affect their constituents.

Underlying accounting concepts are important and should be based on accepted national or international standards. However, for many general users of government documents, including some parliamentarians, the accounting basis can be a secondary consideration. Recipients of government financial information are often more concerned with the “veracity and consistency” of government reporting and that documents and information are presented in an accessible, user-friendly format. The federal government maintains online data sets and data retrieval systems, such as the GC InfoBase and the Open Data portal¹⁹⁾, that respond to this need. Most of the holdings are current and historical data generated by the core programs and activities of organizations, such as the Main and Supplementary Estimates. There are also some data sets that respond to specific information requests from Parliament, like the estimated expenditures of organizations on measures announced in the Government’s COVID-19 Economic Response Plan.

19) GC InfoBase. <https://www.tbs-sct.gc.ca/ems-sgd/edb-bdd/index-eng.html>. Open Data <https://open.canada.ca/en/open-data>



V. Conclusion

The Canadian experience demonstrates that the alignment of policy direction with decision-making processes, training and professional development in the financial community, and system-wide communication are vital to the successful implementation of accrual accounting methods. Beginning with the initial commitment in Budget 1995, there has been continuing and significant engagement from many organizations across the legislative and executive branches – from the lead ministers and central agencies, to Standing Committees of Parliament, to line ministries, and to the Auditor General – that, in turn, prompted the resource commitments and capacity building required to institutionalize the use of accrual concepts and information.

In a lengthy and often difficult process of change, the Government has moved from the initial production of accrual information, into regular and systematic analysis of this information in preparing the Budget and Public Accounts, and into active usage of accrual information for the purpose of financial and fiscal management for key issues and portfolios. While the OCG has provided overall leadership and guidance, no new machinery, institutions or task teams were specifically created to oversee the introduction and use of accrual information. However, the working arrangements among officials in central agencies and the responsible departments to manage, for example, liabilities for contaminated sites and claims against the Crown, demonstrate how the integration of accrual concepts and information in the planning, approvals, and management processes has contributed to better information and analysis for these programs.

Canada's experience suggests the introduction of accrual accounting in public finance requires a long-term commitment to change and adjustments to behaviour. It is a long but rewarding journey.

Appendix A. List of Interviews

Roch Huppé

Comptroller General of Canada
Treasury Board of Canada Secretariat

Nick Leswick

Assistant Deputy Minister
Economic and Fiscal Policy Branch
Department of Finance

Diane Peressini

Executive Director
Government Accounting Policy and Reporting
Office of the Comptroller General
Treasury Board of Canada Secretariat

Brad Recker

Director General
Fiscal Policy Division
Economic and Fiscal Policy Branch
Department of Finance

Dillan Theckedath

Analyst
Government, Industry and Finance
Parliamentary Information, Education and Research Services
Library of Parliament

Greg Smith

Senior Economist
Funds Management Division
Financial Sector Policy Branch
Department of Finance



Appendix B. Interview Questions

Management of Fiscal Risk

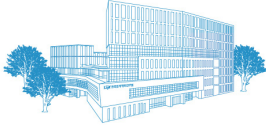
- 1) How is the Budget used to manage fiscal risk?
- 2) What is the annual cost to produce a Budget?
- 3) What are the critical success factors to produce an effective accrual-based Budget?

Management of Assets and Liabilities

- 1) How does the use of accrual information in the Public Accounts of Canada aid the effective management assets and liabilities?
- 2) What is the annual cost to produce the Public Accounts of Canada?
- 3) What are the critical success factors to produce accrual-based financial statements?

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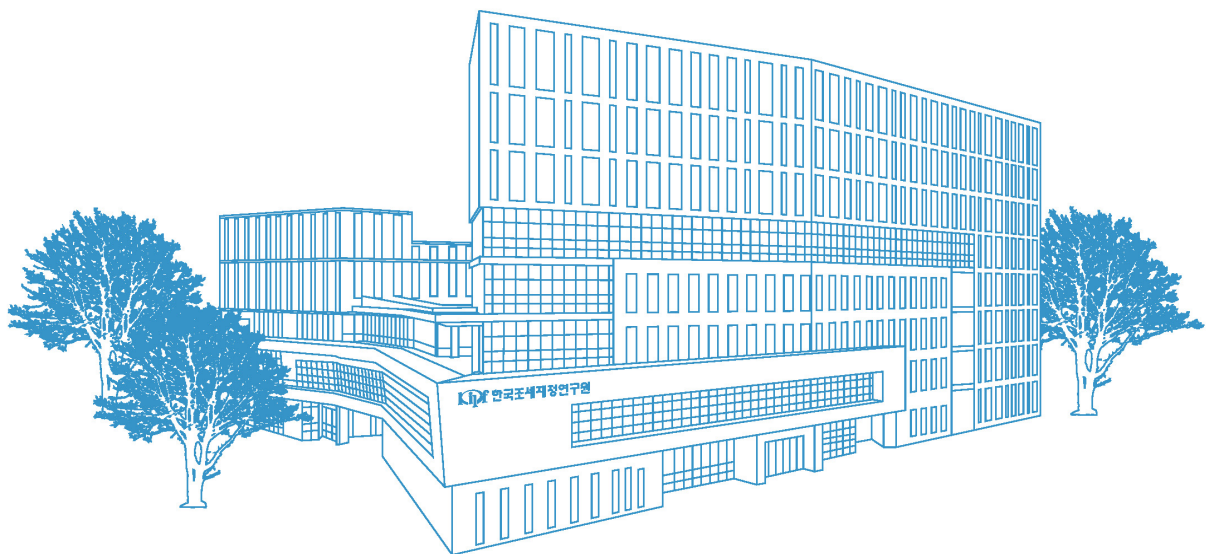
Austria

Use of Accrual Accounting Information

for Accountability and Decision Making in Austria

2021

Bernhard Schatz



kipf KOREA INSTITUTE OF
PUBLIC FINANCE
Government Accounting and Finance Statistics Center



KOREA INSTITUTE OF PUBLIC FINANCE

Government Accounting and Finance Statistics Center

Statement of Submission

The research was undertaken by the agreement for the research project “USE OF ACCRUAL INFORMATION: Focusing on Fiscal Risk Identification and Assets and Liabilities Management” between the Korea Institute of Public Finance (KIPF) and the PwC Österreich.

Hence, this publication, *Use of accrual accounting information for accountability and decision making in Austria*, is a result from the agreement proposed by KIPF with the purpose to conduct an in-depth study on the use of accrual information in Austria.

Date Submitted: August, 2021

Signature:

A handwritten signature in blue ink, appearing to be 'Bernhard Schatz', is written over a horizontal line.

Author of the report: Bernhard Schatz



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Summary

The result of the study on the use of accrual accounting information for accountability and decision making in Austria can be summarized as follows:

During the years between 2009–2013 on federal government¹⁾ level a very comprehensive budget reform has been conducted. This reform established new information sources (accrual accounting and budgeting, performance indicators, long term projections, etc.) for many areas of public financial management.

When analyzing the legal background and current reports published by various stakeholders of the PFM system in Austria it can be concluded that the area of Fiscal Risk Management is quite systematically incorporated into legal requirements, reporting to external stakeholders as well as internal processes and procedures for reporting entities. The area of asset and liability management is substantially less integrated in the legal framework and internal processes and procedures.

In order to answer the research question of how accrual accounting information is used in Austria's Federal Government in the areas of fiscal risk management and asset and liability management information has been collected on the actual practices of the reporting entities.

As a result of this study we found that in accordance with the level of legal requirements practices within reporting entities are more comprehensive in the area of fiscal risk management even though entities reported various challenges depending on the nature of their risks to be managed and the structure of their organizations. Regarding the use of accrual accounting information, it could be shown that the use for decision making of provisions in the financial statements are quite common. The use of impairment information and information on liabilities is not that wide spread. When asked about

1) The federal republic of Austria comprises of the following layers of government: Federal Government (Bund), regional governments (Länder) and municipalities (Gemeinden). The study focused on the federal government since it introduced accrual accounting in 2013 and therefore has sufficient experience and practice. In the other two layers accrual accounting was introduced in 2020.

what could promote the use of this accrual accounting information reporting entities highlighted that it would be useful to have general trainings as well as certified trainings for staff to get more used to analyzing and compiling information as well as incorporating accrual elements into their financial key performance indicators.

When asked about the use of accrual accounting information regarding asset and liability management reporting entities mentioned that they faced specific challenges regarding the necessary accounting knowledge to analyze the information as well as a lack of demand from their senior management for decision making. Therefore, it did not come as a surprise that little to no reporting entities systematically used the information on depreciation or impairments for their decision making. Regarding the management of their liabilities they highlighted that they focused on managing the annual cost behind the structure and amount of their liabilities. When asked about what would promote the use of accrual accounting information for asset and liability management the again highlighted the integration of accrual elements into their financial key performance indicators as well as general training of the use of accruals for planning/budgeting, financial analysis and asset management.

Overall it can be stated that since the introduction of accrual accounting information in Austria in 2013 the use of the information generated for areas of public financial management is still diverse. The single biggest measures for promoting the use of accrual accounting information identified as per the respondents would be having trainings which will highlight the use of accrual information for budgeting/planning, financial analysis as well as asset and liability management in addition to integrating accrual elements into their financial key performance indicators (medium term planning as well as fiscal rules).

Finally, the conclusions of the study can be presented in the following manner:



Policy Implication

Lv. 1: Production	Lv. 2: Analysis	Lv. 3: Usage	Lv. 4: Impact
<p>Governments and related organizations at this stage produce accrual information</p>	<p>Governments and related organizations at this stage analyze the accrual information they have produced</p>	<p>Governments and related organizations at this stage take a step further from the analysis and make use of the analyzed accrual information for a specific purpose (ex: financial management)</p>	<p>At this stage, the “impact” is referred to as the impact of the usage (Lv.3) that reports, projects, institutions or teams are established based on the result from Lv. 3</p>
<p>Examples:</p> <ul style="list-style-type: none"> ▸ [Austria] Federal Budget and Federal Financial Statements 	<p>Examples:</p> <ul style="list-style-type: none"> ▸ [Austria] External Institutions like the Court of Audit or the Parliamentarian Budget Office analyse the information and create reports for the broader public. ▸ [Austria] To some degree the reporting entities themselves analyse the accrual information to support their decision making or internal accountability. 	<p>Examples:</p> <ul style="list-style-type: none"> ▸ [Austria] Currently there is limited usage of the information. Currently there are no published Public Financial Management best practices or guidance. 	

Use of Accrual Accounting Information for Accountability and Decision Making in Austria

I . Introduction

This study has been performed by PwC Austria as requested by KIPF from the period of March 2021 to June 2021. In order to inquire about the desired research questions, we structured the areas of Fiscal Risk Management and Asset and Liability Management in accordance with established practices by the International Monetary Fund (IMF) and the World Bank (WB). We developed a halve structured interview questionnaire which combined predefined answers for the respondents to select as well as open answers where respondents could comment out of structure and to their liking.

The scope of respondents has been all reporting entities of the federal government (all Ministries, High Courts and the President's Office).

Due to the circumstances of the global Covid-19 pandemic we had to adjust from a desired optimal approach in combining physical presence with virtual data exchange to a purely remote approach. We had to rely on the respondents to make room in their busy schedules, which have had additional load due to public interventions to fight Covid. We are very grateful that 36% of reporting entities found the opportunity to answer the questionnaires and grant us insight into their operations and decision making.

We asked the participants about their perception on challenges and hindrances; ideas for promoting the use of accrual accounting information as well as their degree of usage of accrual accounting information in the PFM areas of Fiscal Risk Management and Asset and Liability Management.



The questionnaire can be found in Annex A.

Given our vast experience in the field of public sector budgeting and accounting in Austria as well as Public Financial Management we critically reviewed the response and found them to be representative.

We do very much respect the privacy and discretion under which this study has been performed. Therefore, all answers have been grouped and anonymized in accordance with our client KIPF.

We do hope that the readers will find this report useful and insightful and we are grateful to be able to contribute to a further improvement of Public Financial Management and the role of accrual accounting.

II. Fiscal Risk

1. Background on Fiscal Risk Management in Austria and its legal basis

A. Background on Fiscal Risk Management in Austria

The IMF defines *Fiscal Risks* as “possibilities of deviations in fiscal variables from what was expected at the time of the budget or other forecasts”²⁾. The sources of these deviations could include economic risks (change in growth rates, changes in interest, etc.) as well as specific risks (natural disasters, contingent liabilities, etc.). In Austria’s Federal Government there are many stakeholders for and levels of Fiscal Risk Management which is outlined in the following table published by the IMF³⁾:

Table II-1 Austria: Reports related to Fiscal Risk

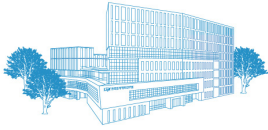
Report	Related Risks and Issues	Author
Stability Program	Macroeconomic risks, guarantees	Ministry of Finance
Guarantee Report	Guarantees	Ministry of Finance
Reports on the issuance of guarantees	Guarantees	Parliamentarian Budget Office
Six Pack Data on contingent liabilities	Off-balance-sheet PPPs, guarantees, public corporations	Statistic Austria
Fiscal Sustainability Report	Long-term risks	WIFO ⁴⁾
Report on hived-off entities and shareholdings	Public corporations	Ministry of Finance
Consolidated Financial Statements	Assets and Liabilities, Guarantees, Public Corporations	Court of Audit
Financial Accounts of the Government Sector	Assets and Liabilities	Statistic Austria
Government Crisis and Disaster Management Strategy	National crisis and disaster protection management	Ministry of Interior
Annual Debt Management Review	Debt	Austrian Debt Management Office

Ministry of Finance Source: IMF 2017 (own presentation)

2) IMF 2013

3) IMF 2017 (own presentation)

4) WIFO (Austrian Institute of Economic Research)



This comprehensive table highlights the widespread use and awareness of fiscal risks within the federal government. Although information is of high quality and readily available there is currently no consolidated document providing a wholistic view.

Fiscal Risk Management in the Federal Government of Austria is predominantly a responsibility by the respective legal entity with some coordination or approval responsibility by the Ministry of Finance (see chapter on legal basis).

Historically main areas where specific fiscal risks would materialize in Austria are natural disasters (blizzards and flooding), guarantees (mainly subsidies) and legal claims for undue conduct of government administration. Main economic fiscal risks have been economic growth and interest rates, were Austria is generally following the trend of the European Union and those impacts usually have been forecasted quite reliably.

In Austria the Ministry of Finance publishes on a quarterly basis the total of issued guarantees (which is around 101.3 bn EUR as of 2020 (or about 23% of the GDP of Austria). The Austrian Parliamentarian Budget Office usually generates on an annual basis a report on the issuance of guarantees, outlining trends, explaining guarantee schemes etc. These reports are available on their website⁵).

A more comprehensive and detailed report on the guarantees for a financial year is to be submitted to parliament by the end of January the following year (Guarantee Report). This report is not publicly available.

The reports on guarantees are an important piece in the Public Financial Management of Austria's Fiscal Risks in the context of the use of accrual accounting information since they provide a basis to reconcile guarantees (contingent liabilities), provisions associated with guarantees as well as payments associated to provisions and guarantees themselves.

5) Parliamentarian Budget Office 2020

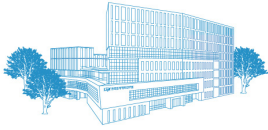
B. Legal Background on Fiscal Risk Management in Austria

The main legal documents governing the fiscal risk management at the federal government level are:

Table II-2 ► Austria: Legal documents for fiscal risk management

Legal document	Content
Organic Budget Law	<ul style="list-style-type: none"> • Mandatory long-term budget forecast (30 years) every third financial year • Medium-Term expenditure framework accompanied by a strategy report (outlining assumptions about macro-economic developments) • Budgeting of provisions is mandatory under accrual budgeting • Annual impairment tests for assets are mandatory • Controlling of public corporations and their risks • Debt Management Strategy mandatory (outlining risk appetite) • Criteria for the issuance of government guarantees • Mandatory annual report on the issuance of guarantees to the parliament • Mandatory monthly budget reporting (incl. accrual information on provisions and impairments)
Federal law on ceiling for guarantees	<ul style="list-style-type: none"> • Process and methodology for issuing a ceiling on government guarantees • Monitoring and data collection process • Sanctions for violations
Annual Budget Law	<ul style="list-style-type: none"> • Outlining ceilings for individual guarantees and the process for approval
Annual Financial Statements	<ul style="list-style-type: none"> • Reporting on annual changes in provisions as well as total stock • Segment on state guarantees as the primary source for contingent liabilities and their development
Federal Financing Act	<ul style="list-style-type: none"> • Outlining debt management and financing strategy (risk averse) • Limiting financial instruments to be used (only foreign exchange rate swaps are allowed) • Requirements for risk management (analysis of market, credit, liquidity, reputational, legal and operational risks)
Fiscal Council Act	<ul style="list-style-type: none"> • Establishing a fiscal council to advise government on public finance issues • Give recommendations on the compliance with the European fiscal framework

Source: Austrian online law platform: ris.bka.gv.at (own presentation)



This table shows that macro-economic fiscal risks and risks from state guarantees and risks from financing are well established, monitored and regulated.

The same is true for risks stemming from public corporations and state-owned enterprises but given the nature of decision-making and the dependence on external factors (e.g. market developments, political risks) risks in those areas are much harder to minimize.

Although the legal basis for the federal fiscal risk management in Austria is well established and quite comprehensive there is some room for improvement:

As the IMF noted in his fiscal transparency review there is comparatively little fiscal management of risks coming from natural disasters⁶⁾. The federal government established a dedicated budget fund for covering the impacts of natural disasters (National Disaster Fund) which is funded by 1.07 percent of income tax and corporate tax respectively which usually leads to a budget of around 450 mn EUR. The fund can create reserves (if after a financial year funding exceeds spending) with a ceiling of 30 mn EUR. The federal government is legally mandated to double the funding in case of emergency.

This quite comfortable financial situation has led to a limited planning and risk management approach at times since nearly every impact of natural disasters is funded.

The IMF also noted that there is no comprehensive report to align all risks and give a wholistic overview on the fiscal risk position. This report element could well be suited in the accrual financial statements since both provisions and contingent liabilities are defined reporting elements in accrual accounting but currently they only cover state guarantees.

6) IMF 2017, p.

2. Composition and major elements of Fiscal Risk Management

In the following section the major categories of accrual accounting elements covering fiscal risks will be explained and highlighted.

A. Contingent Liabilities

In the Federal Budget Law in Austria there is currently no definition or process outlined for the systematic recording of contingent liabilities. In the federal accounting regulation there is a reference to contingent liabilities, but it is limited to the recording of a provision and the respective reduction of a potential contingent liability⁷⁾. As a result, the subsegment of guarantees is well reported and accounted for. Other sources of contingent liabilities are currently not systematically recorded and reported.

Many reporting entities (e.g. Line Ministries) have established a praxis on how to record contingent liabilities and how they use it for their internal reporting. Since guarantees can only be issued by the Minister of Finance in accordance with the Budget Law and a prior approval is needed before the guarantees is legally binding information on the amount and type of guarantee can be collected centrally by the Ministry of Finance.

In the Consolidated Financial Statement there are several presentations on the current status of guarantees. Among those there is the following presentation of the legal ceiling for guarantees as well as their utilization status in accordance with the EU Six-Pack regulation.

7) BHV 2013, § 78, 79 and 81

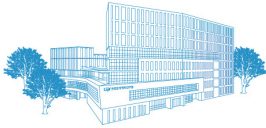


Table II-3 ▶ Austria: Ceiling for Guarantees and extent of Guarantees in the Financial Statement 2019

Position	Legal Threshold for Guarantees 31.12.2019 (in mn EUR)	Current state of Guarantees per 31.12.2019 (in mn EUR) ⁸⁾
Total Guarantees	89,290	44,926
Guarantees by the Ministry of Finance		44,695
<i>Guarantees for Financial Institutions</i>		<i>591</i>
<i>Guarantees for non-financial institutions</i>		<i>44,104</i>
Guarantees by off budget entities		231
<i>Guarantees for Financial Institutions</i>		<i>198</i>
<i>Guarantees for non-financial institutions</i>		<i>33</i>

Source: Consolidated audited financial statement of the federal government 2019 (own presentation)

B. Provisions

In the Federal Budget law there is a mandatory requirement to record provisions on an accrual basis. The practice within reporting entities varies, some to record the change of their provisions on a regular (e.g. monthly) basis, all of them have an emphasis during the closing of the accounts at the end of the year to record all additions and consumptions of provisions.

A provision is defined in the law as a: *“a provision has to be recorded when [an event] is more likely than not to lead to an outflow of service potential in the future⁹⁾.”*

The federal budget law highlights some categories where provisions will have to be recorded as: state guarantees, legal claims, redevelopment of contaminated sites and employee benefits¹⁰⁾. In addition to that short-term provisions are recorded for outstanding invoices.

8) Calculated in compliance with the EU Six-Pack regulation (nominal amount weighted by probability of default)

9) BMF (2013), § 79

10) With the exclusion of pension benefits which are currently not recorded under the Austrian Public Sector Accrual accounting system.

In the financial statements for the year 2019 there is a total of 5.9 bn EUR recorded. Provisions increased steadily over the last 3 years with an average increase of 4.5%. In the financial year 2019 provisions increased by about 235 mn EUR which highlighted a potential future cash obligation.

The most substantial positions are highlighted by the following table:

Table II-4 ▶ Austria: Long term Provisions in the Financial Statement 2019

Position	Amount (in mn EUR)	Increase/Decrease
Long term Provisions	4,877	+63
<i>State guarantees</i>	<i>2,377</i>	<i>+13</i>
<i>Contaminated sites</i>	<i>12</i>	<i>+5</i>
<i>Employee Benefits</i>	<i>1,767</i>	<i>+33</i>
<i>Others</i>	<i>722</i>	<i>+11</i>

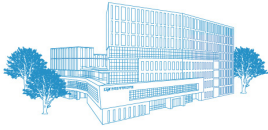
Source: Consolidated audited financial statement of the federal government 2019 (own presentation)

Table II-5 ▶ Austria: Short term Provisions in the Financial Statement 2019

Position	Amount (in mn EUR)	Increase/Decrease
Short term Provisions	1,099	+172
<i>Legal claims</i>	<i>507</i>	<i>+71</i>
<i>Unconsumed Vacations</i>	<i>486</i>	<i>+17</i>
<i>Others (incl. invoices)</i>	<i>106</i>	<i>+84</i>

Source: Consolidated audited financial statement of the federal government 2019 (own presentation)

As those tables show the information added by the provisions in the accrual financial statement highlights not only the likely amount to be financed by the budget in future years (5.9 bn EUR) but also the operational areas where improvements will reduce the amount and likelihood of future budget spending like reduced scope of state guarantees and employee benefits. Quality improvement in the process of law making and staff management.



C. Impairments

In contrast to the provisions who highlight potential future budget obligations based on past events impairments show the loss of service potential or economic benefit through past events. The definition in the accounting regulation is: “an impairment of an asset is to be recorded if the carrying value exceeds the recoverable amount for a sustainable period and the circumstances of the first time recognition changed substantially¹¹⁾).

Total impairments in the financial statements 2019 have been 1.1 bn EUR and increased by 258 mn EUR which mainly resulted in from the write off of tax receivables.

Table II-6 Austria: Impairments in the Financial Statement 2019

Position	Amount (in mn EUR)	Increase/Decrease
Impairments	1,108	+258
<i>Impairments on tax receivables</i>	<i>918</i>	<i>+168</i>
<i>Impairments from family benefits</i>	<i>168</i>	<i>+72</i>

Source: Consolidated audited financial statement of the federal government 2019 (own presentation)

The table highlights that impairments currently are only recorded in some policy areas. To provide some background identifying impairments is one of the most resourceful and accounting skill-dependent element of accrual accounting. To spot an impairment the reporting entity has to identify internal or external impairment triggers¹²⁾ and make a professional judgement on how those events or data will impact the service potential or economic benefit of the asset.

D. Liabilities

Liabilities are not a risk in a sense that they might occur since they result from past events without any uncertainty around but for public Fiscal Risk Management a risk is also

11) BMF (2013), § 80

12) External impairment triggers could be: cessation or near cessation of demand or need for the service provided by the asset; significant long-term changes which will adversely impact the service potential of the asset be it legal, technological, government policy or the environment in which the entity operates Internal impairment triggers could be: physical damage, asset becoming idle, plans to discontinue or restructure the asset; decision to halt the construction of an asset; service performance is significantly lower than expected (IPSAS 26.27)

defined as having the potential to cause a deviation in budget (see for reference the definition in chapter 1A). Liabilities have to potential to cause budget changes (especially short-term liabilities) if they are not adequately taken care of in budget planning.

In the financial statements for the financial year 2019 short term liabilities amounted to 44.9 bn EUR which is a reduction of 2.2 bn EUR compared to the prior year. The following table shows the details of short-term liabilities:

Table II-7 Austria: Short term Liabilities in the Financial Statement 2019

Position	Amount (in mn EUR)	Increase/Decrease
Short term Liabilities	44,969	-2,236
<i>Short term financial liabilities</i>	<i>25,815</i>	<i>-3,429</i>
<i>Short term liabilities from taxes</i>	<i>2,504</i>	<i>+8</i>
<i>Other short-term liabilities¹³⁾</i>	<i>14,152</i>	<i>+214</i>

Source: Consolidated audited financial statement of the federal government 2019 (own presentation)

Long term liabilities amounted to 209 bn EUR which is an increase of 1.9 bn EUR in comparison to the prior period. The following table shows the detail for long term liabilities:

Table II-8 Austria: Long term Liabilities in the Financial Statement 2019

Position	Amount (in mn EUR)	Increase/Decrease
Long term Liabilities	209,411	+1,937
<i>Long term financial liabilities</i>	<i>182,953</i>	<i>+541</i>
<i>Other Long-term liabilities¹⁴⁾</i>	<i>21,580</i>	<i>+1,333</i>

Source: Consolidated audited financial statement of the federal government 2019 (own presentation)

Financial liabilities are connected to the pay back of loans and other government finance instruments and are centrally taken care of by the Debt Management Office.

Other short-term liabilities can be substantial (for the financial year 2019 they came up to 18% of the annual budget) and therefore if unaccounted in budget planning might lead to substantial disruption of public service provision or fiscal performance.

13) Main components are accruals for services received but not yet paid and liabilities to the state-owned railway company

14) Other long-term liabilities are predominantly liabilities to the state-owned railway company.



3. Obstacles and challenges connected to Fiscal Risk Management

To better understand the current practice and challenges reporting entities might face we have conducted a survey among the preparers of financial statements and supervising authorities as described under *1. Introduction*.

A. Results of the survey

Respondents described the challenges and obstacles in regard to the Fiscal Risk Management as follows:

Figure II-1 Survey result: Fiscal Risk Management Hindrances and Challenges



Source: Survey Results (own presentation)

These figures show that the challenges respondents face applying accrual accounting information for Fiscal Risk Management purposes is pretty equally split. Some reporting entities find it hard to compile the data in the quality and timely manner necessary, some feel that they lack the staff or the knowledge to interpret accrual data in this context while others have the perception that their senior management is not using accrual data for fiscal risk management and therefore it is not provided. This result is very plausible since fiscal risk management will always heavily depend on the operations of the entity (and the inherent risks associated to that) as well as their internal approach to manage fiscal risks.

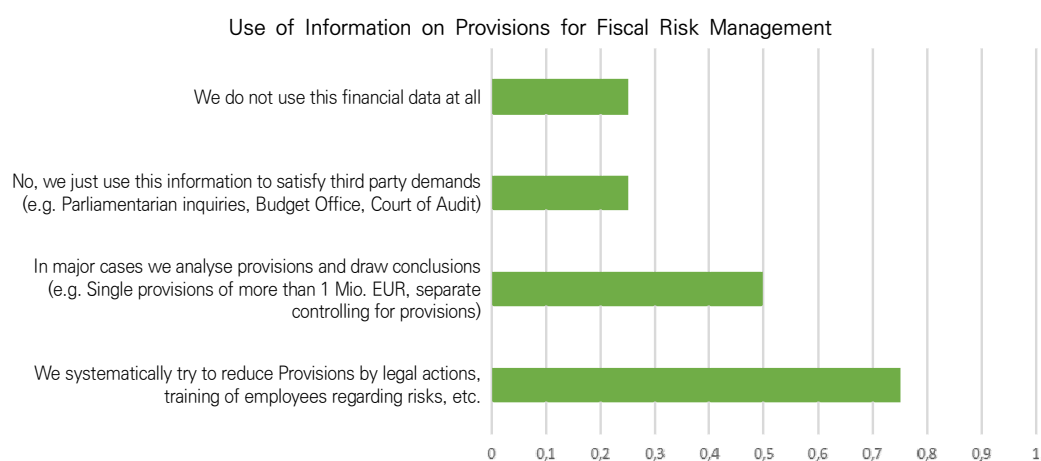
4. Degree of usage of accrual accounting information for Risk Management

To better understand the current practice and challenges reporting entities might face we have conducted a survey among the preparers of financial statements and supervising authorities as described under *1. Introduction*.

A. Use of information on provisions (Results of the survey)

Respondents described their day to day use of accrual information on provisions in regard to the Fiscal Risk Management as follows:

Figure II-2 ▶ Survey result: Fiscal Risk Management: degree of use of accrual provisions



Source: Survey Results (own presentation)

When asked whether they currently use the accrual information on provisions for fiscal risk management respondents by a strong majority acknowledged that they look systematically at their provisions and try to come up with management solutions to manage them.

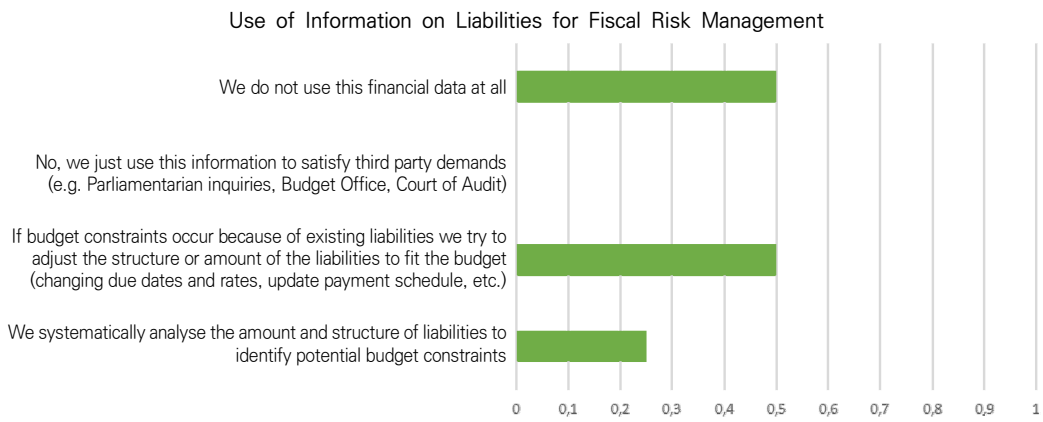
Some add that they dedicate special effort to the most significant single provisions and try to draw conclusions internally. Some also used the information for correspondence with third parties (e.g. the Parliamentarian Budget Office or the Court of Audit).



B. Use of information on liabilities (Results of the survey)

Respondents described their day to day use of accrual accounting information on liabilities regarding the Fiscal Risk Management as follows:

Figure II-3 ▶ Survey result: Fiscal Risk Management: degree of use of liabilities



Source: Survey Results (own presentation)

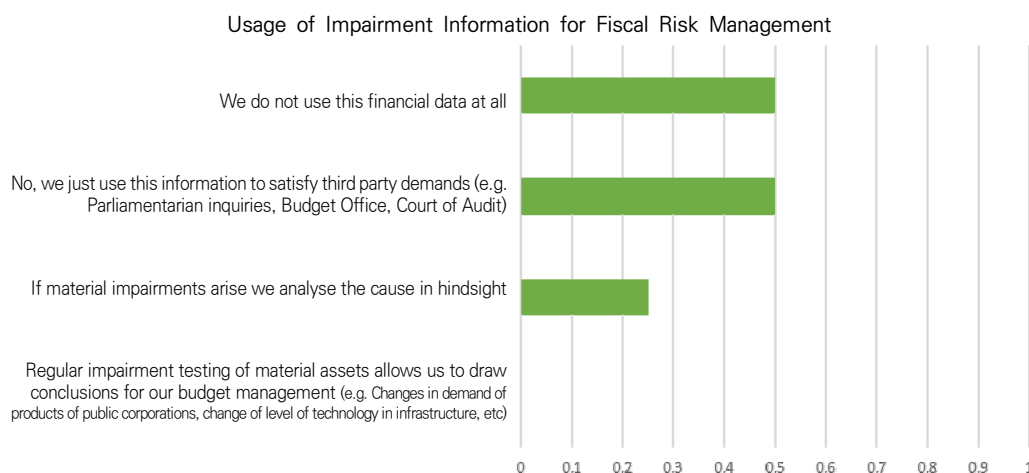
When asked whether they use accrual accounting information on liabilities a large group of respondents answered that they are not using this data to support their fiscal risk management. An equally large group referenced though that they use data on liabilities to manage budget constraints. Just a small group noted that they systematically analyses the structure of their liabilities to prevent budget constraints. Respondents did not feel that liabilities are an area where they have to answer third party questions when it comes to Fiscal Risk Management.

This picture is consistent with the Austrian PFM architecture since financing and the respective liabilities associated to that are performed by a specialized entity and therefore those liabilities are not of a direct concern for other reporting entities.

C. Use of information on impairment (Results of the survey)

Respondents described their day to day use of accrual accounting information on impairments regarding the Fiscal Risk Management as follows:

Figure II-4 Survey result: Fiscal Risk Management: degree of use of impairment



Source: Survey Results (own presentation)

In response to the question whether they use accrual information on impairments for fiscal risk management purposes a big group of respondents answered that they do not use this information in that context. An equally sized group responded that they are use this information if they are asked for it by third parties. Only a small group of respondents said that they analyze big impairments after they have happened to get some insight into the circumstances.



5. Potential methods for spread and promotion of using accrual accounting information

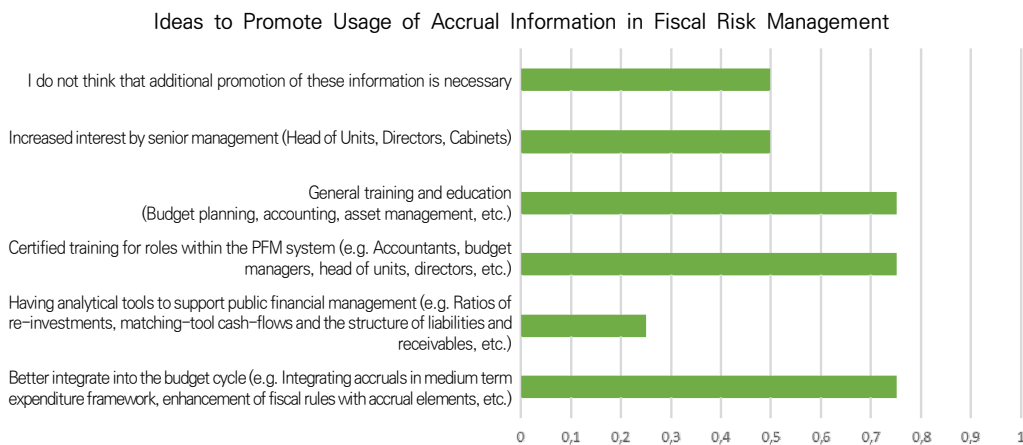
To better understand the current practice and challenges reporting entities might face we have conducted a survey among the preparers of financial statements and supervising authorities as described under *1. Introduction*.

Results of the survey

Respondents supported the following ideas to enhance the use of accrual accounting information for the purpose of Fiscal Risk Management:

Figure II-5

Survey result: Fiscal Risk Management: ideas to promote use of accrual information in fiscal risk management



Source: Survey Results (own presentation)

Respondents have been very supportive of ideas to enhance the use of accrual accounting information for Fiscal Risk Management purposes. A strong majority supported the ideas of integrating accrual information into the budget cycle and the financial KPIs of the government and they liked the idea of having general trainings on the topic (Budgeting and planning, Accounting topics, etc.) as well as specialized, certified trainings for the respective roles within the PFM architecture.

III. Asset and Liability Management

1. Background on Asset and Liability Management in Austria and its legal basis

A. Background on Asset and Liability Management in Austria

In comparison to the Fiscal Risk Management Asset and Liability Management in the federal government of Austria is not very formalized.

There are currently no general documents or reports by the Ministry of Finance or the Court of Audit on general practices regarding Asset and Liability Management. But there are legal requirements for Asset and Liability Management which will be presented in the chapter 5C. Legal Background on Asset and Liability Management.

Therefore, Asset and Liability Management is in the sole responsibility of the reporting entities.

B. Legal Background on Asset and Liability Management in Austria

The main legal documents governing the asset and liability management at the federal government level are:

Table III-1 Austria: Legal documents for asset and liability management

Legal document	Content
Organic Budget Law	<ul style="list-style-type: none"> • Execution of the budget (including assets and liabilities) has to be performed in line with the principles of efficiency, effectiveness and outcome orientation • Define the responsibility of reporting entities for the acquisition of assets, MoF prior approval is necessary if certain thresholds are exceeded. • Assets must not be acquired if they are not needed or a superfluous inventory position would be created • If assets are acquired via a non-exchange transaction prior approval of the MoF is necessary if there are substantial subsequent cost associated • If assets are no longer needed for service provision the MoF has to be notified and other reporting entities have to be offered the asset for the price of the carrying value for one month



Legal document	Content
	<ul style="list-style-type: none"> • Legal entities can only be established or acquired if they are essential to the service provision of the reporting entity; the potential financial need is limited; due influence is guaranteed (e.g. through nominations in management and supervisory board) • A legal basis is required if the acquisition of a legal entity exceeds 75 mn EUR or a majority of shares would be held by the government for the first time • Receivables can be voided if the cost of collection exceeds the value or the void is in the economic interest of the federal government • Asset registers have to be maintained
Federal Asset Management Regulation	<ul style="list-style-type: none"> • Bookkeeping Agency has to check whether invoices regarding assets have been entered into the asset register • Type and structure of asset registers • Assets have to be used carefully and economically; regular stocktaking has to be performed; property management system has to be established, changes have to be recorded in due course • Data to be collected (Acquisition value, date of acquisition, date of capitalization, category, useful life, link to registers, size, volume, amount (depending on the nature), description of the asset, any associated liabilities, other owners if applicable)
Annual Budget Law	<ul style="list-style-type: none"> • MoF approval for “moveable assets” is possible for up to 11 mn EUR if the individual value is below 2.5 mn EUR • MoF approval for “immoveable” assets is possible up to 5 mn EUR in case of a sale or exchange; Public property dedicated to transport purposes up to 0,07 mn EUR; right to use property for no consideration for other government bodies (e.g. municipalities) or for energy purposes up to 0,035 mn EUR; total of approvals is not allowed to exceed 36 mn EUR

Source: Austrian Law online platform: ris.bka.gv.at (own presentation)

This table shows that there are many legal requirements about the acquisition and disposal of assets. The rather low thresholds indicate that a reporting entity has to perform every step of the asset management in close collaboration of the Ministry of Finance and if necessary the Parliament.

The requirements for certain transactions to be preapproved by the Ministry of Finance are regulated in a regulation by the MoF (project regulation). The outlined thresholds for assets are between “always” and 1 mn EUR. Above those thresholds a preapproval by the MoF is necessary.

If the thresholds outlined in the table above set by the annual budget law are exceeded a law has to be passed in Parliament for the approval of the transaction.

2. Composition and major elements of the Asset and Liability Management

In the following section we defined major categories of accrual accounting elements that could be used for Asset and liability management.

A. Depreciation and Impairment (for Assets)

Depreciation is the calculative consumption of an asset over its useful life. It is an accounting estimate and should reflect the actual economic (service delivery) life of an asset. Generally speaking, if Investments (capital spending) equals depreciation the stock of assets remains (overall) unchanged. If Investments exceed depreciation the stock of assets is increased, if Investments are below depreciation the stock of assets is reduced. It is important to state that the observation period for this assessment usually is more than a year up to the useful life of the respective asset.

Table III-2 ► Austria: Long term assets in the Financial Statement 2019

Position	Amount (in mn EUR)	Increase/Decrease
Long term assets	75,697	+2,789
<i>Property, Plant and Equipment</i>	<i>39,177</i>	<i>+31</i>
<i>Shareholdings and investments</i>	<i>31,418</i>	<i>+2,987</i>
<i>Long term receivables</i>	<i>5,060</i>	<i>-229</i>

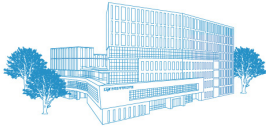
Source: Consolidated audited financial statements of the federal government 2019 (own presentation)

This table highlights that property, plant and equipment (thereof 29,690 mn EUR land and property) and shareholdings are the single biggest position of assets.

Table III-3 ► Austria: Depreciation and Impairment in the Financial Statement 2019

Position	Amount (in mn EUR)	Increase/Decrease
Operating Expenses	7,083	+3
<i>Depreciation of long-term assets</i>	<i>429</i>	<i>-25</i>
<i>Impairment on receivables</i>	<i>1,108</i>	<i>+258</i>

Source: Consolidated audited financial statements of the federal government 2019 (own presentation)



Within the operating expenses depreciation on long-term assets and impairment on receivables (mainly tax receivables) are about 22 percent of total operating expenses.

Table III-4 ▶ Austria: Cash flow from Investments in the Financial Statement 2019

Position	Amount (in mn EUR)	Increase/Decrease
Cash flow from Investments	-465	-34
<i>Cash inflows from Investment</i>	<i>22</i>	<i>-11</i>
<i>Cash outflows from Investment</i>	<i>-487</i>	<i>-22</i>

Source: Consolidated audited financial statements of the federal government 2019 (own presentation)

Cash outflows for Investments are representing capital spending. This information can also be relevant when assessing necessary budgetary capital spending appropriations.

B. Structure and amount (for Liabilities)

The structure and the amount of liabilities indicates the future outflow of resources (cash) to settle the obligations entered into with third parties. The structure and respective amount of these obligations is important for Public Financial Management to make sure that enough funds (either through external financing or through tax income or change in priorities of spending) are available. Otherwise many contracts foresee hefty penalties (interest on arrears) and a loss of reputation as a trusted party. In addition to that a third party might stop to provide necessary goods or services to the public administration.

For information on the presentation of liabilities in the financial statement please refer to 2-D of chapter II.

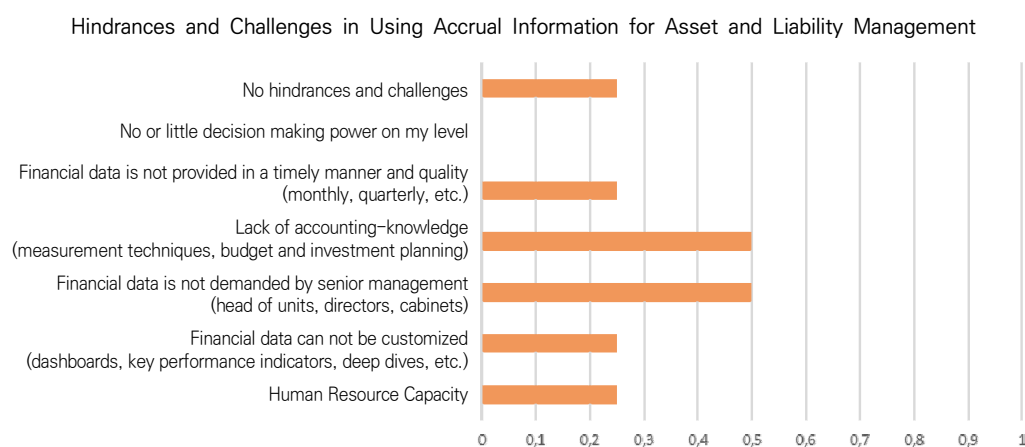
3. Obstacles and challenges connected to Asset and Liability Management

To better understand the current practice and challenges reporting entities might face we have conducted a survey among the preparers of financial statements and supervising authorities as described under *1. Introduction*.

A. Results of the survey

Respondents described the challenges and obstacles in regard to the Asset and Liability Management as follows:

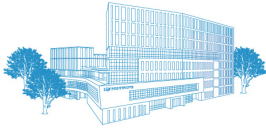
Figure III-1 Survey result: Asset and Liability Management Hindrances and Challenges



Source: Survey Results (own presentation)

This figure shows that respondents particularly feel that they are challenged in the area of Asset and Liability Management by a lack of sufficient accounting knowledge in the entity and a lack of interest from senior management. Some feel in addition to that, that financial data is not able to be customized and not available in a timely manner and the desired level of detail, staff resources are scarce. Some respondents don't feel any hindrances or challenges at all.

Given the legal background described in the chapter above this result is not surprising since the decision-making power on entity level is limited and the sound preparation of information for the approval process requires a lot of technical knowledge and expertise.



In addition to that the Austrian Single Treasury Account system, where financing is centralized within the Debt Management Office, does not create strong incentives for entities to manage liabilities carefully (since they will not feel the impact on their budget or financial KPIs immediately).

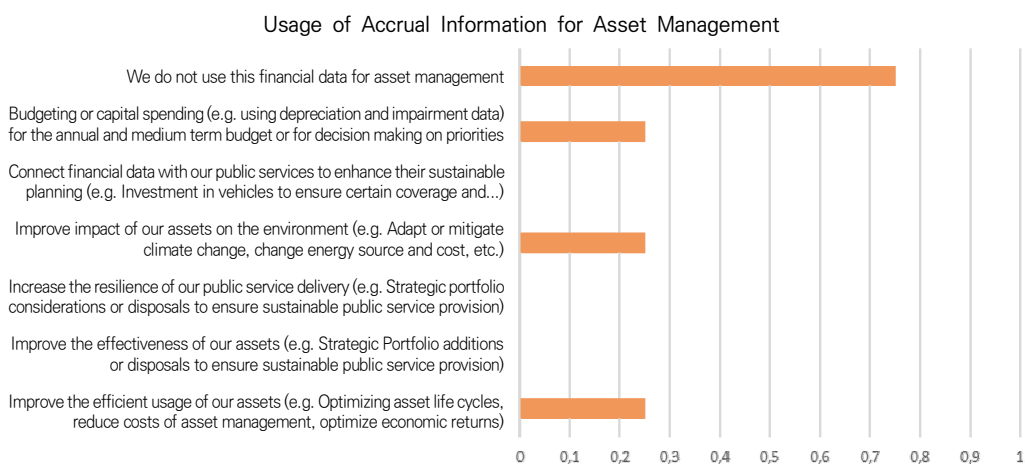
4. Degree of usage of accrual accounting information for Asset and Liability Management

To better understand the current practice and challenges reporting entities might face we have conducted a survey among the preparers of financial statements and supervising authorities as described under *1. Introduction*.

A. Use of information on depreciation and impairment (Results of the survey)

Respondents described their day to day use of accrual information on depreciation and impairment in regard to the Asset and Liability Management as follows:

Figure III-2 ▶ survey result: Asset and Liability Management: degree of use of depreciation and impairment



Source: Survey Results (own presentation)

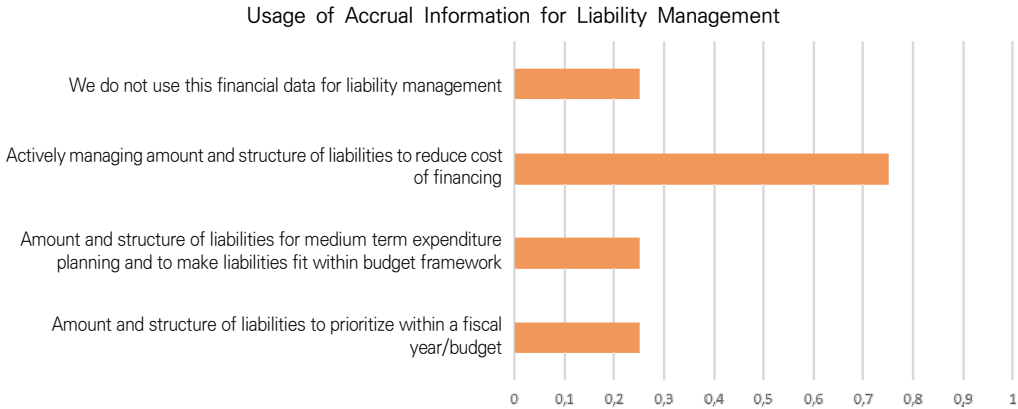
When asked about the day to day use of accrual information for Asset Management respondents answered with a strong majority that they do not use information on depreciation and impairment for their decision-making. Some mention that they use this information for better planning of capital spending, improving the efficient use of the assets as well as the improvement of the environmental impact of assets.

Currently there is no use of accrual information for the improvement of the effectiveness of the asset portfolio; increasing the resilience of public service delivery or sustainable planning.

B. Use of information on liabilities (Results of the survey)

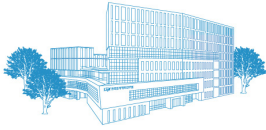
Respondents described their day to day use of accrual accounting information on liabilities regarding the Asset and Liability Management as follows:

Figure III-3 ▶ Survey result: Asset and Liability Management: degree of use of liabilities



Source: Survey Results (own presentation)

Respondents agreed with a strong majority that they use the accrual information about liabilities for the purpose of monitoring/reducing their cost of financing. Some respondents mentioned that they use the accrual accounting information on liabilities for their medium-term expenditure framework planning as well as to priorities within their annual budget.



Some respondents declared that they do not use the accrual information on liabilities for their liability management.

It is important to mention that the reduction of cost of financing is not in the context of external financing (since this is centralized by the Debt Management Office) but in the context of reducing cost of other liabilities (e.g. finance leases, trade liabilities, etc.).

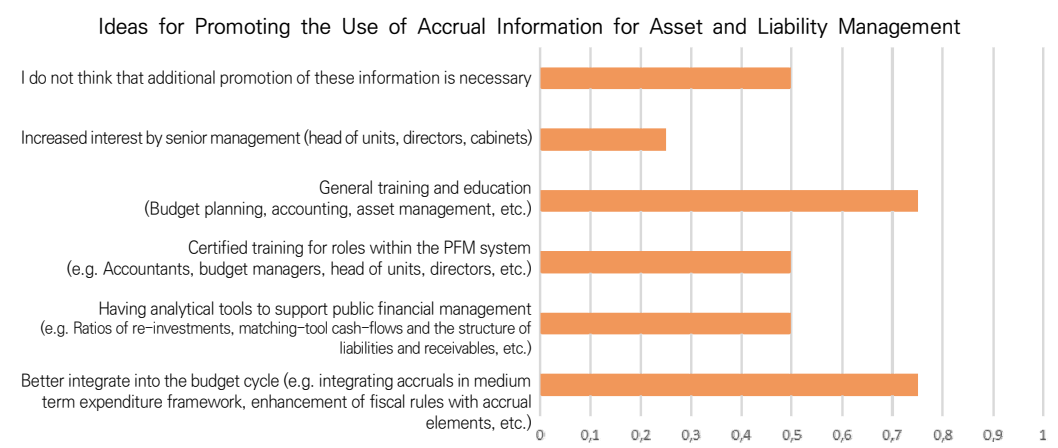
5. Potential methods for spread and promotion of using accrual accounting information

To better understand the current practice and challenges reporting entities might face we have conducted a survey among the preparers of financial statements and supervising authorities as described under *1. Introduction*.

A. Results of the survey

Respondents supported the following ideas to enhance the use of accrual accounting information for the purpose of Asset and Liability Management:

Figure III-4 Survey result: Asset and Liability Management: ideas for promoting use of accrual information for asset and liability management



Source: Survey Results (own presentation)

Respondents have been very supportive of ideas to enhance the use of accrual accounting information for Asset and Liability Management purposes. A strong majority supported the ideas of integrating accrual information into the budget cycle and the financial KPIs of the government and they liked the idea of having general trainings on the topic (Budgeting and planning, Accounting topics, Asset Management, etc.). Some respondents supported certified trainings for the respective roles within the PFM architecture and developing analytical tools for the purpose of public financial management decisions while others stated that they do not think that additional promotion is necessary. A limited group of respondents also supported increasing the interest by senior management.



IV. Description of the institutions in charge for producing accrual accounting information

1. Accrual Accounting and the Consolidated Financial Statement

Accrual accounting information is produced and reported by every reporting entity defined in the Budget Law and further detailed in the Accounting Regulation and Asset Management Regulation. Those entities are by large Ministries and their dependent bodies, High Courts (incl. Constitutional Court, Administrative Court and the Court of Audit), the Parliament and the President's Office.

All entities use the same IT engine to record their transactions and report on their budget spending as well as accrual financial statements. The IT system as well as budgeting and accounting guidance is provided by the Ministry of Finance in accordance with the Austrian Court of Audit.

All accrual accounting information is recorded during the year. This is facilitated by the IT-system which will minimize the manual recording of accounting records¹⁵⁾. In addition to that a specialized agency the "Bookkeeping Agency¹⁶⁾" supports reporting entities by providing quality assurance (four eye principle), specialized reviews of accounting areas and general accounting knowledge to support the recording of more complex and less frequent transactions.

The closing period of the accounts is the end of January the following year. Following the closing period there will be a phase of manual year-end adjustments which can be already supported by the Court of Audit.

15) The system will for example allow for an automated registration of invoices via pre-structured pdfs. Invoice information will be automatically recorded in the cash accounts as well as in the accrual accounts (for budgetary and financial reporting). Invoices related to the purchase of assets will be automatically capitalized and a depreciation rate will be booked in accordance with a predetermined useful live of the asset.

16) The Bookkeeping Agency has been established in 2004 and has about 500 employees, its responsibilities cover accounting support, specialized reviews and subsidy management.

The scope of consolidation only covers budgetary entities. Shareholdings of the Ministries are exempt from consolidation.

The components of the consolidated financial statements are set out in the Financial Reporting regulation and cover:

- a) Report on the federal government
 - 1) Overview of material events (including a report on the differences between the budget and the closing accounts (profit and loss statement and Cash flow statement)
 - 2) Consolidated financial statements (balance sheet, profit and loss statement, Cash flow statement, statement of changes in net equity)
 - 3) Notes to the consolidated financial statement (including accounting policies)
 - 4) Budget management (budget adjustments, use of budget reserves, contingent liabilities)
 - 5) Financing and Risk Management (financing activities as well as risk exposure through guarantees)
 - 6) Development of public finances (medium term analysis and bridging to government financial statistics)
- b) Report on the subdivisions (single financial statements of the subdivisions)
- c) Audit report and matter of emphasis

The audited financial statement must be submitted to Parliament by the 30th of June every year.

The budgeting and accounting system can be described as in the following figure:



Figure IV-1 Austria: Overview on the budgeting and accounting system



Source: Own presentation

2. The Budget and reporting cycle

In Austria the cycle of budgeting and financial reporting is set out in the Budget Law. The budget law requires the Ministry of Finance to submit a first draft of the budget to parliament at the latest 10 weeks before the beginning of the next year.

The main components of the budget draft are:

- Budget Draft (including a cash and accrual budget as well as performance indicators on entity and program level)
- Budget report (outlining the economic circumstances, challenges and main political initiatives as well as an overview of the budget following an economical classification as well as a functional classification).
- Report on subsidiaries (outlining the off-budget entities, their mission, financials and risk exposures)

- d) Staffing plan (ceiling for employees and their grades for all entities)
- d) Budgetary Annexes (auxiliary information on statistical accounts, public debt, the European Union, R&D, government staff, fiscal equalization between layers of government, climate and environmental protection, foreign development aid, infrastructure and payments to supranational organizations)

The government outlines in the budget report its main activities and financial key performance indicators. Usually these are focused on the Maastricht-Deficit¹⁷⁾ and the balance of cash payments.

The budget draft will be discussed in parliament in the budget committee, and then for two sessions in the plenary. In all those stages adjustments can be made by the parliament. After discussion the parliament votes – and typically approves the budget draft before the end of December of the current year.

In January every year the budget execution starts. All budget entities will record transactions and monitor them against their (cash and accrual) budget. This has to be done on a monthly basis and be approved by the Ministry of Finance. If the violation of the (cash or accrual) budget ceiling is to be expected a prior approval from the Ministry of Finance (and with that a shift of budget funds, recognition of additional revenue or a draw from budget reserves) has to be undertaken.

At the end of the year the Austrian Court of Audit is mandated by law to audit the consolidated financial statement of the government and has to submit its audit report and the audited consolidated financial statements to parliament not later than 30th of June the following year. The submission is followed by a parliamentary debate and approval usually in September¹⁸⁾.

The time table of the budgeting cycle is shown in the following graph:

17) Since Austria is part of the European Monetary Union it is subject to the Fiscal Framework constituted by the so called “Maastricht Treaty”.

18) Usually parliament breaks for summer so the first opportunity for discussion is around September.

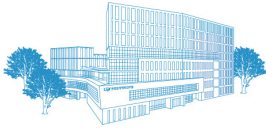


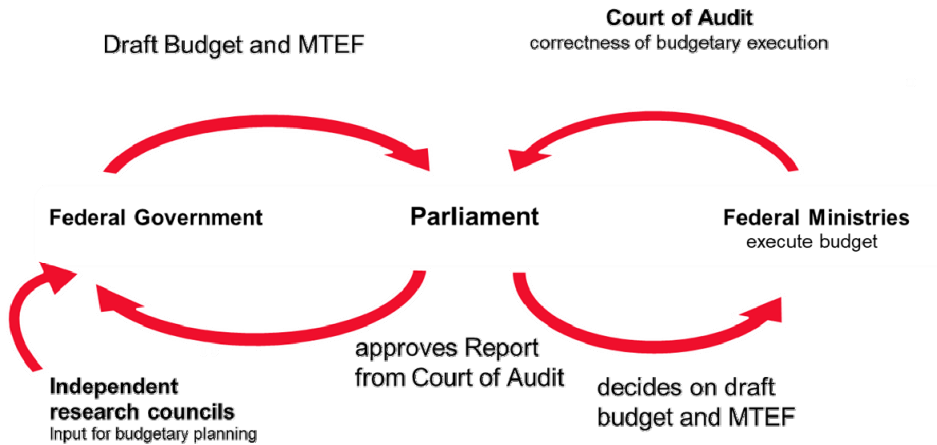
Figure IV-2 ▶ Austria: Overview on the timetable of the budget cycle

	Jan.	Feb.	Mar.	Apr.	May	Jun.	July	Aug.	Sept.	Oct.	Nov.	Dec.
Budget Draft										█		
Budget Debate											█	█
Approved Budget												█
Budget Execution (incl. Budget Reporting)	█	█	█	█	█	█	█	█	█	█	█	█
Audited Consolidated Financial Statement (CFS)						█						
Discussion of ACFS in Parliament									█			

Source: Own presentation

The roles of the key stakeholders in the budget cycle and their interaction is displayed in the following graph:

Figure IV-3 ▶ Austria: Overview on stakeholders and roles of the budget cycle



Source: Seiwald 2019

For a better understanding of the graph it is to be mentioned that in accordance with the budget law the federal government has also to submit a Medium Term Expenditure Framework (MTEF)¹⁹⁾ in addition to the annual budget draft.

19) The MTEF covers four years and is covering only cash payments for so called “Subdivisions” (large policy areas within a reporting entity).

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Appendix

Questionnaire

In this Annex the questionnaire used for the study is documented. This version has been translated from German (the German version was used to collect the data).

Questionnaire on the use of information from the profit and loss account in the areas of risk management, asset and liability management and cost planning and monitoring

Overview

This questionnaire was developed at the request and under the guidance of the Korean Institute of Public Finance. The aim of the study is to investigate the use of accrual accounting in the public sector in different countries, to identify challenges and difficulties and to develop solutions.

The questionnaire is divided into two parts:

- Risk management
- Asset and liability management

In the run-up to the questions, an attempt is made to provide an overview of the area to be queried in a short text.

Contact details

If you have any queries regarding the questions, please contact:

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E-Mail: bernhard.schatz@pwc.com
Tel.: +43 699 1630 5673

FISCAL RISK MANAGEMENT

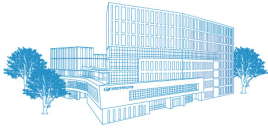
Definition: According to the IMF (2013), fiscal risks can be defined as "events that may lead to deviations in fiscal planning in the short to medium term". These include economic risks (e.g. lower GDP growth, changes in the interest rate environment, etc.) as well as specific risks (e.g. natural disasters, contingent liabilities, etc.).

I. Obstacles and difficulties in data provision and data use

I-1. *What obstacles and difficulties do they face in preparing or using income statement and balance sheet information for risk management? (please choose among the following answers or write into the open text box)*

- a) Personnel capacity (too few employees)
- b) Information cannot be evaluated individually (dashboards, key figures, deeper aggregation levels, etc.)
- c) Low interest among superiors (heads of department, section heads, cabinets)
- d) Lack of expertise (accounting and valuation methods, budget and investment planning, etc.)
- e) Information cannot be produced with the necessary frequency and quality (monthly, quarterly, etc.)
- f) Too little scope for decision-making at my level
- g) Other (please use the open answer option)
- h) None

What I would also like to note:



II. Use for decision-making

II-1. How do you use information on provisions in the income statement or balance sheet to identify or manage specific risks? (e.g. creating budgetary margins to cover provisions, taking material actions to minimize the occurrence of risks). (please choose among the following answers or write into the open text box)

- a) We regularly try to reduce the provisions by taking appropriate measures (e.g. legal improvements in frequently contested legal matters, increased training of employees with regard to specific risks, encouragement to consume leave and time credits)
- b) In the case of particularly large individual cases, these are analysed and conclusions drawn (e.g. if provisions exceed EUR 1 million in an individual case, establishment of separate budget controlling)
- c) If we are asked by third parties about the status of or changes in provisions (e.g. parliamentary enquiries, budget service, RH, etc.)
- d) We do not use these numbers at all
- e) Other (please use the open answer option)

What I would also like to note:

II-2. How do you use information from the income statement or balance sheet on liabilities to identify or manage specific risks? (e.g. additional analyses for budget planning, liquidity management by timing payments, etc.) (please choose among the following answers or write into the open text box)

- a) We regularly analyze the amount and structure of liabilities in order to identify potential budget shortfalls on an ongoing basis
- b) In the event of individual budget shortfalls due to existing liabilities, we try to adjust the maturity or amount of other liabilities (for example, by changing settlement

modalities, agreeing new payment plans, etc.)

- c) When we are asked by third parties about the structure and amount of liabilities (e.g. Parliamentary Questions, Budget Service, RH, etc.)
- d) We do not use these numbers at all
- e) Other (please use the open answer option)

What I would also like to note:

II-3. How do you use impairment information from the income statement/asset statement to identify or manage specific risks (e.g. to assess the impact of certain external specific risks on your own assets)? (please choose among the following answers or write into the open text box)

- a) Regular impairment tests on significant assets allow us to draw conclusions for our financial management (e.g. change in demand for participations, change in technological standards for infrastructure, etc.)
- b) In the case of particularly high impairments, we analyze the causes ex-post
- c) If requested to do so by third parties, we test the recoverability of assets (e.g. by the ACA as part of the §9 audit of the BRA)
- d) We do not use these numbers at all
- e) Other (please use the open answer option)

What I would also like to note:



III. Possibilities for further dissemination of use

III-1. Which of these ideas do you think would be useful to increase the use of information from the profit and loss account for risk management? (please choose among the following answers or write into the open text box)

- a) Better integration into budget planning (e.g. via integration into medium-term planning, expansion of fiscal rules to include double-entry elements, etc.)
- b) Provision of analysis tools (e.g. reinvestment rates, matching tool for deposit and payout profiles, etc.)
- c) Certified training for roles in budget management (e.g. accountants, budget officers, department heads, section heads, etc.)
- d) General training and education (budgeting, accounting skills, asset management, etc.)
- e) Increased interest from superiors (heads of department, section heads, cabinets)
- f) Other (please use the open answer option)
- g) I do not think that more use of this information is necessary

What I would also like to note:

Sources:

Strengthening Fixed Asset Management through Public Sector Accounting (World Bank 2020)

Public Financial Management and its emerging architecture (IMF 2013)

ASSET AND LIABILITY MANAGEMENT

Definition: The purpose of public asset and liability management is, on the one hand, to be able to offer better services with the existing assets (including the possible generation of additional income or increases in value) and, on the other hand, to accept the lowest possible costs by building up and servicing liabilities.

I. Obstacles and difficulties in data provision and data use

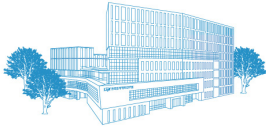
I-1. What obstacles and difficulties do they face in preparing or using income statement and balance sheet information for asset and liability management? (please choose among the following answers or write into the open text box)

- a) Personnel capacity (too few employees)
- b) Information cannot be evaluated individually (dashboards, key figures, lower aggregation levels, etc.)
- c) Low interest among superiors (heads of department, section heads, cabinets)
- d) Lack of expertise (accounting and valuation methods, budget and investment planning, etc.)
- e) Information cannot be produced with the necessary frequency and quality (monthly, quarterly, etc.)
- f) Too little scope for decision-making at my level
- g) Other (please use the open answer option)
- h) None

What I would also like to note:

II. Use for decision making

II-1. How do you use information from the income statement or asset statement for asset management (e.g. to improve planning and use of assets)? (please choose



among the following answers or write into the open text box)

- a) To improve the efficiency of the use of our assets (e.g. via life cycle optimization, cost reductions, revenue optimization)
- b) To improve the effectiveness of our assets (e.g. strategic portfolio considerations to deliver sustainable services)
- c) To improve the resilience and robustness of our service delivery (e.g. via investment in service continuity plans)
- d) To improve the impact of our assets on the environment (e.g. to better address climate change impacts, such as through the use of air conditioning units)
- e) To show connections to our political tasks and to be able to plan them better (e.g. the use of a vehicle fleet to fulfil response times)
- f) To plan reinvestment needs (e.g. through depreciation and impairments) into the medium-term budget planning or prioritization in the budget
- g) We do not use the information to manage the assets
- h) Other (please use the open answer option)

What I would also like to note:

II-2. How do you use information from the income statement or the balance sheet for liability management (e.g. to improve planning, optimize the budget and total costs)? (please choose among the following answers or write into the open text box)

- a) Amount and timeliness for in-year prioritization of budget funds
- b) The amount and structure of liabilities to bring them in line with the medium-term budget framework
- c) Proactively influence the amount and structure of liabilities so that they generate the lowest possible costs
- d) We do not use the information to manage liabilities

e) Other (please use the open answer option)

What I would also like to note:

III. Possibilities for further dissemination of use

III-1. Which of these ideas do you think would be useful to increase the use of information from the income statement and the balance sheet for asset and liability management? (please choose among the following answers or write into the open text box)

- a) Better integration into budget planning (e.g. via integration into medium-term planning, expansion of fiscal rules to include double-entry elements, etc.)
- b) Provision of analysis tools (e.g. reinvestment rates, matching tool for deposit and payout profiles, etc.)
- c) Certified training for roles in budget management (e.g. accountants, budget officers, department heads, section heads, etc.)
- d) General training and education (budgeting, accounting skills, asset management, etc.)
- e) Increased interest from superiors (heads of department, section heads, cabinets)
- f) I do not think that more use of this information is necessary
- g) Other (please use the open answer option)

What I would also like to note:

Sources:

Strengthening Fixed Asset Management through Public Sector Accounting (World Bank 2020)

Public Financial Management and its emerging architecture (IMF 2013)



Author Biography

Bernhard Schatz

Graduated from Business University Vienna, Socio Economics

He worked in the Budget Directorate of the Ministry of Finance in Austria for more than ten years where he held positions of Deputy Head of the Budget Unit for Agriculture, Infrastructure, Subsidies and R&D as well as a Senior Advisor Role for Public Sector Accounting to the Budget Director. He also served in the Austrian Court of Auditors as a Senior Accounting and Auditing Standards specialist for more than three years.

He worked as a short term expert in the area of public financial management for the IMF, World Bank and OECD/EC. He is also an author and lecturer on public financial management in many journals and institutions in Austria.

Bernhard currently serves as the leader of Public Sector Accounting Advisory Services at PwC Austria. He is a member of the International Public Sector Accounting Standards Board (IPSASB) as well as the accountancy body for Public Sector Accounting in Austria.

Bernhard was assisted in the data collection process by his colleagues at PwC Austria and wants to extend his special thanks to the officials in the Austrian Federal Administration who took their time to respond to this survey while having an extended workload due to the global Covid pandemic and its related government interventions.

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Switzerland

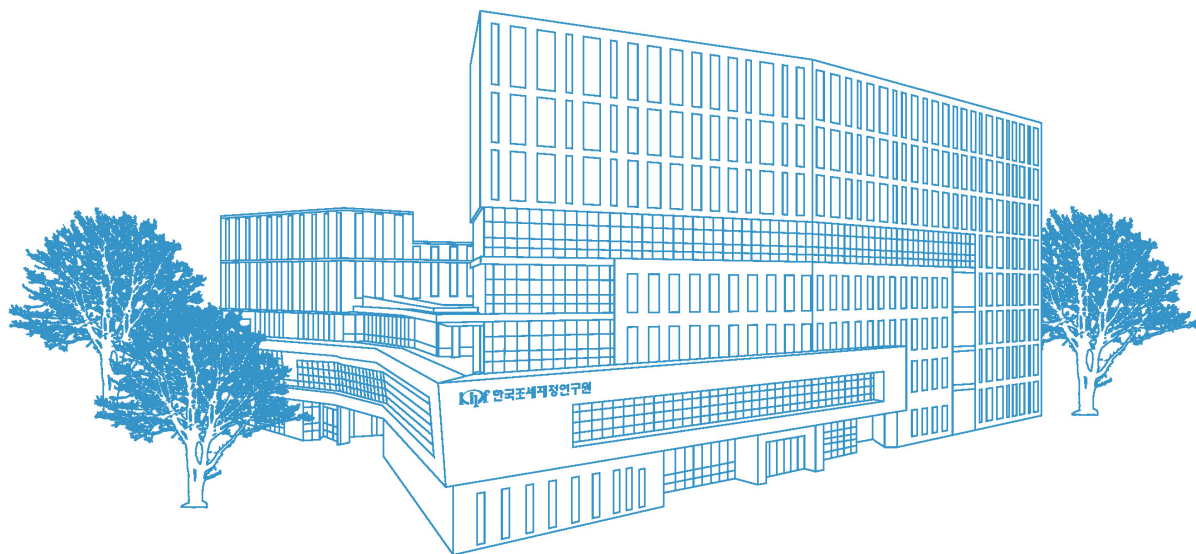
The Role of Accrual Accounting

in the Identification of Fiscal Risks, the Management of
Assets and Liabilities and Fiscal Policy Rules

A Case Study from Switzerland

2021

Marc Wermuth, Claudia Beier



IPSASB[®]



KOREA INSTITUTE OF
PUBLIC FINANCE

Government Accounting and Finance Statistics Center



KOREA INSTITUTE OF PUBLIC FINANCE
Government Accounting and Finance Statistics Center

Statement of Submission

The research was undertaken as part of the research project “USE OF ACCRUAL INFORMATION: Focusing on Fiscal Risk Identification and Assets and Liabilities Management” of the Korea Institute of Public Finance (KIPF).

Hence, this publication, *· The role of Accrual Accounting in the identification of fiscal risks, the management of assets and liabilities and fiscal policy rules ·*, is a result from the proposed joint research by the KIPF with the purpose to conduct an in-depth study on the use of accrual information in Switzerland.

The report was prepared free of charge in the capacity of the authors being member and TA of the International Public Sector Accounting Standards Board (IPSASB).

Date Submitted: August, 2021

Signature:

A handwritten signature in blue ink, appearing to read 'M. Wermuth', written over a horizontal line.

A handwritten signature in blue ink, appearing to read 'C. Beier', written over a horizontal line.

Authors of the report: Marc Wermuth & Claudia Beier



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The Role of Accrual Accounting

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The Role of Accrual Accounting in the Identification of Fiscal Risks, the Management of Assets and Liabilities and Fiscal Policy Rules

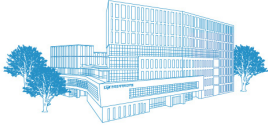
I . Introduction

1. Brief overview of the report

This report analyses the role of accrual accounting and budgeting in terms of the management of assets and liabilities. It delivers examples from the Swiss experience on the level of individual of assets or liabilities as well as from the fiscal policy perspective as a whole. It then elaborates how accrual accounting contributed to the identification of fiscal risks in Switzerland. The final chapter looks at how financial statistics deal with liabilities encompassing fiscal risks and which statistical models used in Switzerland are most suitable to reflect fiscal risks.

2. Brief description on cost and expertise input for the publication of the report

The authors wrote the report in their capacity as IPSASB member und technical advisor. The relevant experience and expertise was acquired in their respective function(s) in the Federal Finance Administration and in the Finance Administration of Canton of Zurich.



3. Main findings of the report / Summary

Following the implementation of IPSAS by the Swiss Government in 2007 and by the Government of Canton of Zurich in 2009 the role of accrual accounting and budgeting increased significantly. From the beginning, one of the key benefits of accrual accounting was an increased transparency as IPSAS enabled a comprehensive view on the financial position and performance of the government. In addition, all fiscal rules and decisions of Canton of Zurich were based on consolidated data and view in General Purpose Financial Statements (GPFS). At the federal level, after roughly 15 years of experience with an accounting framework, fiscal policy will work mostly on accrual basis from 2022 as well.

The implementation of IPSAS had a positive effect in terms of the identification of fiscal risks. Accrual accounting has helped to better identify and measure some of its fiscal risk arising from contingent liabilities and putting it into a more prominent place within financial reporting. It also led to various policy measures, adapted processes and responsibilities in determining what the obligation from the perspective of the government is.

Switzerland applies different statistical models which deal differently with liabilities encompassing fiscal risks. The national FS model is currently the most suitable as it encompasses important provisions relevant for fiscal risks.

II. Accrual Reform in Switzerland

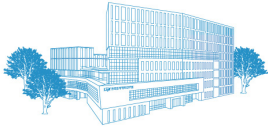
1. Maturity Levels of Accrual Accounting in Switzerland

Public sector entities in Switzerland have made various efforts in the past forty years to improve the quality of public sector accounting data. On the state (provincial) level, the 26 Swiss cantons accomplished two major accounting reforms which led them to steadily improve their accounting system. On the federal level, one major project in 2008 enabled the federal administration to directly move from (modified) cash accounting to the implementation of IPSAS, which was rather one big step at once.

In order to assess the maturity levels of accrual accounting between the public sector entities in Switzerland it has to be taken into account that the Federal Constitution allows for a high degree of autonomy when setting accounting rules at the state level. This means that each canton has the power to define its own accounting model. Until the late 1970s, the cantons were based on cash or modified cash accounting. However, already in 1977 the Conference of Cantonal Finance Ministers (CFM) managed to establish a first harmonized accounting model (HAM1) and offer it to the cantons and municipalities (CFM, 1981). Even though the HAM1 was only a recommendation, it served as a first step towards modified accrual accounting. It consisted of a detailed chart of accounts with an income statement and a balance sheet¹⁾. But it also allowed for hidden reserves and was minimally prescriptive concerning provisions or accrual/deferral of expenses and revenues (Soguel and Luta, 2021). HAM1 was fully implemented in the late 1990s.

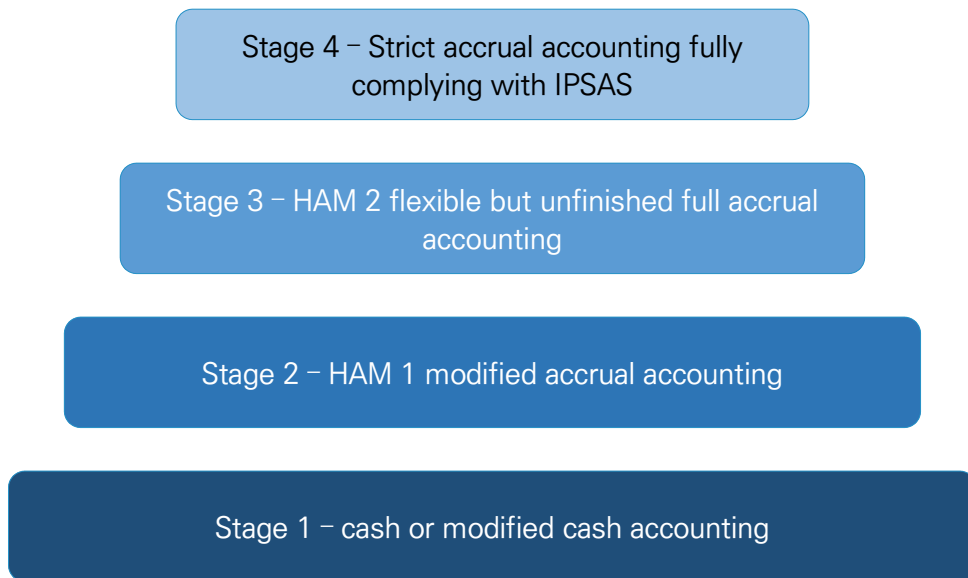
In 2008, the CFM released an updated version, the Harmonized Accounting Model for the Cantons and Municipalities (HAM2). Compared to HAM 1 these standards generally follow IPSAS's principle of true and fair view and it restricts the possibility of accumulating hidden reserves and requires more systematic accrual/deferral of expenses and revenues.

1) Note: This paper uses the terms "balance sheet" and "income statement". These have the same meaning as "statement of financial position" or "statement of assets and liabilities" and "statement of performance" or "statement of revenue and expenses".



At the same time it also openly offers some forms of political finessing (Soguel, 2020). In the 2010s some cantons decided to go further than HAM2 recommendations and referred to IPSAS with some deviations in place. In the light of these developments, the maturity stages can be described as follows:

Figure 1 ▶ Maturity Stages in Switzerland



Source: Soguel and Luta, 2021, partly modified.

It is important to note that all cantons incorporated HAM1 and HAM2 into their own legislation at some point in time and exercised their sovereignty to implement the models in a way to meet their own needs. As a result, while all cantons eventually reached the same *maturity stage* (HAM2), the degree of maturity or *maturity level* of their practices varies between cantons within each maturity stage (Soguel and Luta, 2021). Thus, to be able to compare the maturity levels of cantons a recent Swiss study took into account 15 weighted assessment criteria which in most cases measure the extent to which the accounting policies converge with IPSAS. They are explicitly listed in HAM2 as alternatives to cantons who choose not to follow the IPSAS. This resulted in one of the first studies in Switzerland to support the assessment of the degree of IPSAS compliance at various

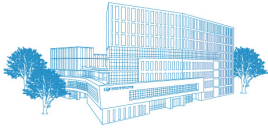
stages in time by relying on a multiple criteria decision analysis technique and by using weighted criteria (Soguel and Luta, 2021).

The following table shows the results of the study with the individual maturity levels achieved by the cantons at two stages (HAM1 and HAM2):

Table 1 Swiss cantons' maturity levels

Canton	Maturity level	HAM1 Time of introduction	Early bird or Latecomer	Maturity level	HAM2 Time of introduction	Early bird or Latecomer
Zürich (ZH)	48.61	1982	EB	97.76	2009	EB
Basel Stadt (BS)	83.81	1999	LC	97.55	2013	EB
Lucerne (LU)	55.34	1988	LC	97.52	2012	EB
Solothurn (SO)	67.98	1982	EB	87.61	2012	EB
Geneva (GE)	88.25	1985	LC	87.37	2014	LC
Basel Land (BL)	45.42	1981	EB	84.45	2010	EB
Graubünden (GR)	49.37	1988	LC	78.20	2013	EB
Aargau (AG)	48.17	1995	LC	76.77	2014	LC
Bern (BE)	47.14	1989	LC	76.47	2017	LC
Neuchâtel (NE)	66.76	1981	EB	72.17	2018	LC
Schwyz (SZ)	49.27	1987	LC	72.05	2016	LC
Appenzell A. (AR)	47.16	1978	EB	68.73	2014	LC
Schaffhausen (SH)	27.26	1990	LC	65.20	2018	LC
Ticino (TI)	56.38	1986	LC	63.72	2014	LC
Uri (UR)	55.07	1984	LC	62.91	2012	EB
Thurgau (TG)	41.49	1987	LC	62.40	2012	EB
Nidwalden (NW)	46.71	1980	EB	60.54	2010	EB
Glarus (GL)	34.98	1984	LC	59.19	2011	EB
Vaud (VD)	50.31	1992	LC	57.26	2014	LC
Freiburg (FR)	47.75	1996	LC	55.37	2011	EB
St. Gallen (SG)	46.59	1997	LC	55.21	2014	LC
Jura (JU)	54.57	1979	EB	54.26	2012	EB
Appenzell I. (AI)	34.98	1979	EB	53.12	2015	LC
Valais (VS)	52.22	1983	LC	48.62	2018	LC
Zug (ZG)	60.04	1979	EB	46.55	2012	EB
Obwalden (OW)	33.33	1986	LC	45.96	2012	EB
<i>Min</i>	27.26	1978		45.96	2009	
<i>Max</i>	88.25	1999		97.76	2018	
<i>Mean</i>	51.50	1986		68.73	2013	
<i>Median</i>	48.94	1986		64.46	2013	
<i>Std. dev</i>	13.80	6		15.90	3	

Source: Soguel and Luta, 2021



A score of 100% represents a high level of compliance with IPSAS, while a score of 0% means a wide departure from generally accepted accounting practices. It is important to mention that IPSAS compliance is measured in terms of the criteria reflecting the Swiss accounting environment (HAM2) and not in terms of criteria developed along the suite of IPSAS standards. Nevertheless the results show that with the HAM1 reform starting in the 1980s the cantons' maturity levels already laid in a range between 27,26% (SH) and 88.25% (GE). With HAM2 maturity levels generally trended upward and reached a range between 45.96% (OW) and 97.76% (ZH). Thus, the move from HAM1 to HAM2 increases the mean and median scores indicating cantonal accounting standards converging towards IPSAS over the two successive reforms (Soguel and

Luta, 2021). In addition, IPSAS are a referred standard for most of the large cantons with the highest score (ZH, GE, BS, LU). The Federal government was not scored in the study because it does not apply the state-level HAM2 but rather adopts IPSAS directly. The score on the federal level can reasonably expected to be in the same range as the large cantons referring to IPSAS.

2. Main Description of the Reform of the Federal Government

Growing demands by the politicians and the public for more comprehensive information regarding the financial situation of the Federal Government and in order to harmonize the accounting framework with lower levels of government to increase comparability, the Swiss Federal Finance Administration (FFA) decided in 2001 to initiate a project to move from modified cash accounting and budgeting to accrual accounting and budgeting and to adopt the IPSAS from fiscal year 2007. The project aimed to increase the cost transparency at the level of administrative units and to provide them with an adequate accounting framework when using performance budgeting. Another driving force was the need for restructuring and developing the existing IT landscape within the federal administration (Wermuth, 2014).

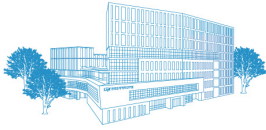
The move to full accrual accounting and budgeting was a huge step for the administrative units, facing higher requirements. Especially, better accounting knowhow had to be achieved. Moreover, organizational adjustments were necessary (roles, tasks, responsibilities, competencies) together with reallocations of jobs. The training of specialists could be covered with educational courses and a comprehensive accounting manual provided by the FFA. For the opening balance sheet around 35'550 items in the areas of real estate, loans and participations/stake holdings had to be revalued and new provisions had to be made. In addition a completely new IT environment based on SAP was implemented resulting in the removal of the IT interface between the centralized accounts and the accounts of the administrative units (Wermuth, 2014).

The first financial statement based on IPSAS for the fiscal year 2007 was issued in March 2008 and approved by the parliament in June 2008. The way to the implementation of full accrual accounting and budgeting based on IPSAS proved to be challenging. There was a considerable risk of failure due to the simultaneous introduction of IPSAS and an entire new IT landscape. However, the projected timeline could be met resulting in a timely introduction (Wermuth, 2014).

From the point of view of the stakeholders the introduction of accrual accounting and budgeting was mainly well-received and overall seen worth the efforts and costs. The new IT systems have improved the linkages between budgeting and ex post reporting data resulting in a clearer line of sight between budget and actual financial results.

Overall data quality has increased due to better system controls and processes implemented along with the project. Linking cost accounting, budgeting and accounting together have led to better and more readily available data and generated efficiencies in the production of financial reports. However, the preparation period was rather insufficient and not all questions concerning the accounting treatment could be answered on a satisfying level. Therefore, the process of steadily improving the quality of accounting data was important in the subsequent years.

Consequently, the FFA started another project to further improve the accounting model



and to close most of the remaining and material deviations from IPSAS (ONRM, 2014). Namely, a consolidated statement encompassing the controlled entities according to IPSAS 35 was introduced, IPSAS 28–30 Financial Instruments were implemented and a liability for retirement benefits using an actuarial calculation according to IPSAS 39 was recorded in the balance sheet. The project was completed by fiscal year 2017 (ONRM, 2014). With the exception of applying (modified) cash accounting to taxes (income tax, value added tax and heavy vehicle charges), recognizing only main weapons systems on an aggregate basis and not applying IPSAS 18 Segment Reporting, the financial statement of the Swiss federal government today is almost fully compliant with IPSAS.

3. Main Description of the Reform in the State of Zurich

A. Administrative Reform

The Canton of Zurich moved from cash accounting to accrual accounting by approving an appropriate law on cantonal finances and fiscal policy in 1979 (Finanzhaushaltsgesetz, 1979). Much of the innovation has proven to be sound and is retained in their form by political sector and public administration (CRG, 2004). Budget, accounting, and financial statements are prepared by uniform accrual accounting principles based on standard accounting principles comparable with the private sector. Economic and social developments are leading twenty years later to fundamental changes of the requirements in good governance in the area of public and financial affairs (CRG, 2004).

The requirements of financial markets and banks, of politics, residents, and taxpayers regarding transparency of accounts are increased. An efficient and effective management of accounts and monitoring of the public sector require that cost accounting, budgeting and financial reporting are based on solid information from the accounting. The cantonal parliament believed that with a linkage to modern general accepted accounting principles transparency, reliability, and comparability could be significantly improved. For the first time, with IPSAS there was a comprehensive international accepted accounting principle

for the public sector (CRG, 2004).

The revision of the cantonal law on cantonal finances and fiscal policy including accounting principles was part of bigger administrative reform in Canton of Zurich which was started by their Government Council in September 2000. The Canton of Zurich used this revision to refer their accounting principles to IPSAS by implementing an endorsement process (CRG, 2004). Beside the income statement, the balance sheet should be received in future greater attention comparing to their previous use. Through the usage of public sector general accepted principles which are aligned with private sector general accepted principles the financial statements in the public sector are comparable with financial statements in the private sector. It enables the practised financial statement readers and taxpayers to gain a quick and efficient insight into the financial situation of the public institution (Bergmann and Gamper, 2004).

In view of these underlying conditions the entirely revised law was approved by the parliament of Canton of Zurich in 2006. This law modernised the financial reporting, adopted IPSAS, and oblige to prepare consolidated general purpose financial reports (GPFs). The IPSAS adoption is based on an endorsement process. Each new standard needs to be reviewed whether they need modification for the local context in Zurich (RLV, 2007). The endorsement process is guided by the Government Council. Any modification from IPSAS needs additional approval from Cantonal parliament (CRG, 2006). The fiscal year 2009 was the first time the new accounting principles were used. Since then budget, fiscal planning and actual financial statements are based on IPSAS and on a consolidated view.

B. Rationale for moving to IPSAS

General accounting principles shall ensure that the financial statement includes all relevant information which is necessary for the analysis of financial situations in the public sector. Content, presentation and wording of the information are neutral as well as faithfully represented (IPSAS Handbook, 2021). They prove transparency, acceptance, and confidence in GPFs. The cantonal parliament acknowledges that from increased



quality of accounting data and their reliability stakeholders of public sector will benefit (CRG, 2004).

Quite important was that the systematic of IPSAS is based on private sector standards which are brightly accepted in the Canton of Zurich. The parliamentarians expected a better understandability as Switzerland is built up on a militia system and in comparing to full-time parliamentarians. Additionally, the financial supervision will be remarkably eased through the consistent and standardised measurement. IPSAS was also the fundament of a meaningful consolidated financial statement as a basis for the future fiscal performance measurement and fiscal policy rules. Furthermore, a positive impact of credit rating was expected. IPSAS promote comparability of financial statements internationally (CRG, 2004):

C. Developments since first time implementation of IPSAS

Since 2009 the number of used IPSAS standards by Canton of Zurich increased due to the enhancement by the IPSAS Board in the meantime. From fiscal year 2022 all applicable standards are implemented (RLV Appendix A, 2021). Since the first implementation of IPSAS the three main modifications for Canton of Zurich are unchanged. The modifications are (RLV, 2007)

- IPSAS 39: Defined benefit obligations are presented in the disclosure instead in the balance sheet. The approach is based on Swiss Generally Accepted Accounting Principles for the private Sector (Swiss GAAP FER, 2020)
- IPSAS 35: Definition of consolidation scope, and
- IPSAS 41: Non-consolidated state owned government-related entities (GREs) held for their operational capacity are measured by historical costs instead of fair value.

III. Management of assets and liabilities

1. Relevance of accrual accounting information for the management of assets and liabilities

One of the objectives of accrual reforms is to contribute to a better management of assets and liabilities. The management of assets and liabilities has various forms and impacts on different levels. For example, the Asset and Liability Management (ALM) Approach has been used in financial institutions for many years to reduce currency, tenor, index and other mismatches between assets and liabilities so that the balance sheet is able to withstand shocks better (Cangoz et al., 2018). The main objective of government liability management is to ensure financing of the budget at the lowest possible cost subject to an acceptable level of risk (IMF, 2014). In contrast, the objectives of the asset management are to ensure that cash balances meet commitments and maximize the purchasing power of the long-term capital given a moderate level of risk (Das et al., 2012). These approaches often focus on the management of financial assets and liabilities. However, the scope of a (sovereign) balance sheet goes beyond financial assets and liabilities and varies across countries in terms of its complexity and comprehensiveness. Recent case studies have shown that following accrual reforms many countries subsequently changed their management methods concerning assets and liabilities. Examples include defense inventories, PPPs, concessions contracts, financial guarantees and provisions (Moretti and Youngberry, 2018). Thus, it can be expected that the implementation of accrual accounting potentially has an impact on the management of the balance sheet, especially when including non-financial assets and liabilities. Experience of other countries has shown that this could finally lead to a comprehensive balance sheet approach at an overarching level, with key balance sheet figures such as net assets (net worth) or net debt becoming important fiscal targets (NZ Treasury, 2021) and making the balance sheet more relevant for budgeting purposes.

The next chapters focus on how the availability of accrual information affected the management of the balance sheet in general and of key balance sheet figures in Switzerland.



2. Federal Government

A. Swiss Confederation Bonds

IPSAS 29 Financial Instruments: Recognition and Measurement became effective on January 1 2013 and its implementation at the Federal level from fiscal year 2017 had an impact not only on the measurement of the Swiss Confederation Bonds but also on the reported amounts relevant for the fiscal rules.

Previously to IPSAS 29 the bonds were measured at their face value with the premium being recognized as a deferral. This deferral was, however, outside of the main fiscal policy mechanism called the “debt brake” which intends to stabilize nominal debt over an economic cycle. The cornerstone of the debt brake consists of a simple rule: expenditure may not exceed receipts over an economic cycle. The annual expenditure ceiling is linked to the amount of receipts, which are adjusted using a cyclical factor that takes the economic environment into account (Debt brake, 2018). The debt brake requirements have to be taken into account when preparing the budget and the subsequent supplementary credits. As soon as the closing accounts are available, compliance with the requirements is checked: the maximum permissible expenditure is recalculated based on the receipts actually achieved and the revised economic outlook. If the expenditure actually incurred exceeds the recalculated expenditure ceiling, the excess is charged to the so-called compensation account; any amounts below the expenditure ceiling are credited to the compensation account (Debt brake, 2018). As the deferral representing the premium received was not included in the value of the bond it was equally not part of the nominal debt. Thus, nominal debt only encompassed the face value of the bond. Rather than being treated as a debt the value of the premium received was at inception fully credited to the interest expenditure. As a consequence the total expenditure relevant for the debt brake was lower than without the premium increasing the room for maneuver in terms of budgeting in case of expected premiums and forecasting errors in case of unexpected premiums (ONRM, 2014). On the other hand, a higher premium at inception goes hand in hand with higher coupons than the effective interest (return) in subsequent years which in contrast decreases the room for budgeting in the future. The amortization of the

deferral every year had no effect on the expenditure as it was only a non-cash credit entry having no effect on the debt brake.

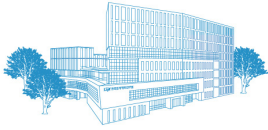
With the implementation of IPSAS 29 the measurement of the Swiss Confederation Bonds changed. According to IPSAS 29 such bonds shall be measured initially at fair value and subsequently at amortized cost using the effective interest method (paragraphs 45 and 49). This provision will remain unchanged with IPSAS 41 superseding IPSAS 29 from January 1, 2022 (IPSAS, Volume III, 2020). The measurement at fair value and subsequently at amortized cost had several impacts on the debt brake. As the premium is now part of the entry value for the bond measured at its fair value it is at the same time included in the nominal debt. Large premiums occurred in the past so by the end of fiscal year 2016 there was a measurable effect of around 5.3 bn. Swiss Franc on the nominal debt following the implementation of IPSAS 29. This amounts to around 5 percent of total nominal debt at the end of 2016. Furthermore, the premiums are initially not credited to expenditure anymore but rather spread over

the term of the bonds in accordance with the effective interest method and offsetting the higher coupons in each subsequent year (SR, 2017).

The benefits of the different accounting treatment are evident: Instead of the coupon the effective interest is included in the budget every year and the premium is treated as a debt because it is a debt from an economic perspective. It provides better information about the real interest costs which is not the case with the coupon. Finally, the amount of the premium and the rate of the coupon have no potential effect anymore on the room for decision-making in terms of the budget, neither short-term nor long-term.

B. From cash basis to accrual basis fiscal rule

Despite the move from cash accounting and budgeting to accrual accounting and budgeting from fiscal year 2007, the Swiss Confederation anchors its fiscal policy with the mechanism of the debt brake that is the most important fiscal rule (see also previous chapter A.). Until today, the debt brake is cash based with the corresponding line items



being derived from the financing statement encompassing expenditure and receipts. The reporting of the debt brake is in conjunction with the accrual based financial reports. So rather than for the purpose of fiscal policy on an overall level, accrual data up to now is mainly used for evaluating the operational performance on the level of the administrative units where the income statement is supplemented by cost accounting information. This encouraged cost awareness, the economical use of funds, fees and charges for government services based on accrual information and facilitated a comparison of cost performance between similar functions of government.

Nevertheless, the availability of accrual based financial information regularly triggered parliamentary debates in the past ultimately leading to a parliamentary motion in 2016 (Motion Hegglin, 2016). The motion requested government to examine whether fiscal policy needs to be based on the income statement or in other words, whether the debt brake should be moved from cash to accrual based. The motion addressed criticism raised in terms of the current treatment where the debt brake records revenue and expenses only at the time of payment and not when the underlying economic event takes place. The timing difference between both of them impeded a realistic assessment of the fiscal position according to the parliament.

In November 2019, the Swiss Government made a proposal to move fiscal policy closer to accrual accounting. This resulted namely in adding the following line items to the fiscal rule (Botschaft Haushaltsteuerung, 2020):

- *Accrued and deferred items*, e.g. transactions such as prepayments for mobile phone licences.
- *Gains and losses on financial assets*, including foreign exchange gains and losses, losses on accounts receivable, changes in fair value of derivatives etc.
- *Gains and losses on financial liabilities*, in addition to the premiums on Swiss Confederation Bonds already recorded (see previous chapter A.). This includes for example financial guarantees recognized as a financial liability in accordance with IPSAS 41.

- *Earmarked funds:* The difference between cash inflows and outflows for earmarked funds recorded as a liability during a fiscal year is neutralized. This is because an inflow directly leads to an increase in liability and vice versa, therefore not affecting the income statement. In the same way such cash in and outflows are not relevant anymore for the purpose of the fiscal rule.
- *Provisions:* An expense is relevant for the fiscal rule at the time when the Swiss Confederation recognizes a new or a change of the provision in the balance sheet rather than at the time of payment. This also includes provisions for employee benefits where IPSAS 39 service costs bore by the employer are fully charged which is not limited to the contributions paid.

Despite these proposed changes, not all line items in the income statement are included, e.g. depreciation expense remains outside the fiscal rule. This is because the inclusion of capital expenditure and receipts at the time of investing remains crucial for the effectiveness of the debt brake.

In March 2021, the parliament approved the proposed amendment to the law but made some notable changes. An important one is the substitution of the financing statement encompassing expenditure and receipts with the income statement and investing statement. Both of them are the new basis to derive the line items relevant for the fiscal rule (Finanzhaushaltgesetz, 2021). The balance of the substituted financing statement is directly derived from the income and investing statement. In addition, revenue from income taxes will be recorded from 2022 at the time of the tax invoice and not at the time of cash inflow.

To sum up above considerations, relevant for the purpose of the fiscal rule and the debt brake is the time of the recognition of an asset or liability rather than the time of the payment. In other words, many transactions will be subject to the debt brake earlier than before. This clearly shifts the focus on the time the underlying economic event or change in risk occurs. This is particularly relevant for liabilities involving significant amounts such as the provision for employee benefits taken into account not only at the time when restructuring payments are due.



Resulting from this reform, fiscal policy works mostly on accrual basis from 2022. It is important to mention that the mechanism of the debt brake having a constitutional basis remains unchanged. There are *no additions or removals of transactions* to or from the scope of the fiscal rule. What differs however is, *when* the transactions become subject to the fiscal rule what is more often at the time the economic event takes place. Accrual accounting plays an important role and is a prerequisite because it provides the necessary data in terms of bookkeeping entries for the purposes of managing the debt.

3. State of Zurich

A. Consolidated financial statement

All fiscal rules and decisions of Canton of Zurich are based on consolidated data and view in GPFS (like budget, financial planning and actual financial statement). In the view of Canton of Zurich consolidation is the crucial requirement to receive a complete overview of the situation of the Canton and their state owned enterprises. That allows a reliable risk assessment of the whole Canton (CFM, 2008). Additionally, the focus of fiscal policy is moved to the balance sheet. How crucial the scope of consolidation as basis for fiscal policy decision is, is underlined by an official parliamentarian request to clarify why certain important state owned enterprises are not consolidated (KR, 2021) and the overview is therefore incomplete.

The consolidation scope includes the responsibility of the government with the Government Council, all departments, all cantonal courts, and cantonal state agencies as well as all public institutions and organisations which receive significant transfers from and are controlled by the Canton. The consolidated GREs include four state owned hospitals, four universities and the cantonal public transport network organisation (RLV, 2007). The state owned financial institution Zürcher Kantonalbank (ZKB) is not consolidated because it does not receive any transfers and therefore does not fulfil the cantonal consolidation scope requirements.

B. Assets

The cantonal finance law requests to retain the substance of the cantonal assets (CRG, 2006). The teleological interpretation of this requirement is that government can only invest in safe and risk-free assets. The key competence of achievement of return of investments with higher risks is delegated to financial institutions.

In order to operate and manage its assets the Canton of Zurich categorised them along how they meet the objectives of financial reporting into operational and financial capacity (CRG, 2006). This approach has some similarity with the classification in the IPSAS Conceptual Framework according to the objective of measurement. The selection of measurement bases should contribute to the objective of financial reporting (IPSAS Handbook, 2021). If the focus lies on the assets' operational capacity, historical costs are selected, otherwise fair value. The IPSAS Board in its measurement project

(ED 76, 2021) proposed this broad understanding of selecting a measurement model recently.

The Canton of Zurich defined its assets held for their operational capacity as assets which are used to fulfil public service deliveries defined by laws or resolutions of cantonal parliament, which were subject to a referendum (CRG, 2006) in the future periods. These assets are public schools, hospitals, administration offices etc. All other assets are defined as assets held for their financial capacity. They could be sold without any impact on the fulfilment of public service deliveries (CRG, 2006), or in other words, they fund the state activities. Examples are leased out properties.

As a consequence of this categorization, the responsibility for the asset management is defined. Capital expenditure in assets held for the operational capacity need an approval by the Government Council or cantonal parliament depending on the amount and law based scope of manoeuvre as they are financed by tax revenue. Capital expenditure in assets held for their financial capacity could be decided at department level but have to be consequently aligned with the market and comparable with private investors. The usage of taxes or other public revenue (e.g. transfers) is forbidden. These mechanisms prevent



the speculation with funds from tax revenue.

In resolutions requesting capital expenditures in assets held for their operational capacity, besides the amount of the expected capital expenditure all consequential costs needs to be disclosed. Consequential costs are maintenance, depreciation and financial costs (e.g. internal interests) over the useful life of the assets. Capital expenditure and consequential costs are based on recognition and the measurement principles of IPSAS. Internal interest is calculated based on cantonal financial debts and related interest. Including internal interests as financial costs allows the approving authority a better management of financial debts.

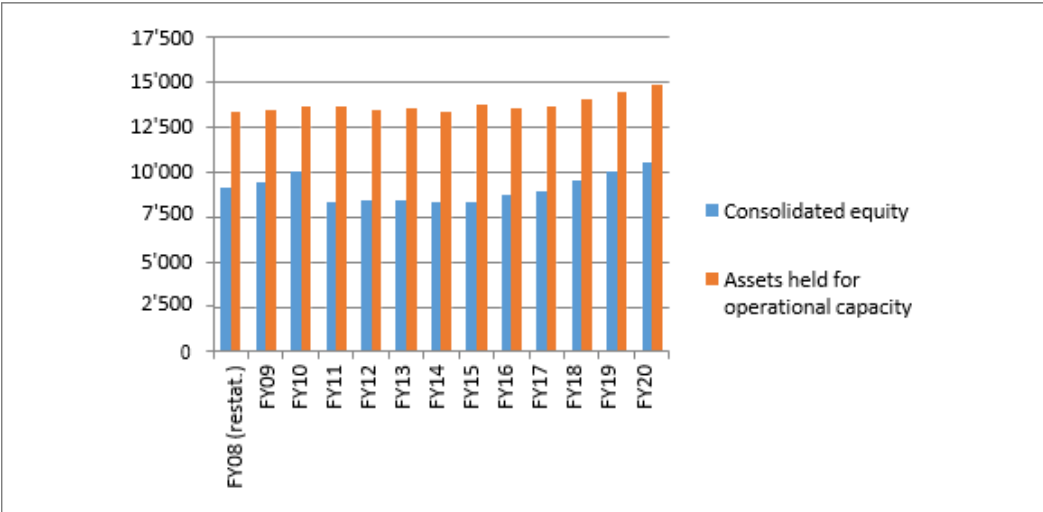
The increasing significance of the balance sheet can be illustrated by an actual request from the cantonal parliament to reduce the total assets and use the money to reduce the financial debt (KR, 2021).

C. Equity

The management of equity should be attracted more attention due to the actual request from the cantonal parliament as it substantially influences the resilience of the Canton of Zurich (KR, 2021). There is no legally defined equity ratio.

The equity is committed to the assets held for public sector reasons. To fulfil the legally defined public service deliveries permanently and independently from private investors the equity should equal the assets held for their operational capacity in the long run. In other words, the so-called net debt I (see definition in chapter 3.D “net debt on cantonal level”) has to be zero. Due to the legal binding of assets held for their operational capacity to fulfil public service deliveries, a reduction of capital commitment is extremely reduced.

Table 2 Relationship between equity and assets held for their operational capacity in million Swiss Francs



Source: own presentation based on actual financial statements by Canton of Zurich from Fiscal Year (FY) 2009 to 2020

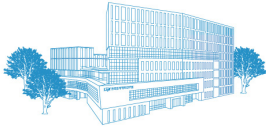
Equity has increased in the last five years. Nevertheless only 70% of the assets held for public sector reasons are covered by equity. Despite slight fluctuation this ratio is nearly unchanged since 2008 (68%) for the Canton of Zurich.

D. Performance indicators and fiscal rules

In order protect their equity in a sustainable way, the Canton of Zurich uses a system of performance indicators. The indicators are medium-term financial equalisation, cash flow, degree of self-financing, and net debt I. All calculations are based on the consolidated data of Canton of Zürich.

Medium-term financial equalisation

In the yearly budget and fiscal plan are defined the quantity and quality of outputs and the service delivery from the Canton in the following four years as well as their related



financing (CRG, 2006). Changes in equity during the budget and fiscal planning periods result from the expected net revenue. Due to the cantonal constitution a medium-term financial equalisation is required (Constitution, 2005) as the overarching binding fiscal policy. Specified is this requirement in the fiscal policy order (FCV, 2008) by the equalisation of the net revenue from the consolidated income statement. Medium-term means a period of eight years (FCV, 2008). This equalisation acts as a balancing

mechanism. If this balancing is at risk, the Government Council is required to review all planned service deliveries if they are material, relevant and urgent (CRG, 2004). The Government Council reports to the cantonal parliament and proposes adequate measures to reduce service deliveries and/or capital expenditure permanently, especially if changes in laws are required.

The calculation of the medium-term financial equalisation bases on the last three actual financial years, the actual budget and the next four planned fiscal years. Losses can therefore be compensated by gains in the income statement.

Table 3 ▶ Medium-term financial equalisation in million Swiss Francs

	FY 2018 (actuals)	FY 2019 (actuals)	FY 2020 (actuals)	FY 2021 (Budget)	FY 2022 (Plan)	FY 2023 (Plan)	FY 2024 (Plan)	FY 2025 (Plan)
Net revenue	476	494	427	-701	-430	-488	-273	-149
Medium-term financial equalisation 2018-2025								-644

Source: KEF, 2021

At the beginning of the budget and planning process for the period 2022–2025 there was calculated a non-achievement of the medium-term financial equalisation by 644 Mio. Swiss Francs (KEF, 2021). Therefore, in the instructions to the actual budget and planning process requirements are included which service deliveries should be reviewed to exploit saving potentials. The Government Council also revised the capital expenditure (investment) program in assets held for the operational capacity for the next years to reduce the consequential costs and to influence the development of total assets. Net investments is the result of capital expenditure and inflows from capital investments, e.g. loan repayments

Table 4 Net investments in million Swiss Francs

	FY 2018 (actuals)	FY 2019 (actuals)	FY 2020 (actuals)	FY 2021 (Budget)	FY 2022 (Plan)	FY 2023 (Plan)	FY 2024 (Plan)	FY 2025 (Plan)
Net investments	-1110	-1213	-1334	-1475	-1245	-1227	-1410	-1410
Total 2022-2025								-5292

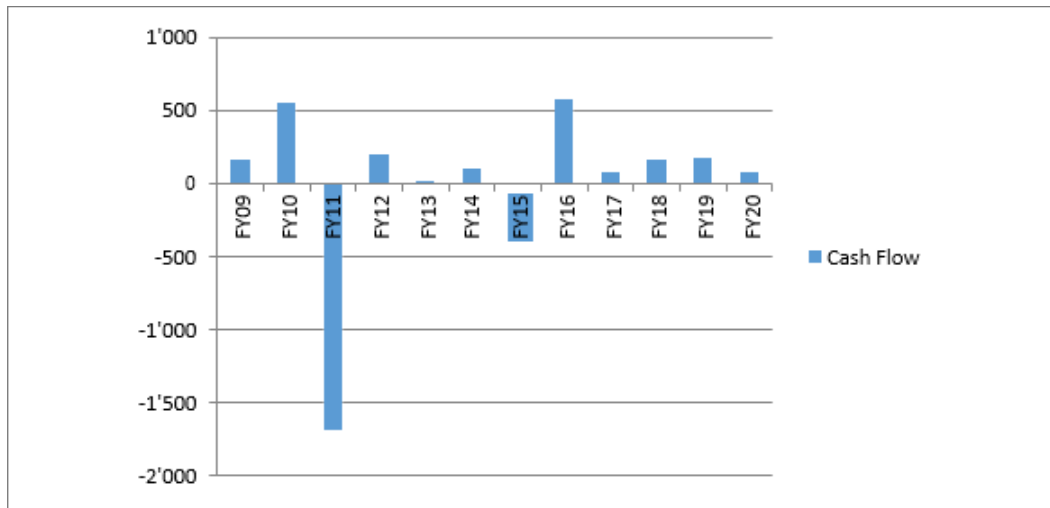
Source: KEF, 2021

Additionally, there are constitutional requirements to avoid the event of an adverse balance or to reduce an adverse balance (Constitution, 2005). The adverse balance needs to be reduced by at a minimum of 20% per year. Since implementation of IPSAS in Canton of Zurich there was no adverse balance so far.

Cash Flow

The cash flow is the difference of net investments and self-financing. Self-financing is the total of net revenue less fair value changes plus depreciation of assets held for their operational capacity. The cash flow is the result of the increase or deduction of net debt I.

Table 5 Cash flows in million Swiss Francs



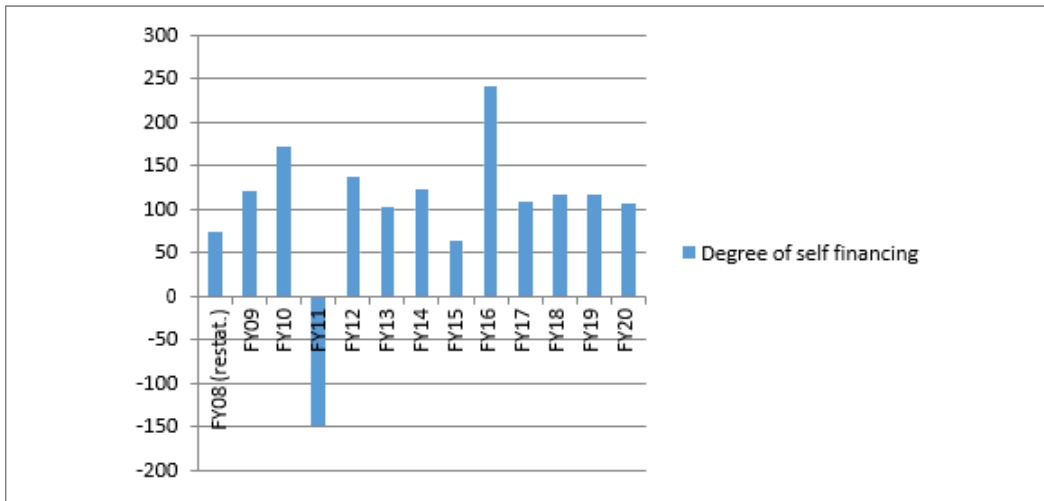
Source: own presentation based on actual financial statements by Canton of Zurich from Fiscal Year (FY) 2009 to 2020



Degree of self-financing

The degree of self-financing shows how much of the net investments of the Canton of Zurich has to be financed using liquidity reserves or debt accumulation. If the degree of self-financing is more than 100%, all net investments could be financed using liquidity reserves and net debt I could be reduced. If the degree less than 100%, net investments have to be financed using debt accumulation provided by external financial institutions, and net debt I will increase.

Table 6 Degree of self-financing in %



Source: own presentation based on actual financial statements by Canton of Zurich from Fiscal Year (FY) 2009 to 2020

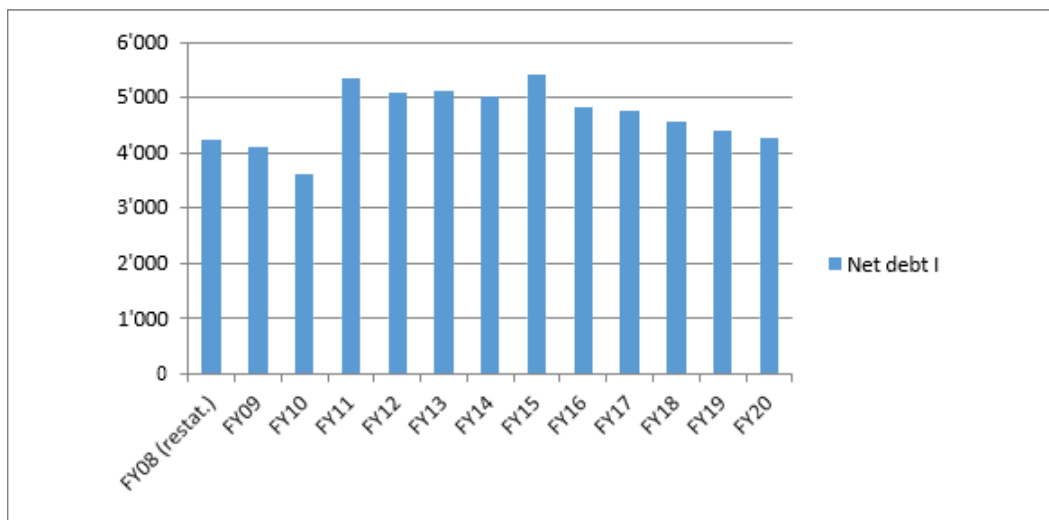
Several fiscal years since using the new accounting model based on IPSAS have had a degree of self-financing of more than 100%. Therefore, a reduction of net debt I was possible.

At the beginning of the budget and planning process for the period 2022–2025 there was a calculated degree of self-financing of only 34% (KEF, 2021). The monitoring of this performance indicator supplemented the monitoring of net revenue, net investments and a sustainable debt path in the medium term.

Net debt I

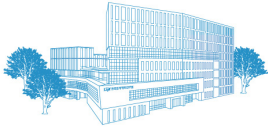
The total liabilities correspond to the sum of all cantonal obligations to third parties. To calculate net debt I, the value of assets held for their financial capacity is reduced from total liabilities. These assets could be sold without any reduction in the fulfilment of public service deliveries. As they are already measured with fair value a calculated ratio can be used without any adjustments for hidden reserves or debts. The net debt ratio is actively managed by the Government Council. The calculation is done for budget and fiscal planning as well as for actuals and is published regularly in their GPFS.

Table 7 Net debt I in million Swiss Francs



Source: own presentation based on actual financial statements by Canton of Zurich from Fiscal Year (FY) 2009 to 2020

All performance indicators are published regularly in budget, fiscal planning and actual financial statements. To ensure comparability of the indicators all set of accounts are based on the same accounting principles and the same consolidation scope.



IV. Identification of fiscal risks

1. Relevance of accrual accounting information for the identification of fiscal risks

A. Definition and classification of fiscal risks

Fiscal risks can be defined as “factors that may cause fiscal outcomes to deviate from expectations or forecasts. Fiscal risks can arise from macroeconomic shocks or the realization of contingent liabilities” (IMF, 2016). It can be concluded from this definition that “what constitutes a fiscal risk depends crucially on which potential developments in the public finances you choose to incorporate into the central projection and which you regard as potential deviations” (OBR, 2017).

How can fiscal risks be classified?

The following matrix shows a possible way to classify fiscal risks along with examples:

	Unconditional	Conditional
Explicit	<ul style="list-style-type: none"> • Foreign and domestic public debt • Interest rate risk • Automatic stabilizers (tax revenue, unemployment benefits) • Legally binding budget expenditures in the current year and over the long term 	<ul style="list-style-type: none"> • Guarantee schemes (loans, credit risk from export, etc) • State insurance schemes (deposit insurance, flood insurance)
Implicit	<ul style="list-style-type: none"> • Old age pensions • Social security schemes • Health care • Climate mitigation • Future recurrent cost of public investments 	<ul style="list-style-type: none"> • Defaults of sub-national governments • Bank failures • Natural disaster relief • Medical emergency measures

Source: Own compilation based on the following sources: OECD, 2020 and World Bank, 2017.

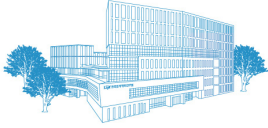
For the purpose of this classification, fiscal risks are explicit when there is a legal obligation for government, whereas they are implicit when an expectation or political decision leads to an obligation. When the risk has not yet occurred they are conditional, else they are unconditional or predictable.

Alternatively, fiscal risks are sometimes classified into the following categories (OECD, 2020):

- *Macro-economic risks*: They affect government revenue directly and the spending forecast indirectly. Risks include growth, demography, commodity prices and risks arising from the financial sector.
- *Government policy or programmes risks*: These are risks that tax collection or spending controls won't happen as planned leading to revenue losses or additional spending.
- *Uncertain budgetary claims or contingent liabilities*: All commitments that the government has formally entered into but would not be able to avoid such as guarantees. However, they are still (highly) uncertain and difficult to measure.
- *Balance sheet risks*: These are mainly risks associated with assets and liabilities controlled by the government.

The various risks are often linked together. For example, the issuance of a guarantee in light of the Covid-19 pandemic is a government programme risk. At the same time the future defaults highly depend on the recovery of the economy which is a macroeconomic risk.

Given the wide scope of fiscal risks and because they are potentially infinite, it may not be possible to cover all potential fiscal risks faced by governments. It is therefore suggested that "a definition should not aim at comprehensive coverage of potentially infinite fiscal risks, but rather aim at supporting policy decision-making and facilitating oversight and accountability" (OECD, 2020).



B. Relevance of accrual accounting

Accrual accounting can play a supporting role in helping to identify and monitor risks that were previously not acknowledged or reliably measured. There is a commonly expressed view that the scrutiny that comes with disclosure of contingent liabilities in financial statement creates pressure to ensure that these risks are identified, measured and managed, and ideally leading to earlier and smoother policy responses (Moretti and Youngberry, 2018). This seems to apply even more for the recognition of provisions or financial liabilities as some countries have started to subject them to the same degree of scrutiny and control as ordinary spending (Moretti and Youngberry, 2018).

In the light of the Covid-19 pandemic additional measures have been taken by government to mitigate the negative impacts on society and economy. Many of these measures create additional fiscal risks that will crystallize over time. This leads to new challenges in how to measure and how to transparently report them. Measures taken by various countries include but are not limited to:

- Government guarantees: The government provided guarantees for loans granted to enterprises by commercial banks.
- Government loans: The government grants loans directly to beneficiaries.
- Government equity injections: The government provides additional equity, for example to state owned enterprises.

In some countries the scheme size of loans under such guarantee schemes amounts to around 3% to 5% of GDP, such as in Austria, USA and Switzerland and in one case, France, exceeds 10% (Braendle and Leroy, 2021). The actual take-up of the loans is lower but still relevant in terms of the respective GDP. These measures allow government to support households and enterprises by providing access to liquidity and preventing insolvencies, while at the same time preserving the government fiscal balance in the short-term. They can be described as “off-budget” because they may increase the government debt and the fiscal risk without affecting the budget balance in a cash budgeting system. However,

these measures will be accounted for in accrual basis budget and accounts as they generate liabilities (Braendle and Leroy, 2021). A necessary condition is the measurability which is to estimate the losses over the lifetime of the scheme and thus, to quantify the fiscal risk.

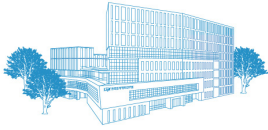
The following chapters will present examples how accrual accounting has contributed to increase transparency concerning fiscal risks at the level of Federal Government and how the State of Zurich makes use of accounting to manage fiscal risks.

2. Federal Government

A. Covid-19 credits

In 2020, the Federal Council announced several measures in response to COVID-19. Alongside measures that directly affected the fiscal balance, the Swiss Government also guaranteed loans for SMEs up to CHF 40 billion. Companies affected by the Covid-19-crisis were able to apply for bridging credits (loans) guaranteed by the federal government of up to 10% of annual sales and not higher than CHF 20 million to ensure their liquidity. Loans up to CHF 0.5 million were secured to 100% and amounts between CHF 0.5 and 20 million were secured to 85%. The loans have to be repaid within eight years (Easygov, 2021). The federal government assists viable SMEs in obtaining bank loans by funding designated loan guarantee cooperatives. They facilitate SMEs access to bank loans by providing the banks with guarantees. In Switzerland there are three regional loan guarantee cooperatives, as well as a national loan guarantee organisation for women (Seco, 2021). The legal basis for the guarantee program clarifies the reporting requirements for the cooperatives to the federal government such as guaranteed loan volumes, defaults on interest rate payments, calls on guarantees, repaid loans and other information needed (Covid-19-SBüG, 2021).

By the end of 2020, the maximum exposure of the guarantee scheme due to effectively issued guarantees amounts to CHF 15.2 billion. With regard to the risk of future cash



outflows the Swiss Confederation estimated the expected losses over the lifetime of the scheme and recognized a provision of CHF 2.3 billion. The remaining CHF 12.9

billion are treated as a contingent liability (SR 2020). Estimating loan default probabilities, however, are surrounded by high uncertainty. The amount of the provision was calculated based on the assumption that 15% loans would default over the next eight years. It was assumed that a high percentage of defaults would happen in the first two years. For obvious reasons historical data on calls on guarantees did not serve as a sufficient reference point as the probability of losses strongly depends on factors unique to this situation such as the course of the pandemic or the timing of the economic recovery (SR 2020). Nevertheless, following the use of professional judgement the Swiss Confederation recorded a provision according to IPSAS 19 in the balance sheet.

B. Pension Obligation

As mentioned in the description of the reform (see chapter II 2.), the federal government recognized a provision for the retirement benefits using an actuarial calculation according to IPSAS 39 from fiscal year 2017. Previously, the obligation was recorded off-balance as a contingent liability that constituted a deviation from IPSAS. The full net defined benefit liability according to IPSAS 39 was recognized in the opening balance sheet of 2017 (SR 2017). It amounted to CHF 11 billion and became one of the most significant single line item on the liabilities side.

The plan to recognize the full liability in the balance sheet of the federal government alongside the fact that the liability has constantly risen in the previous years due to a low interest rate environment and higher life expectancy of the beneficiaries triggered several discussions on different levels within the federal administration. Discussions on the nature of Swiss pension plans have already been ongoing with private sector entities applying IAS 19. Namely, it was criticized that the current application of IAS 19 to Swiss pension plans resulted in the plan being classified as a defined benefit obligation with the resulting liability being fully charged to the employer's balance sheet. This treatment, however, assumes that the employer is responsible for the full amount of additional

funding costs of the plan in case the current level of regular contributions is not sustainable. This would not be in line with the regulatory framework of these plans (plan rules) and the current practice, notably the fact that in case of actual or expected underfunding the plans can take measures by adapting the level of benefits by reducing the conversion rates and/or by obliging employers and employees to pay higher contributions. Therefore, risk-sharing features between employer and employees would not be appropriately considered in the measurement of the liability which would not result in a faithful depiction of the liability on the employer’s side as in case of restructuring employees need to play their part as well with additional contributions and/or reduced benefits.

This relationship is illustrated as follows:

Figure 2 ▶ Shortfall in pension plan

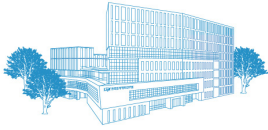
Liabilities	Assets
Present value of employee benefit obligations (DBO)	40% Employee risk-sharing shortfall
	60% Employer risk-sharing shortfall
	Benefit plan assets

Shortfall

Source: Own compilation

Consequently, the parties involved at the federal level raised the following questions in terms of the liability:

- What is the legal obligation by the employer in terms of a funding shortfall? Is it above 50%?



- What is the customary entity-specific practice in the past?
- Does a “risk sharing-approach” better reflect the nature of the obligation of the employer to bear the costs of a shortfall?

The federal pension plan is a defined benefit plan. In the event of a funding shortfall the risk is to be shared between employer and employee according to the regulatory framework. This means that the employer has no legal obligation to pay more than 50%. Above that threshold, a de facto obligation for the employer to pay restructuring contributions can be derived from customary company-specific practice in the past, for example based on the ratio of the contributions paid by employer and employee. However, this is not 100 percent and in light of possible higher shortfalls in the future it remains highly unlikely.

The Federal Government finally decided that for the purpose of measuring the net liability the financial assumptions related to risk sharing are taken into account in two steps from the fiscal year 2019 (SR 2019):

- *Step 1:* The Federal Government anticipates that the pension fund will continue its past practice also in the future of taking measures in order to keep the pension plan in financial balance and to counteract systematic redistribution between insured employees and recipients of pensions. The single and most likely measure is assumed to be a correction of the conversion rate down to an actuarially appropriate rate of 4.7 percent based on a technical interest rate of 1.3 percent.
- *Step 2:* Even assuming a future reduction of benefits resulting from the first step a structural funding gap still remains. In a second step, the gap is divided mathematically between the employer and the employees while it is assumed that the employer’s share amounts to 60 percent according to the current ratio between employer’s and employee’s regular contributions.

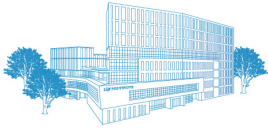
It is important to stress that these assumptions are made from the perspective of the employer and not the pension plan itself. The new practice is furthermore a matter of professional judgement and derives from the principles in IPSAS 39 paragraphs 89c/d and

90c which stipulate that any limit on the employer's share of the cost of the future benefit and contributions from employees needs to be taken into account. For example if the terms of the plan state that it will pay reduced benefits or require additional contributions from employees if the plan assets are insufficient (IPSAS, 2021).

The change in accounting estimate led to a reduction of the net liability of around CHF 2.3 billion in the opening balance sheet of fiscal year 2019 and was recorded directly in net assets in line with IPSAS 3. The annual employee benefit expenses decreased by around CHF 150 million (SR, 2020).

Applying the risk sharing approach in accordance with IPSAS 39 resulted in a more faithful depiction of the economic reality and the risk exposure of the federal government and in adapted processes and responsibilities in determining what is the obligation of the employer. Furthermore, it can help to "stimulate" earlier discussions and decisions on measures to be taken in order to guarantee the financial sustainability of the pension system. Not overstating the liability in the employer's balance sheet also avoids an incentive for the employer to push towards more fundamental changes to the plans (for example so-called 1e plans which are common in Switzerland). This is in the interest of beneficiaries as well. It also means that accounting figures don't forestall decisions but rather inform decision-makers by reporting the risk bore from the perspective of the employer based on current conditions and by taking into account the past practice of the pensions plans.

In addition, the assumed correction of the conversion rate in step 1 is treated as a remeasurement (IPSAS 39 paragraph 129) and recognized in net assets. Later in the future, when the conversion rate is effectively changed following a plan amendment (IPSAS 39 paragraph 105) no "gain" or revenue needs to be recognized in surplus or deficit of the employer. In other words, actuarial losses due to a longer life expectancy or a decrease of interest rate which are the main drivers of future amendments of the conversion rate and the anticipated reduction of the conversion rate itself are both treated as a remeasurement. This decreases the volatility in the statement of surplus and deficit and increases the readability of the financial statement.



3. State of Zurich

A. State guarantees for liabilities of their owned financial institution

The Canton of Zurich is the bank's guarantor and sole owner of the financial institution ZKB. ZKB's management is independent and not subject to political influence, but is directly supervised by the cantonal parliament (ZKB, 1997). The financial institution is a domestically and systemically important bank declared by the Swiss banking supervisor (FINMA). The Canton of Zurich guarantees all of ZKB's non-subordinated liabilities under the specific Cantonal Bank Act (ZKB, 1997). This means the Canton has responsibility for these liabilities in the case of bankruptcy or illiquidity.

This sovereign guarantee is a financial risk and reported as a contingent liability in the disclosure of the consolidated financial statement (FB KTZH, 2020).

ZKB is the largest cantonal financial institution and one of the largest in Switzerland. The public service mandate entails providing full financial services for the public (e.g. local households) and businesses, supporting the Canton in performance of its tasks in the economic, social and environmental arenas (Cantonal Bank Act, 1997). ZKB's balance sheet is roughly 10 times the Canton of Zurich's operating revenue and therefore large relative to the Canton's budgetary resources, but the bank's business model and capital buffers, defined in the specific law, ensure manageable recapitalisation needs (FitchRatings, 2021). A possible recapitalisation of ZKB might have negative impact on the Canton's ratings. ZKB has a contingency plan to be approved by FINMA. The plan could require the Canton to commit a large volume of contingent capital relative to its own resources. The provision of this contingent capital, if needed, would be manageable for the Canton given its strong financial position, and would not on its own drive a negative action on the Canton's ratings (FitchRatings, 2021).

Since 2016 according to a resolution of the cantonal parliament the yearly compensation for this guarantee of around 22 million Swiss Francs was collected in a specialised «basket» to reduce the risk of the cantonal guarantee in the long-term (KR, 2015). In April 2019, the cantonal parliament instructed the Government Council to develop a modification

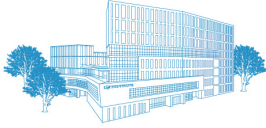
of the law to liquidate this «basket» as it could never fulfil the expected aim. In a case of emergency the collected amount would have never sufficient resources to rescue this financial institution with total assets of 188 billion Swiss Francs. The total assets per end of 2020 of Canton of Zurich were only 24 billion Swiss Francs. The received compensation should be used to repay state loans to increase the creditability of the Canton and the ability to withstand possible shocks better. In February

2021 there was the first reading of the draft modified law with none opposition against the removal of this «basket» (KR, 2020).

B. Guarantees for Covid-19 loans

In 2020, the Government Council announced like the Federal Council several measures in response to Covid-19. Beside the payment of several transfers already included in the financial statement of 2020, a guarantee up to volume of CHF 500 million loans was granted additionally to the financial aid of the Swiss Federation. The loans could be drawn from 12 registered financial institutions by SME with tax domicile in Canton of Zurich and affected by the situation due to Covid-19-crisis. These loans were secured by the Canton up to 85 %. Finally, 135 loans were given with a total amount of 169 million Swiss Francs. Thereof, 69 loans with a total amount of 57 million Swiss Francs to start-ups with a higher risk profile.

By the end of 2020, the exposure of the guaranties was 89 million Swiss Francs. Due to responses from the financial institutions and different additional financial aid programs in 2020 and 2021 a credit default was not highly probably. Therefore, the exposure is a fiscal risk and was reported as a contingent liability in the disclosure of the consolidated financial statement (FB KTZH, 2020).



V. Conclusions

1. Degree of usage of accrual accounting information

How are the measures described in the previous chapters reflective of (an increased) usage of accrual accounting information? In order to assess the various measures taken by several countries in a consistent way the Government Accounting and Finance Statistics Center (GAFSC) under the Korea Institute of Public Finance (KIPF) developed the following table:

Table 9 Degree of usage of accrual accounting information

Lv.1: Production	Lv.2: Analysis	Lv.3: Usage	Lv.4: Impact
<p>Governments and related organizations at this stage take a step further from the analysis and make use of the analyzed accrual information for a specific purpose</p> <p>(ex: financial management)</p>	<p>Governments and related organizations at this stage analyze the accrual information they have produced</p>	<p>Governments and related organizations at this stage produce accrual information</p>	<p>At this stage, the “impact” is referred to as the impact of the usage(Lv. 3) that reports, projects, institutions or teams are established based on the result from Lv. 3</p>

Source: GAFSC – KIPF, 2021

This classification is used in the following two subchapters to assess the measures taken in Switzerland.

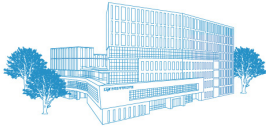
2. Federal Level

Accrual accounting enabled the federal government to adapt the main fiscal policy instrument – the debt brake – to be based on accrual instead of cash accounting from 2022. Many transactions are taken into account for budgeting when the corresponding accrual entry is made and not only at the time of cash in- or outflows. This was an active decision taken based on the availability of accrual accounting information since 2007, which corresponds to Level 4. The same applies to the implementation of IPSAS 29 in 2017 where the effective interest became relevant for the purpose of the budget and treating the premiums received as part of the debt.

Accrual accounting has helped to better identify and measure some of its fiscal risk arising from contingent liabilities and putting it into a more prominent place within financial reporting. Risks arising from guarantees are made transparent in the balance sheet and relevant for budget e.g. future increases of risks. Uncertainty about the timing, magnitude or likelihood of outflows surrounding the estimates are disclosed. This provides a starting point for policies aimed at monitoring and mitigating fiscal risks by

better quantifying the impact on government spending. The cash flows can still deviate from the estimate of risk as fiscal risks are by definition uncertain and there can never be thorough understanding of the timing of outflows of resources. However, they are taken into account earlier than at the time of the cash outflow what is best described with Level 3.

In terms of the pension obligation, the measurement of the liability has become increasingly important as it reflects the future and realistic exposure of the government and constitutes a typical balance sheet risk. On top of that, in the case of the pension obligation this has triggered discussions about the degree of risk sharing between employer and employee and led to new processes on how to assess the risk periodically which corresponds to Level 3, if not 4.



3. State of Zurich

The usage of accrual based information is the common approach from Canton of Zurich since the implementation of accrual accounting in 1980s. The authors of this research define the Level 3.

The financial management for all GPRS (like budget, fiscal planning and actuals) of the Canton are based on the same set of accounts, measurement and recognition principles. Furthermore, the governmental and parliamentary resolutions base on definitions from accounting standards. E.g. rental agreements are classified by IPSAS 13 in operational and finance lease. These classifications are used by defining the relevant level of authorization within the Canton to approve expenses or capital expenditure. Generally, all operational leases could be approved by the Government Council; finance leases often need an approval from cantonal parliament or even are subject to a referendum in accordance to the volume of the contract. As financial lease contracts often include higher risks due to their larger amounts, the authorization level was seen to be more adequate by cantonal parliament. In 2011, the law was accordingly modified (CRG, 2006).

Furthermore, five years after building up the special basket for the guarantees of ZKB liabilities the decision was verified by the cantonal parliament. The balance sheet transparently presented the increase of total assets as a consequence of the decision made. Finally, the cantonal parliament has concluded that a reduction of cantonal debts influenced instead a favourable credit rating of the Canton of Zurich. This leads to a better credit profile and allows the Canton to receive additional funding at favourable conditions at a potential entry date. Therefore, the yearly compensation will probably be treated in the future as unrestrictive revenue.

At Canton of Zurich, the fiscal policy is supported by and connected with accrual accounting. Transparency and a state-of-the-art accounting standards for the public sector allow taking right decisions which are in favour for their taxpayers.

VI. Identification of fiscal risks in financial statistics : a comparison

1. Introduction

The previous chapter discussed the question of how accrual accounting can help to identify fiscal risks and to monitor them. One of the key goals of financial statistics is to analyze and evaluate the impact of fiscal policies (GFSM 2014, A6.11). This is closely related to the question of fiscal risks because they emerge from fiscal policy programs. As the financial statistics directly relies on accounting data as its “source data” – including balance sheet line items – this chapter figures out how fiscal risks are finally considered in the statistical set of data. For this purpose, it will start with looking at the definition and role of fiscal risk in the relevant international statistical guidance GFSM 2014 (Government Finance Statistics Manual 2014) issued by the IMF and compare the degree of inclusion of “accounting liabilities” into the various statistical models used in Switzerland. It will then analyze how accounting reforms had an effect on the liabilities reported in terms of the national statistical model in Switzerland from 1990 until 2020 and compare them to one of the international models. It will assess the current rationale by international statistical guidance in treating provisions before concluding the chapter.

2. Fiscal risk in GFSM 2014

GFSM 2014 defines fiscal risks in accordance with its other literature as “any potential differences between actual and expected fiscal outcomes (e.g. fiscal balances and public sector debt)” (GFSM 2014, 7.251, footnote 69). The same paragraph further states that “contingent liabilities create fiscal risks and may arise from deliberate public policy or from unforeseen events”. Notably, it emphasizes the strong link between contingent liabilities and uncertainty: “With contingent liabilities, there is typically uncertainty over whether a



payment will be required, and its potential size.” Like in IPSAS, contingent liabilities are generally not included in the balance sheet according to GFSM 2014 (GFSM 2014, 7.13). Given that uncertainty also exists in the case of provisions recognized in the balance sheet (see IPSAS 19: “A provision is a liability of uncertain timing or amount”) the question arises how GFSM 2014 treats provisions. Paragraph 7.13 is equally clear that “amounts set aside in business accounting as provisions to provide for a unit’s future liabilities, either certain or contingent, or for a unit’s future expenditures, are not recognized in the macroeconomic statistical systems.” However, there are exceptions. Some liabilities involving some degree of uncertainty are recognized in accordance with GFSM 2014 such as standardized guarantee schemes (GFSM 2014, 7.253) and employment-related pension provisions (GFSM 2014, 7.197), see also next chapter.

As the case of GFSM 2014 shows, the degree of reporting fiscal risks in the balance sheet depends on whether the statistical literature treats them as liabilities or not. The following chapter will elaborate this question in the context of the three Swiss statistical models used in practice.

3. Definition of liabilities in the statistical models in Switzerland

A. Overview of the statistical models

The statistics on Swiss public finances give an overview of the financial position and performance of the government units in Switzerland. The financial statistics data is in the first instance recorded, processed and evaluated according to the so-called national “*FS Model*” based on the accounting standard HAM 2 used by the cantons and municipalities (see also chapter I). The FS Model ensures the national comparability of the accounting data of Switzerland’s government units (Financial Statistics Methods, 2021).

Consequently, the FS Model serves as a basis for international comparisons, which are carried out in accordance with the guidelines of GFSM 2014 using the so-called “*GFS Model*”. Like IPSAS, GFSM 2014 is a standard for the financial reporting of government

units and is accrual based (Financial Statistics Methods, 2021).

Switzerland's system of national accounts, which is based on the ESA 2010 (European System of Accounts 2010), is a GNP account forming a realistic representation of the Swiss economy, the main objective of which is to determine the value added, i.e. GDP. The general government sector's basic data required for the system of national accounts are compiled using the “ESA Model”, which is based on the GFS Model (Financial Statistics Methods, 2021).

Both the ESA 2010 and the GFSM 2014 are based on the standard reference work for national accounts, the System of National Accounts (SNA 2008) of the international organizations (UN, OECD, IMF, World Bank, European Commission).

B. Recognition of liabilities

Regarding the recognition of liabilities, there are notable differences between the three statistical models.

Under the *FS Model*/liabilities are recognized according to HAM 2 as soon as they meet the recognition criteria (past event, future inflows/outflows are probable and can be measured reliably), which is generally in line with the requirements of IPSAS (HAM 2, Recommendation No. 11, paragraph 3).

In contrast, the *GFS Model* has a significantly narrower scope of liabilities. GFSM 2014 is clear in this regard by stating, “There are no nonfinancial liabilities recognized in the GFS framework, and thus the term liability necessarily refers to a liability that is financial in nature” (GFSM 2014, 3.44). The key area of difference are the provisions that IPSAS define as liabilities of uncertain timing or amount (IPSAS 19, paragraph 18). According to GFSM 2014 provisions include obligations for which there is no counterparty—for example, provisions for restructuring and environmental restoration (GFSM 2014, A6.22). GFS would not recognize either these (changes in) assets/liabilities or the resulting revenue/expense until a point in the process where another party can be identified as



receiving value (GFSM 2014, A6.23). This primarily affects conventional provisions, e.g. for restructuring costs, legal claims or restoration costs. It also affects many financial guarantees, which are with the exception of standardized guarantee schemes not recognized as liabilities in GFSM 2014 and ESA 2010. Notably, restoration costs are not recognized as a provision but instead treated as so-called “terminal costs” – as costs incurred on acquisition and disposal of assets (GFSM 2014, 8.6). There are a few exceptions to this rule in GFSM 2014. Some provisions for employees, provisions for coins in circulation and insurance claims incurred are financial liabilities. The liability of a defined-benefit pension scheme (including non-autonomous pension funds and unfunded pension schemes) is the present value of the promised benefits. The liability of a defined-contribution pension fund is the current market value of the fund’s net assets, which is determined according to the performance of the assets acquired with the pension contributions (GFSM 2014, 7.197).

The *ESA Model* is similar to the GFS Model in terms of recognition of liabilities with one significant exception: it does not recognize pension entitlements for government employee social security schemes in the core accounts but only in a supplementary table (ESA 2010, 17.48).

C. Measurement of liabilities

The *FS Model* uses various valuation methods. Depending on the purpose for which an asset/liability is held, the most common one is historic cost or nominal value. In some cases such as derivatives market value is applied (HAM 2, Recommendation No. 21).

In the *GFS Model* liabilities are generally valued at market prices. If no market prices are available, alternative valuation methods have to be used, e.g. the price of a similar asset, production costs or the discounted value of future revenue. In the case of financial assets and liabilities that are not traded on an active market (e.g. loans), the nominal value can be used. Negotiable liabilities are measured at fair value (GFSM 2014, 3.113–3.127).

In the *ESA Model* the stock of the assets and liabilities recorded in the balance sheet are

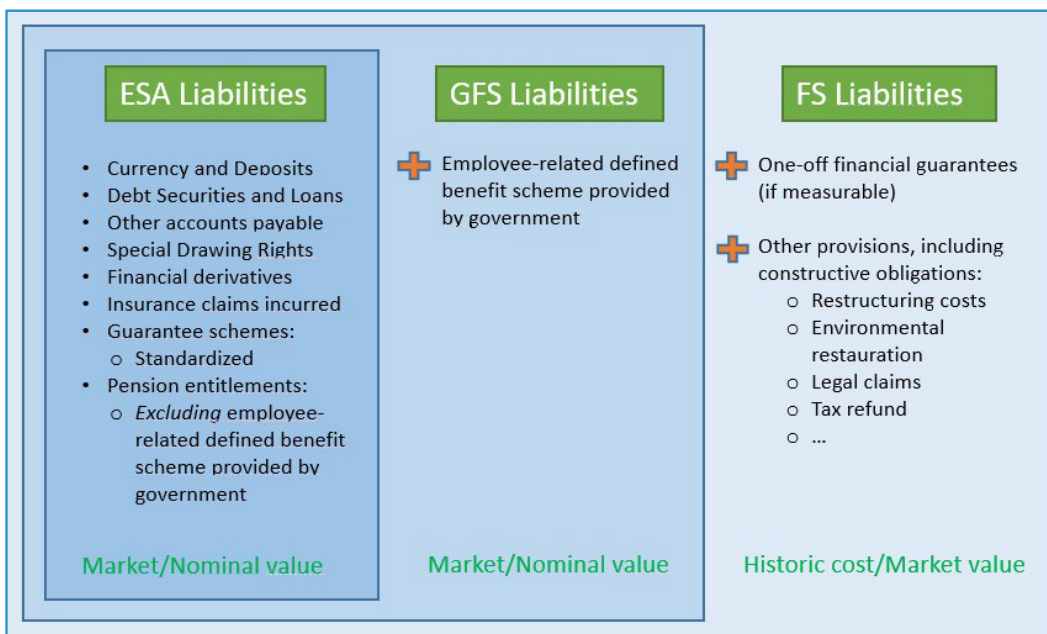
valued at the appropriate prices, which are usually the market prices prevailing on the date to which the balance sheet relates, but for some categories at their nominal values (ESA 2010 7.02). This treatment is similar to the GFS Model.

D. Summary

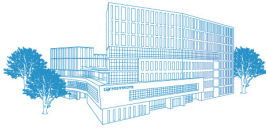
The ESA Model has the smallest scope of liabilities, followed by the GFS Model which in addition includes provisions for employee related defined benefit schemes. The national FS Model has the largest scope of liabilities. It generally includes all provisions recognized according to the national and international accounting standards (HAM 2 and IPSAS) used by public sector entities in Switzerland.

The following table summarizes above considerations:

Figure 3 Scope of liabilities in different statistical models in Switzerland



Source: Own compilation



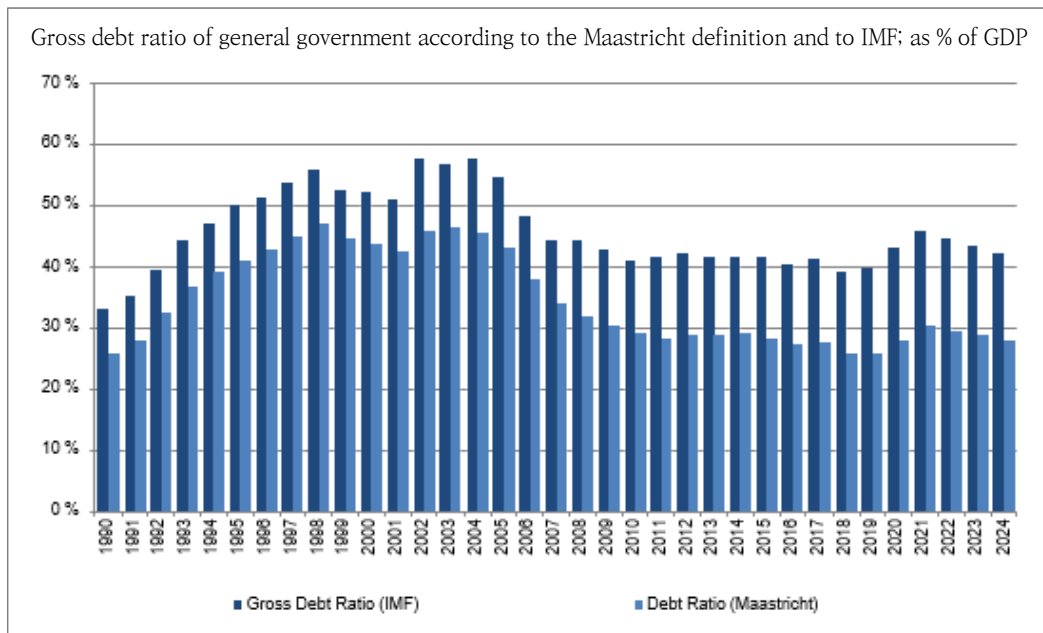
E. IMF vs. Maastricht debt ratio

Based on their respective liability definition, GFS and ESA both define a gross debt ratio:

- The *Maastricht gross debt* is reported at face value in the following categories of government liabilities: currency and deposits, debt securities and loans (EDP, 2021).
- The *gross debt position of IMF* has a wider definition and comprises all GFS liabilities less shares and other equity instruments and financial derivatives (GFS, 7.237). Especially, it includes other accounts payable and some pension provisions recognized in the GFS Model. The IMF gross debt is valued at market value and if not available, at face value (GFS, 7.238). This follows, that debt securities are valued differently for Maastricht and IMF debt ratio.

The two debt ratios for the General Government Sector in Switzerland since 1990 have evolved as follows:

Table 10 Gross debt ratios according to Maastricht and IMF



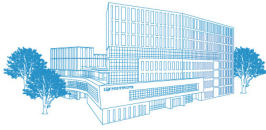
Source: EFV, 2021

Although the debt ratios have both decreased due to a general reduction in debt in the general government sector since the mid-2000s, the gap between Maastricht and IMF debt ratio has widened and the IMF debt ratio is now considerably higher.

While it is quite evident that the IMF debt is higher than Maastricht because it encompasses a broader definition of debt, what are the reasons for the widening of the gap? On one hand, increasing values in other accounts payable and provisions may explain one part. On the other hand, market value adjustment for debt securities have risen as well. In the early 2000s the face value was adjusted by financial statistics between 0 – 10 percent. In the late 2010s the average adjustments increased to between 10 and 20 percent. This development is a consequence of the lower interest environment in Switzerland in recent years.

Because IMF and Maastricht use a different valuation for the debt securities a direct comparison is less meaningful. It is also questionable whether market values more faithfully reflect the fiscal risk bore by the government unit. It seems counterintuitive that falling interest rates and rising market values of issued bonds lead to an increased fiscal risk as existing bonds with higher yields will be substituted with lower ones as soon as they expire. Furthermore, government usually has no incentive to repurchase them above par on the market.

Therefore, the following chapters focuses on the scope comparison between the FS Model and Maastricht whose liabilities have a similar valuation – with the exception of some less significant line items such as derivative instruments. Maastricht debt is in addition a more suitable basis because it encompasses the “traditional” cash-based debt (currency and deposits, debt securities and loans).



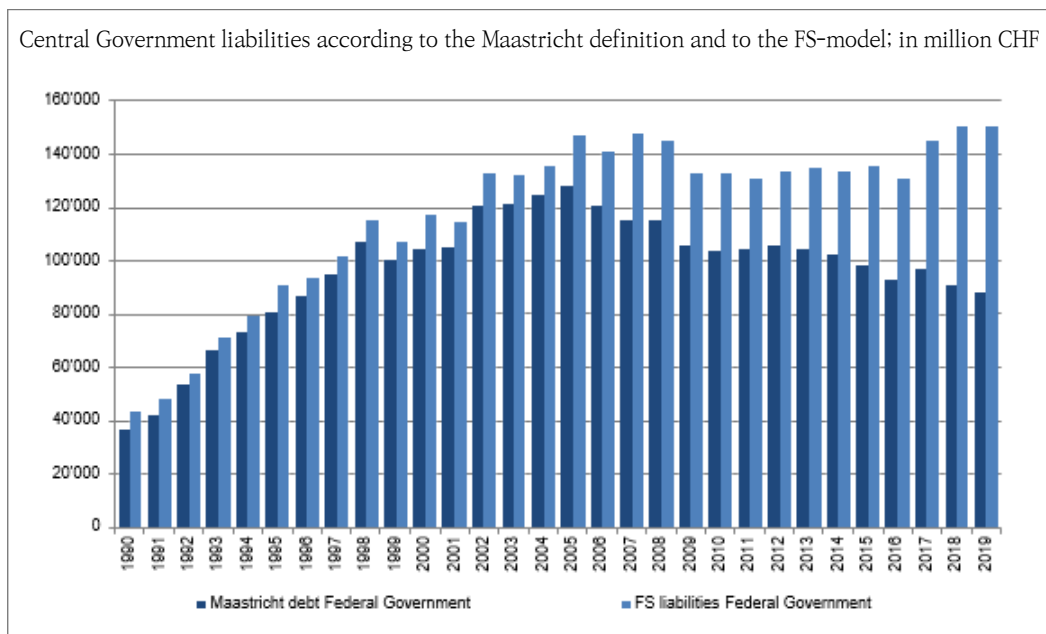
4. Evolution of liabilities in the statistical models in Switzerland

This sub-chapter looks at how accrual accounting changed the ratio since 1990 between “narrow” cash-based definition of liabilities according to Maastricht and the wider set of liabilities recognized in the FS model for the three subsectors Central, State and Local Government.

A. Federal level (Central Government)

The Maastricht debt and the FS liabilities on the federal level have changed as follows:

Table 11 Federal Government liabilities according to Maastricht and FS

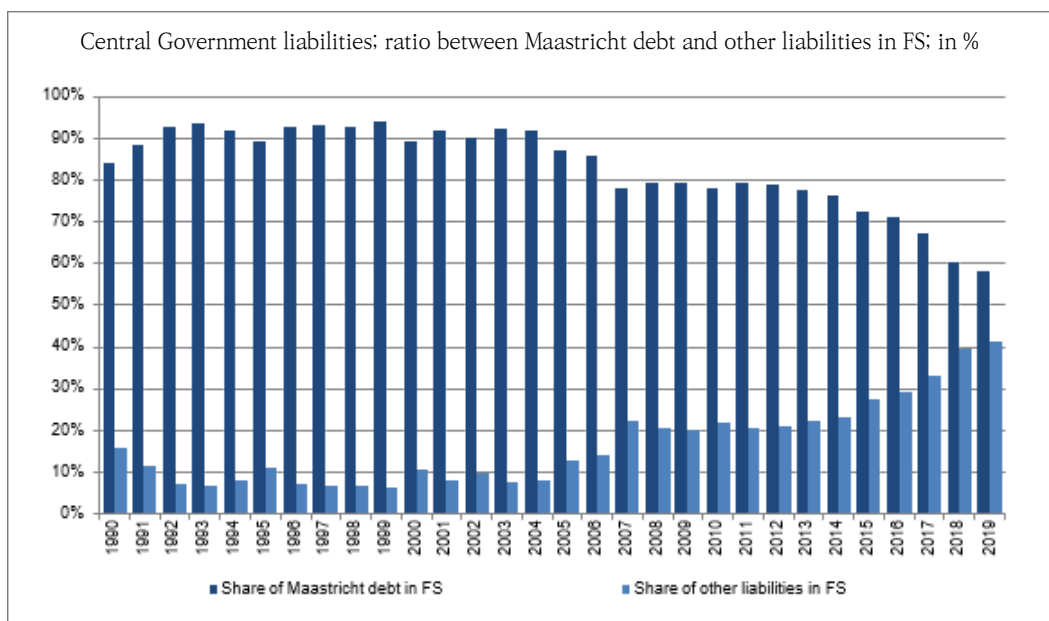


Source: EFV, 2021

The national statistical model (FS Model) mirrors the effect of the implementation of IPSAS in 2007 on the federal level quite well. While Maastricht debt has declined since the mid-2000s, FS liabilities remained stable or even gone up slightly. The following

graph highlights this development even better as it directly compares the share of Maastricht debt–relevant liabilities compared to the other liabilities included in FS.

Table 12 Federal Government liabilities share of Maastricht debt and other liabilities



Source: EFV, 2021

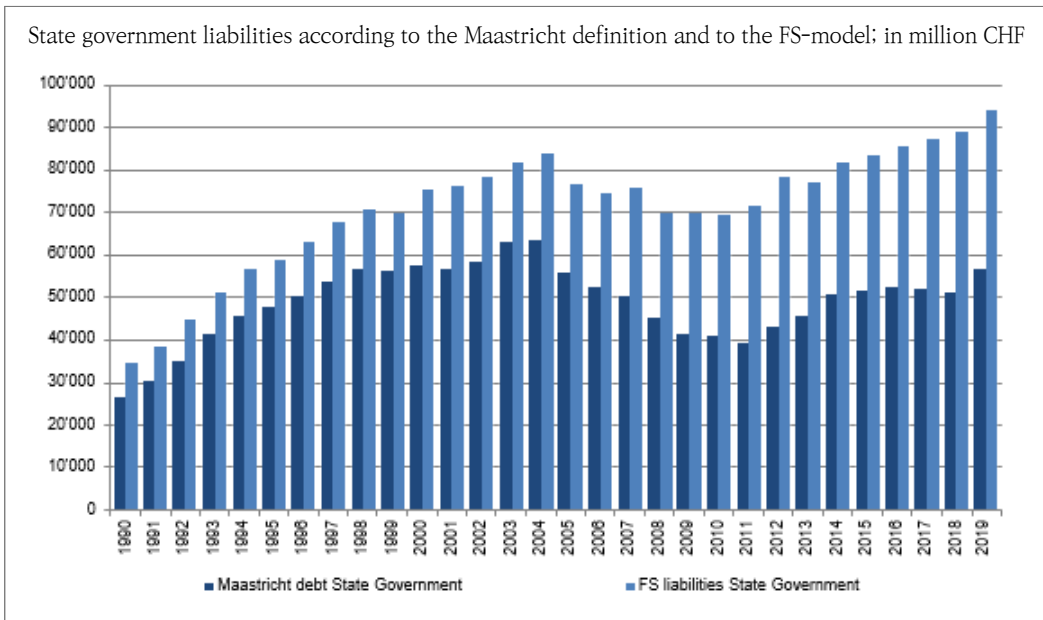
From the early 1990s until the mid-2000s, the share of Maastricht debt amounted to around 90 percent on average of all FS liabilities. Only in the year 1990, it fell slightly below 85 percent. With the implementation of IPSAS from 2007, the share suddenly dropped by almost 10 points to 75–80 percent while the share of other FS liabilities increased to 20–25 percent. With the increased recognition of provisions such as the retirement benefits according to IPSAS 39 in 2017 and together with the constant reduction of Confederation Bonds resulting from annual surpluses the share of other FS liabilities reached an all-time high of 40% in 2019 while the share of Maastricht debt fell below 60 percent of all recognized liabilities.



B. Cantonal level (State Government)

The following table shows the same comparison as in the previous sub-chapter for the cantonal level:

Table 13 State Government liabilities according to Maastricht and FS

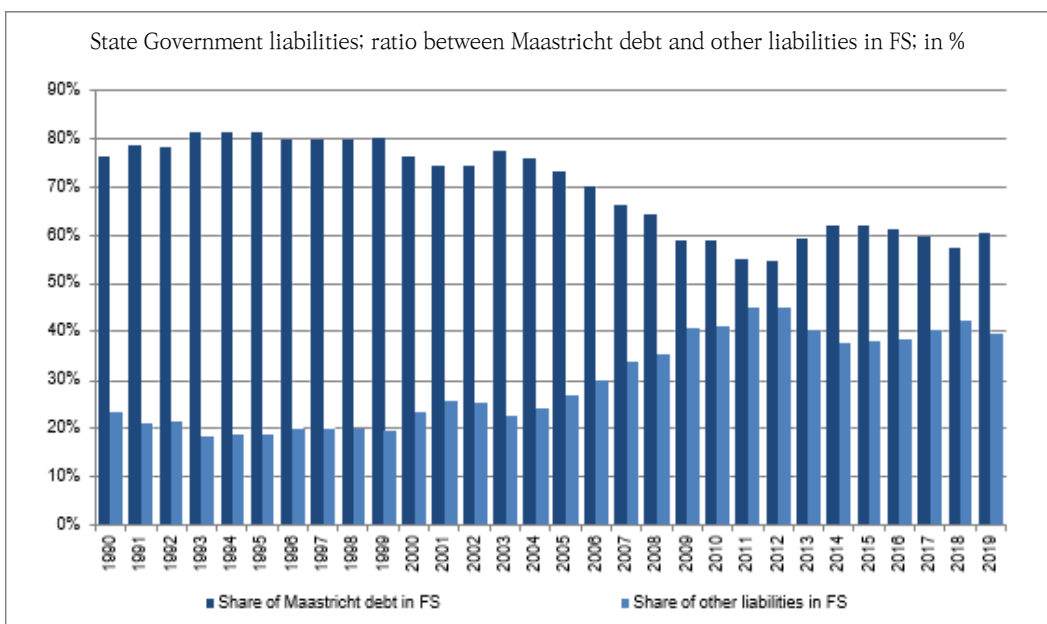


Source: EFV, 2021

Compared to the federal level, the FS liabilities on the cantonal level surpassed Maastricht debt already from the beginning of the recording of the data in 1990. This could be attributed to the fact that the cantons have applied accrual accounting earlier than the Federal Government with the implementation of HAM 1 already in the 1980s (see chapter I.).

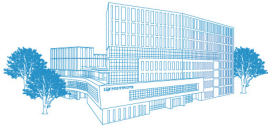
The following graph illustrates the respective ratio:

Table 14 State Government liabilities share of Maastricht debt and other liabilities



Source: EFV, 2021

The share of non-Maastricht liabilities has increased over time as well, although not quite as steadily as on the federal level. Yet, the share of other liabilities in FS Model reached a similar level as in the case of Federal Government and stabilized at around 40 percent of all liabilities. At some point in time (years 2011 and 2012) it even came close to 50 percent almost equaling Maastricht debt.

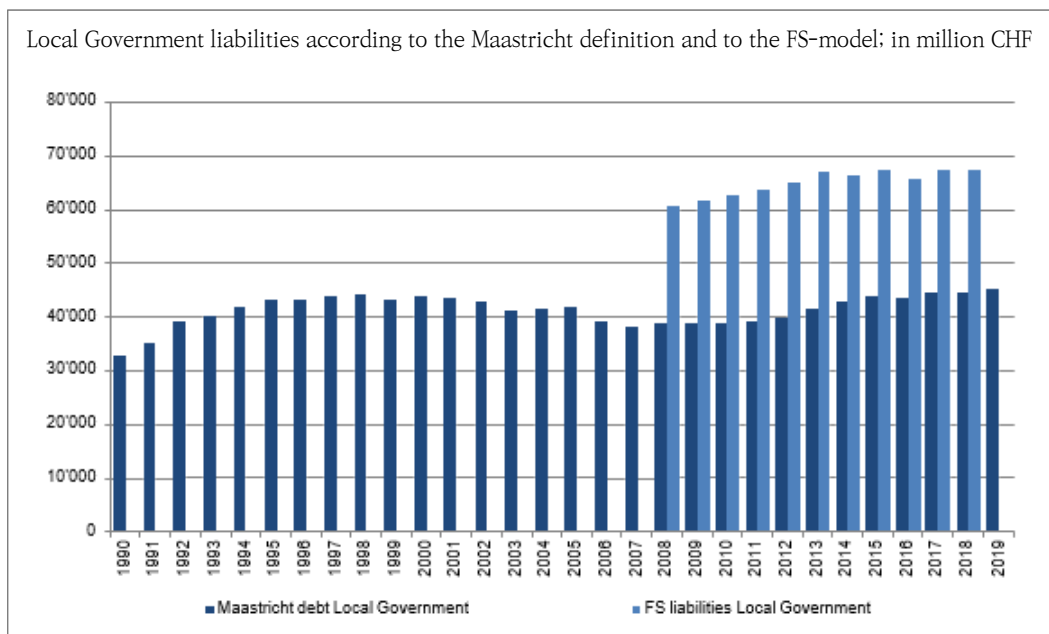


C. Municipal level (Local Government)

On the municipal level, data for FS liabilities are available only from 2008 while Maastricht debt is available back to 1990.

The comparison is as follows:

Table 15 Local Government liabilities according to Maastricht and FS

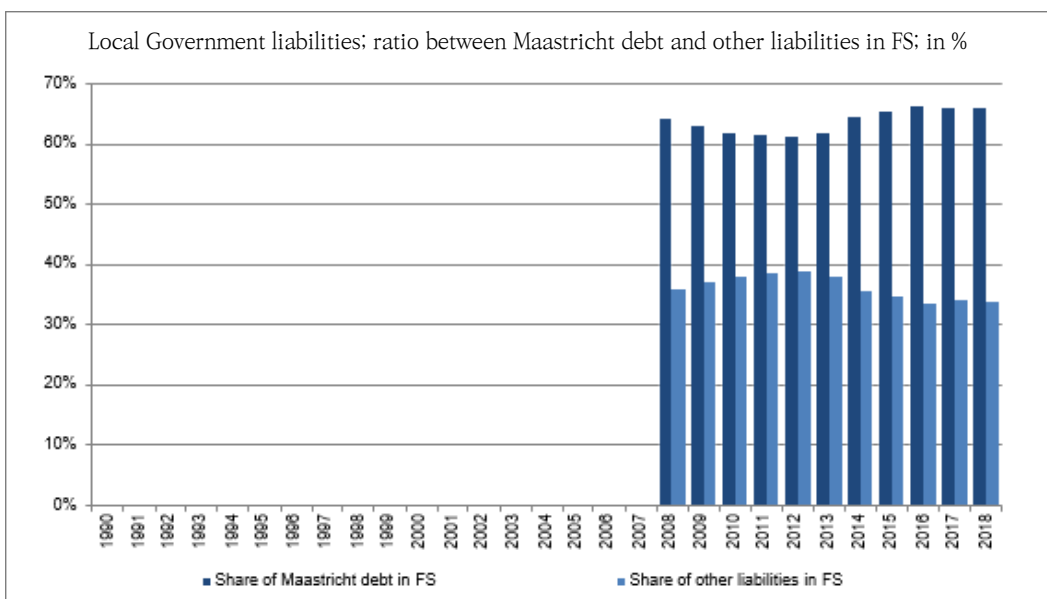


Source: EFV, 2021

Already from the start in 2008, the table shows a gap between Maastricht debt and FS liabilities implying – although not statistically validated – that municipalities probably already recognized other liabilities before that date. This would not be surprising given the earlier application of HRM 1 also at the local level (see chapter I).

The respective share between Maastricht debt and other liabilities in the FS model can only be made from 2008:

Table 16 Local Government liabilities share of Maastricht debt and other liabilities

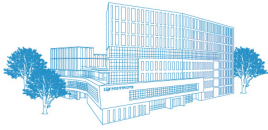


Source: EFV, 2021

For the period 2008 to 2018 the ratio between Maastricht debt and FS liabilities remained stable around 35–40 percent to 60–65 percent.

D. Conclusions for the General Government Sector

This analysis did not consider the fourth General Government Subsector, the Social Security Funds, as the corresponding liabilities are rather insignificant compared to the other subsectors. Furthermore, the share of Maastricht debt remained high over the period analyzed. This is because a social security scheme currently does not record provisions for future payments, e.g. beyond eligibility for the next benefit payment which is in line with current international accounting and statistical guidance such as IPSAS 42 Social Benefits and GFSM 2014 / ESA 2010. However, GFSM 2014 acknowledge that “...implicit



contingent liabilities, such as the net implicit obligations for future social security benefits (...), are important factors in fiscal risk and vulnerability analyses (GFSM 2014, 7.252).”

One of the main takeaways, the share of Maastricht debt and other FS liabilities today is similar for all the three government subsectors and amounts to around 60 percent for Maastricht debt and 40 percent for other liabilities according to the FS Model. The share of other liabilities seems to be increasing subsequent to an implementation of accrual accounting in a government unit as more liabilities find into the balance sheet. This is particularly observable on the federal level with IPSAS. On the cantonal and municipal level, the same is not directly observable as the timing of projects with the goal of enhancing accrual accounting was at different points in time for individual cantons or data is only available from 2008 in the case of municipalities.

Not covered in this analysis are the effects of the Covid-19 pandemic from 2020 as the data were not yet available at the time of compiling this report. However, it is to expect that the comprehensive measures taken to mitigate the negative impacts of the pandemic will have a significant effect on both Maastricht debt and other FS liabilities at the same time. Additional expenses needed a financing through newly issued debt securities and other measures without an immediate cash outflow such as guarantees lead to new provisions in the balance sheet. Therefore, such non-financial liabilities will probably continue to increase and are representative of medium to long-term risks for the government units.

5. Treatment of Provisions in GFSM 2014 and SNA 2008

As the previous analysis has shown, the treatment of provisions is a main difference between international accounting standards and international statistical guidance. GFSM 2014 and SNA 2008 state the following reasons for the exclusion of provisions from liabilities and thus, from recognizing in the balance sheet:

- Contingent liabilities (and following that also provisions) are conditional. In contrast,

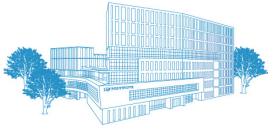
liabilities are unconditional (GFSM 2014, 3.45). One or more conditions must be fulfilled first before a liability can be recognized (GFSM 2014, 7.251).

- With the exception of standardized guarantee schemes, many guarantees are deemed not to be measurable, such as one-off guarantees (GFSM 2014, 7.256) or excluded from scope, such as deficit guarantees that do not involve three parties (GFSM 2014, 7.202).
- For the purpose of national accounts, each liability must have a corresponding (“symmetrical”) asset of equal value held by a counterparty (SNA 2008, 3.35).

Following above considerations, the impact of provisions will generally be recorded in the national accounts only at the time when the payment is due or guarantees are called. Instead, disclosure of the provisions as GFS memorandum items is encouraged, for example (maximum) exposures to explicit one-off guarantees and provisions for doubtful debts (GFSM 2014, Box A6.1).

From the viewpoint of the Swiss national FS Model, which recognizes the provisions, the following objections against exclusion can be raised:

- The past event leading to a provision is not conditional. For example, a contract leading to a guarantee is not conditional anymore as the relevant past event already happened. Rather, the uncertainty about future defaults of guaranteed loans needs to be reflected in the valuation of the guarantee and not whether to recognize or not. In the case of standardized guarantee schemes, GFSM 2014 already applies this kind of rationale. Uncertainty furthermore already exists in GFSM 2014 with recognized liabilities. For example, uncertainty about the potential size of liabilities (GFSM 2014, 7.252, footnote 72) or uncertainty about the valuation as a result of market prices (PSDS 2011, 4.5, footnote 3) do not make these liabilities contingent liabilities in terms of GFSM 2014.
- Public and private sector accounting use a range of measurement techniques for valuing liabilities, from relatively simple techniques such as historical data to more complex techniques by considering present market conditions. The approach adopted depends on the availability of information on the type of uncertainty.



Professional judgement is necessary in order to assess whether a liability is measurable or not. If reliable estimates by the accounting profession can be made, e.g. for decommissioning costs or pending legal claims, financial statistics should not deviate from this assessment. Otherwise, there is a risk of understating liabilities and the likely expenses or overstating related assets. Some statistical guidance acknowledge, “National accountants should not diverge from this estimate, as it is doubtful that they could themselves be in a better position to make reliable estimates of expected losses.” (MGDD 2019, 7.4.3.1.2/52).

- Concerning the requirement of symmetry, there are already cases in GFSM 2014 where debtor and creditor originally do not recognize the same value in their books. For example, debtors who are the beneficiaries of standardized guarantee schemes are unlikely to recognize a corresponding asset. As a result, the general government sector recognizing a liability imposes its view on the other sectors in national accounts. On the other hand, provisions exist in reality where the counterparty recognizes an asset and the requirement of symmetry would be met, such as in the case of withholding taxes. Corporations and to some extent households pay these taxes on interest income and dividend payments and they can be used to reduce taxable income in the future. Corporations recognize them as deferred tax assets. Government recognizes a payable for declared refunds and in addition a provision for expected refunds in the medium term.

There are furthermore severe limitations to the approach to disclose guarantees as memorandum items as it offers no information on the likelihood of the contingency occurring and may overstate the possible risk as acknowledged by GFSM 2014 (GFSM 2014, 7.255, footnote 74). For above reasons, the FS Model recognizes provisions in accordance with the relevant accounting standards HAM 2 and IPSAS.

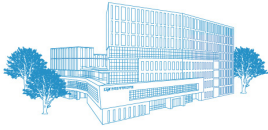
6. Conclusions

Chapter 4 described the evolution of Maastricht debt and FS liabilities in the General Government Sector in Switzerland. While the Maastricht debt remained stable or in some subsectors even decreased significantly, the FS liabilities in the same period increased in all subsectors. As the FS Model encompasses a wider set of significant risk-relevant liabilities, such as pension obligations, guarantees and environmental risks it more faithfully reflects the economic reality and the degree of fiscal risk to which the General Government Sector is exposed. The FS Model also aligns with the relevant national and international accounting standards HAM 2 and IPSAS.

As the implementation of accrual based accounting standards is evolving worldwide, the current liability definitions in international statistical guidance, in contrast, do not seem to capture the economic reality and the degree of fiscal risk exposure of the government to a full extent. This maintains the need for complementary statistical models suited to meeting such demands. However, the Swiss FS Model is limited to useful comparison between entities only nationally and there is at the same time a rising need for international comparability of accrual based information.

In many countries, governments define and report fiscal targets on a statistical basis. At the same time, fiscal policy increasingly bases on accrual information. Expenses in terms of recognized provisions become relevant for the budget and for the corresponding fiscal rules such as debt brakes or medium-term financial equalization. In other words, fiscal risks such as provisions become management-relevant, however, they must be simultaneously eliminated from statistical figures. This warrants the question, to what extent government finance statistics should be allowed to provide a more faithful depiction of the government financial position. If consistency with national accounts (SNA) is deemed to be the overriding principle, the recognition of provisions will remain a big hurdle in international financial statistics unless the SNA was revised accordingly.

Another important consideration is the feasibility of implementing new statistical rules. Accounting data is a substantial source for producing high-quality statistics. Recently,



various countries have started to digitalize the interface between accounting and statistics with the goal to reduce the capacity burden and making the data more reliable and free from human error. Useful tools such as multidimensional chart of accounts help to achieve this goal. Nevertheless, in case of different rules for accounting and statistics, available accrual information on recognized provisions and related expense line items need to be separately identified and eliminated only to be added later at the timing of cash outflow with no corresponding information in the accounting income statement at that later date. This again adds to unnecessary complexity, increases the workload in a significant way and reduces the benefits of digitalization accordingly. The same capacity issue also arises on the asset side where losses on financial instruments are not considered for the purpose of financial statistics at the time of impairment but rather at the time of derecognition of written-down assets. In this regard, the forward-looking expected loss model according to IPSAS 41 would be another opportunity to align with a more risk-relevant approach taking into account credit risks and to avoid a misrepresentation of the creditor's net assets what is in line with the key goals of GFSM 2014.

Above considerations are probably even more relevant when talking about a possible inclusion of public corporations (financial and/or non-financial) into a more comprehensive "public sector" statistics. GFSM 2014 states: "Public corporations are a potential source of fiscal risk to the extent that their liabilities could be explicitly or implicitly guaranteed by government, or may hold reputational risks for government." While GFSM 2014 acknowledges the significant role of public corporations in terms of fiscal risk of the government, the question remains, what exactly encompasses their risk-relevant liabilities? It probably goes beyond loans, debt securities and accounts payable constituting the "classic" debt servicing. Significant risks for government in terms of public corporations are in addition embedded in different provisions recognized in accordance with the relevant private sector accounting standard (e.g. IFRS) such as pension liabilities, environmental risks and legal disputes. In a more general sense, the capability of public corporations to absorb shocks and to maintain the business as a going concern and with that the degree of risk exposure of government – depends on the resilience of the balance sheet as a whole and the amount of net assets of the entity.

Non-financial liabilities such as provisions are therefore essential to take into account as they can critically reduce net assets of a public corporation. In line with this, the IMF states that “hidden liabilities” of public corporations create fiscal risks as they have an unexpected impact on the net financial position (Baum et al., 2020, page 9). It follows that the benefits of fully integrating public sector corporations in the overall fiscal framework to reduce fiscal risks can only crystallize when taking the full range of risk-relevant liabilities into account. Furthermore, the issue of capacity might prove to be even more onerous for statistical offices as a number of provisions and impairments for numerous corporations need to be identified separately and eliminated to align with the current statistical rules.

The use of consolidated financial statements for fiscal policy could be another way to present the total risk exposure and avoid exporting risks from Governmental reports to separate financial statements of state-owned enterprises.

Alignment between IPSAS and GFSM 2014 remains a very important task. Removing unnecessary differences from a conceptual perspective and from the viewpoint of capacity will benefit the statistical profession relying on high quality and audited accounting data and addresses stakeholders’ needs for clarity in terms of the boundary between accounting and statistical products. Consistent cross-country comparable data is key for international statistics and a consistent application of IPSAS can potentially serve as a suitable basis for the required data quality.



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