Paris, 27 February 2004

TASK FORCE ON HARMONIZATION OF PUBLIC SECTOR ACCOUNTING: SUMMARY OF CONCLUSIONS OF FEBRUARY 11, 2004 MEETING

28 participants attended the Task Force on Harmonisation of Public Sector Accounting's plenary meeting (OECD headquarters, room 6) on February 11, 2004. Were represented in the TFHPSA and Working Groups meetings:

- Countries: Australia, Austria, Belgium, Denmark, Czech Republic, France, Germany, Greece, Hungary, Japan, New Zealand, Sweden, United Kingdom, United States.
- International organisations: IMF, OECD, IFAC-PSC, European Central Bank, Eurostat

1) Strategy for the TFHPSA

Lucie Laliberté (IMF), Chairperson of the TFHPSA, emphasised the importance of countries being represented in the Task Force, along with international organisations. Absent countries will be encouraged to join.

She submitted a presentation to be shown the following week (16-20 February) in Washington DC at the meeting of Advisory Expert Group (AEG) of national accountants, in charge of selecting the issues to be discussed in the SNA review process. The purpose of this presentation is to clarify the role of the TFHPSA, its strategy (harmonisation of international accounting and statistical standards), its place among other working parties providing to the SNA review and the issues to be dealt with in the TFHPSA working groups (in particular 10 issues derived from the 5 priority topics).

2) Report of Working Group I (see Annex I for more details)

Betty Gruber (IMF) reported on the Working Group I meeting (6-7 February). WG I examined in detail Matrix 1, identifying the differences between IPSAS (from IFAC-PSC) and the GFS manual 2001 (IMF), as well as ESA95 (for the European countries).

Action was decided vis-à-vis:
- IFAC-PSC: to make recommendations that the PSC consider on 1. Sector reporting – explicitly allow introduction of the general government, 2. Performance reporting – develop a performance statement showing two columns: transactions and other economic flows, and 3. allow and encourage current value of assets and liabilities,
- TFHPSA Working Group II: to consider the requirements and current projects of the PSC when developing recommendations for the treatment of the following: Public sector definition, Control definition, payments between governments and public corporations, low interest and interest-free loans
- Canberra II group of national accountants: to consider the current requirements and developing projects of the IASB, and where relevant PSC, when dealing with Research and development, Intangible assets, Mineral exploration, Computer software, Defense weapons platforms, BOOT schemes, Subsoil assets, and
- Other Expert Groups: to consider the current and emerging PSC and IASB treatments when developing positions on non-performing loans (provisions), pensions, ownership transfer costs.

It was decided that Matrix 1 would be amended to reflect all TFHPSA meetings' discussions. The long-term goal is to align definitions and terminology between IPSAS and GFS. Future meetings of WG 1 will be undertaken on "as a need basis".

3) Report of Working Group II (see Annex II for more details)

Jean-Pierre Dupuis (OECD) reported on the Working Group II meeting (9-10 February). WG II examined 4 of the 5 priority issues (Provisions and contingent liabilities, including guarantees, Capital injections and dividends, Tax revenue and tax credits, Public / private sector delineation). Eurostat made a short point for information on the 5th issue (privatisation, restructuring agencies and securitisation) as well as on the recording of public-private partnerships (PPPs).

The discussion showed that:

- All 5 topics should be split into 2 or 3 issues and sometimes re-formulated (see below), some issues requiring longer examination and discussion

- Tax recording, and Delineation of public sector: on these issues, principles are quite firmly established, and some guidelines exist, even though implementation is problematic. An opportunity exists to reach convergence between national accounts, GFS and IPSAS (the PSC will commence the process of considering responses to the Invitation to Comment in the second half of 2004)

- Contingent liabilities (including guarantees) and funding of public corporations: these issues need more interpretation of our systems and sometimes conceptual changes. This may require more lengthy discussions.

Issues and tasks being identified, it was agreed on proposals from the Chair to set up working teams, and nominate team leaders, resulting in five teams and leaders:

Topics/issues	**Team leaders** and members
1. Government transactions with public corporations 1.1 Earnings (reinvested earnings, dividends) 1.2 Funding (dividends and capital injections)	**P. de Rougemont,** J. Golland, A. Braakmann, B. Robinson, T. McCarron, T. Dobbs, L. Rivas, I. Argyris, V. Gidaris, G. Meskos
2. Privatisation / restructuring agencies and SPVs 4.1 Privatisation 4.2 Agencies, bad banks and other special purpose vehicles (SPVs) 4.3 Securitisation	**D. Besnard/JP. Dupuis**, R. Mink, G. Csonka, B. Robinson, B. Baker, J. Libens, A. Kester, K. Wilson, P. O'Hagan, J. Magniez
3. Tax revenue 3.1 Tax revenue and accrual recording 3.2 Tax credits	**J-P. Dupuis**, C. Heady, M. Rasmussen, I.Carruthers, W. Stübler, B. Robinson, K. Lundquist, T. McCarron, A. Braakmann, B.Kaufmann, M. Roy, B. Cowan, F. Campi
4. Private / public / government sector delineation 2.1 Public vs private: the definition of control (including BOOT schemes) 2.2 Government vs other public sector: the market / non market criterion	**B. Gruber**, G. Jenkinson, A. Kester, G. Csonka, L. Vebrova, K. Warren, I. Carruthers, Y. Fujishiro, R. Hemming
5. Contingent assets / guarantees / provisions / constructive obligations 5.1 Guarantees and loan partitioning	**J. Golland**, P. Harper, R. Mink, B. Kilpatrick, B. Kaufmann, K. Lundquist, S. Leith, Y. Fujishiro, I. Argyris, V. Gidaris, G. Meskos

It was agreed that IFAC-PSC would focus on any projects emerging from the recommendations of Working Group 1 and would provide input to the other teams on decisions made by the IFAC-PSC at meetings during 2004 and beyond which may be relevant for their project.

The electronic discussion group (EDG) will be organised accordingly. Each team leader will endeavour to update one unique central paper for each issue, submitted to the team members. Secondary papers and contributions will be also available on the EDG, in the relevant group of issues.

In addition to the five groups of topics, WG II keeps on looking at other issues relevant for the government. This includes, for instance, reviewing the Canberra II group proposals for recording BOOT schemes and PPPs.

Time table:

All teams must produce a paper by June 2004 (at the latest), to be circulated in the TFHPSA, before discussion in the next WG II meeting and TFHPSA (in Washington DC, hosted by the IMF). ***Development after the February 11 meeting*****:** ***while the date of October 4-6 had been suggested for the next meeting, it would need to be advanced for in September given the Annual Meetings in Washington and the need for the AEG to have the paper 2 months in advance).***

Having in mind the timetable of AEG and ISWGNA, the following horizon for reporting to these groups has been agreed on:

- November 2004: . Tax revenue and tax credit (first version)
  . Privatisation and SPVs
  . Earnings and funding of public corporations

- November 2005: . Tax revenue and tax credit (second version)
  . Delineation of public sector
  . Contingent assets and guarantees

Each paper presented to these groups should comprise in annex a first draft of SNA paragraphs (for SNA corpus or appendix). The Strategy paper will be updated by the Chair for the next meeting.

It was agreed that if possible a flow chart, or schematic outline, identifying the relationship between each of the groups providing input to the 2008 SNA review would be prepared and circulated.

ANNEX 1**: Working Group I: Report on the February 6-7, 2004 meeting**

Background

- A Steering Committee Meeting of the Task Force on the Harmonization of Public Sector Accounting (TFHPSA) was held on October 3, 2003 in Paris (following a preliminary meeting between PSC, IMF and others in June 2003 in Washington). Attendees were representatives of:
  - IFAC PSC (Public sector Committee)
  - IMF
  - OECD
  - Eurostat
  - ECB
  - Australia
  - United Kingdom

- The meeting commenced consideration of a matrix that had been prepared identifying differences between the IFAC PSC's IPSASs and the IMF's *Government Finance Statistics Manual 2001* (*GFSM 2001*).

- Between October 2003 and February 2004:
  - Further work has been undertaken on the matrix with the differences being grouped into 10 broad categories and possible convergence processes being identified for each difference. For example, recommendations for action by the PSC or IMF, referral to other Groups (ISWGNA, OECD, Canberra II Group, and IASB), and clarification of existing standards on some issues.
  - Electronic consultation with participants at the October meeting has been undertaken throughout.

- At the February 2004 meeting, Working Group I reviewed the matrix with a line by line discussion of each difference and suggested convergence process. Generally, the suggested action was accepted by the meeting. For some differences further elaboration is required.

- The IMF and the PSC acknowledge the principle that as far as is possible, they should work jointly towards convergence.

Outcomes

The main outcomes of the February 2004 meeting are as follows:

- Reporting entity/sector reporting

  The PSC will be asked to consider explicitly allowing the disclosure of financial information for the general government sector (GGS), as defined in the *GFSM 2001*, in whole of government general purpose financial statements, and specifying rules where a government elects to make such disclosures. For example, the PSC could consider requiring "Investment in controlled entities in other sectors" to be disclosed and measured at the government's proportional interest in the net assets of the other sectors – a form of the equity method of accounting. To the extent that the net assets of the other sectors is accepted by GFS as the market value of those other sectors, that would enable GGS stand-alone financial information to be extracted from the fully-consolidated general purpose financial statements, thereby facilitating substantial progress towards convergence.

The Working Group recommends that the IPSASs encourage disclosures of GGS information and acknowledge that other sectors may also be disclosed in a manner similar to the GGS information.

Consistent with the objective of enabling GGS stand-alone financial information to be extracted from the fully-consolidated general purpose financial statements, the PSC will also need to consider which GAAP/GFS principles and presentation are to be followed and the GFS/GGS prominence including GFS aggregates.

- Performance reporting

  The Group noted that the IPSAS and GFS frameworks are very similar.

  For convergence, one way forward would be for PSC to require comprehensive reporting of financial performance that splits the comprehensive result into two components that aligns as far as possible with the GFS split between transactions and other economic flows.

  The Working Group recommends that the PSC action such a project. The Working Group did not think that it is necessary for the PSC to await the outcome of the IASB Reporting Comprehensive Income Project before developing/amending an IPSAS on financial performance. Developing public sector specific performance reporting requirements would not conflict with the PSC's policy of aligning IPSASs with IASB standards unless there are public sector specific reasons not to. That PSC policy was supported by the Working Group.

- Current value of assets and liabilities

  The PSC will be asked to consider allowing and/or requiring current value in the IPSASs. This would entail adopting IAS 39 (possibly indirectly but explicitly through the PSC hierarchy), which provides options that are expected to facilitate convergence with GFS treatments of financial instruments. The PSC will also be asked to consider:
  - removing the historical cost option from certain standards (for example, property, plant, and equipment); and
  - requiring current replacement cost for inventories when all other assets and liabilities are measured at fair value.

- Other differences

  These will be the subject of convergence or reconciliation. It is expected that reconciliation will be required for:
  - Fundamental differences arising from differences between GAAP and GFS principles (for example, ownership relations, emphasis on time series, and counterparty symmetry)
  - In the interim, differences that are the subject of convergence work.

  The Working Group feels that it would be premature at this stage to develop a reconciliation statement.

- Differences that are the subject of other Groups

  The Working Group will not undertake any further work on differences that are currently under consideration by other Groups. Instead it will monitor developments in those Groups. The

Working Group encourages these other Groups to work as closely as possible together to avoid duplication and overlaps. Examples of other Groups are:

- ISWGNA (research and development, intangibles, pensions, and nonperforming loans)
- OECD Canberra II Group (military assets, intangibles, research and development, leases and licences, definition of economic assets, classification of assets and terminology, cultivated assets, mineral exploration, obsolescence/depreciation, and BOOT schemes, costs of ownership transfer)
- Working Group II of the TFHPSA (distributions to owners, capital injections, and reinvested earnings; privatization and restructuring agencies; public/private sector delineations; tax revenue, uncollectible taxes, and tax credits; and provisions, contingent assets, and constructive obligations)
- IFAC PSC (impairment of assets, non-exchange revenue, and social policy obligations)
- IASB (research and development, extractive industries, and leases)

Future directions

- Matrix I is to be amended to reflect the Working Group discussion and outcomes. It will be provided to the PSC at its March 2004 meeting as a foundation document along with recommendations for consideration

- Some differences will be referred to TFHPSA and subsequently to the ISWGNA and other relevant Groups

- The Working Group will monitor the work being undertaken by other groups

- In the longer term, the Working Group will work towards aligning, to the extent possible, definitions and terminology. For example, differences exist for revenue, expense, assets (e.g., control versus ownership) and liabilities. In addition, it will look to limit differences emerging in the future.

Annex II**: Working Group II: Topics/Issues: terms of reference**

1. Transactions between government and public corporations

1.1 Recording of earnings

The income of general government from its investment in public corporations is recorded through dividend except for non resident public corporation. The timing of dividends does not necessarily correspond to the occurrence of profit in public corporations. Conversely, this entails that the deficit of public corporations does not show in government accounts when they occur. The accumulation of such losses is financed through *ad-hoc* capital injections. Dividend and capital injection, though recorded respectively as revenue and expense, are net worth neutral and as such doe not meet the revenue/expense criteria. Further, as dividends and capital injections do not correspond to the timing of the underlying activity, they provide an inexact measure of government activities, and may lead to a certain level of arbitrariness in the time of recording.

Current treatment

The above treatment is not consistent with that of foreign direct investment (FDI) where the profit/loss of foreign subsidiaries is recorded as it occurs (1993 SNA and BPM5). A FDI relationship is established with an ownership that gives a say/influence in the management of an entity in another country (a conventional 10% threshold ownership is used). The amount of profit/loss not distributed in the form of dividends is recorded as reinvested earning (D.43), that is an additional financial investment. The rationale for such treatment is that "the decision to retain some of its earnings within the enterprise must represent a conscious deliberate investment decision of the part of the foreign direct investors" (SNA 1993, 7.121).

Possible changes

- Should the direct investment treatment of accruing earnings be extended to public corporations?
- What ownership thresholds would be most appropriate?

1.2 Funding (dividend, capital, financing)

The current treatment of income in the form of dividend makes it difficult to classify various transactions between general government and public corporations. Public corporations frequently pay lump sums to government, exceeding their operating profits for the year in question (sometimes referred as superdividends). Conversely, they can receive capital injections in cash or in kind (including via debt assumption/cancellation) with no expectation of future profits. In the absence of full accrual of profits, what should be the criteria for classifying these transactions as financial or non-financial? While dividends may be viewed as revenues if they represent past operating profits, the timing of recording such income is an issue; this is exacerbated when dividends also include capital gains/losses. As for capital injections, they should be expensed to the extent that they represent past or future losses, but as financial investment otherwise.

Current treatment

The *1993 SNA* records funding provided by shareholder to cover past losses accumulated for two years or more as capital transfer (expense) (*1993 SNA* 10.141). However, it is unclear what the recording is when the shareholder receives a claim, such as an equity stake in exchange. Payments made to cover deficits over less than two years are subsidies on products, that is are expensed (*1993 SNA* 7.78). In the case of quasi corporations, the *1993 SNA* excludes from government income large payments in excess of current year's profit.

The *ESA 1995 manual on government deficit and debt* as well as the *GFSM 2001* provide the following guidelines: dividends should not substantially exceed the income of the year, the remainder being retreated as financial transactions. As for capital injections, they are (generally) booked as non-financial transactions, even if a claim is provided in exchange. Debt cancellation and assumption (except for three cases, including discontinued units) are also expensed in ESA 95. However, GFSM 2001 does not expensed systematically all debt assumption.

Possible interpretation

a. Should the dividend/capital injections treatment of corporations be extended to quasi corporations? Should dividends be conventionally limited to the income of the period?

b. Should funding conventionally be expensed even when a claim is received?

2. Privatisation, restructuring agencies and SPVs

2.1 **Privatisation**

The government gives up control on corporations, financial or non-financial, in different ways:
- Direct privatisation: the Ministry of Finance disposes of its stake in a public corporation directly on the market
- Indirect privatisation: an entity (public holding, public agency), managing government shares and other equity, sells the shares and gives all or part of the proceeds to the government.

Other arrangements may be more complicated: the intermediate entity may securitise the shares, and make a prepayment to the government.

Current treatment in *SNA93*

No recommendations are made in *SNA93* for the recording of privatisation. Some are in *GFSM 2001*, and *ESA95* (Manual on Government deficit and debt). A general orientation should be that any flow (usually of cash) to the government resulting from privatisation is a financial transaction: this flow should not be viewed as an income / revenue flow, but as proceeds from the sale of financial assets. This would apply to both direct privatisation and indirect privatisation. What is basically involved in privatisation is a reshuffling of assets in the balance sheet of the government (usually F.2 against F.5).

Other arrangements (securitisation etc.) may need further elaboration, but in the same global framework: a reshuffling of assets in the balance sheet of government, and recording of the flow to government as a financial transaction.

NB: note that, if the *direct* sale of a *non-financial* asset has an impact on the capital account and therefore on the net borrowing / net lending of the general government, an *indirect* sale of *non-financial* asset has the same neutral effect on the net borrowing / net lending of the general government as in the case of indirect sale of financial assets.

Possible clarification

- Should the treatment of privatisation in the rev *SNA* be clarified?

4.2 **Restructuring agencies, bad banks and Special Purpose Vehicles (SPV)**

Government creates specialized agencies that apparently meet the institutional unit criteria, in order to manage the portfolio of financial assets, government real estates, impaired assets purchased in support of distressed banks (creation of bad banks), or in the context of securitization (Special Purpose Vehicle, which are borrowing entities). The generic issue is whether those entities are institutional units, their sectorisation and their activities. Are they financial intermediaries or are they government?

Current treatment

Financial institutions are entities that borrow on the market to acquire assets, and in the process carry out financial transformation. Quite separately, government units engage in redistribution of wealth or in the provision of non-market products. The SNA defines auxiliary units as entities that formally meet the institutional unit criteria. The 1993 SNA defines government.

Clarifications

- Should the financial intermediation / government delineation be clarified? How to apply the market non-market criteria for bad banks?

- Should the application of ancillary units treatment be extended?

3. Tax revenue

Under this heading there are three issues, all for clarification of the SNA (and convergence with IPSAS):

Issue 1**:** clarify the **definition of taxes** in the SNA

Current treatment: the SNA definition of tax is a compulsory, unrequited payment to government. The terms "nothing in return" are used. This definition is broadly consistent with GFSM 2001 and with IFAC-PSC. However, clarification may be needed on borderline cases.

Possible clarification: There is no need of major change in the SNA Should the wording "nothing in return" be modified alongside the idea that "nothing is obtained *directly* in *exchange*"?

Issue 2: **Accrual recording** of taxes: clarify the time of recording and the amount to be recorded

Current treatment : *Time of recording***:** all three guidelines (SNA, GFSM, ESA) agree on the general principle "when the taxable event occurs". However, they also all agree in giving some flexibility for income tax. This flexibility may be interpreted differently. *Amount to be recorded*: all converge on the fact that the amounts are those due but excluding tax not expected to be collected. The exact passage between amounts due and expected to be collected differs between the systems (see IPSAS guidelines on the tax gap issue).

Possible solutions: There is no need of major change in the SNA**.** Should the recommendation to record the tax when the taxable event occurs be reinforced, leaving however still room for flexibility? Should the way amounts not expected to be collected be harmonized? There are three options proposed by the new ESA (assessed amounts adjusted by a coefficient, time adjusted cash, capital transfer). Should they be limited to the first two?

Issue 3: **Tax credits**: there are no guidelines on tax credits in the SNA. Guidelines would be useful

Other guidelines: GFSM and OECD revenue statistics converge on the recommendation that the tax credit is to be deduced from the tax value, but that any amount exceeding the tax liability and paid by general government should be classified as expenditure. The IFAC-PSC tries to distinguish more "tax expenditures" and "expenses paid through the tax system" which should be expensed.

Possible solution: Should the principle stated by GFSM and OECD Revenue statistics be adopted in the SNA? Should this principle be augmented by a definition of what is a tax credit? Does the recording of personal tax credits raise specific questions, compared to corporate tax credits?

4. Public/Private Sector Delineation

The definition of the public sector and the rules for identifying and classifying units to the public sector and its sub-sectors (general government sector and public corporations) are essential to the compilation of government finance statistics. Establishing which related governmental entities are to be included in the public sector is problematical. This requires determining who controls each entity. Once public sector entities have been identified it is necessary to classify them as either engaging in market or non-market production.

In addition, there is a range of units for which there is little or no guidance in the *1993 SNA*, for example, special purpose vehicles, joint ventures, and corporations jointly controlled by several government units or public corporations. Consideration, clarification, and elaboration of the definitions of the public sector, inclusive of control, and economically significant prices and more specific guidance on classification of units would be useful.

Current treatment

The public sector consists of the general government sector plus resident government-controlled entities, known as public corporations, whose activity is to engage in market activities. The general government sector consists of all resident government units and all non-market nonprofit institutions that are controlled and mainly financed by government units. Prices are said to be economically significant when they have a significant influence on the amounts the producers are willing to supply and on the amounts purchasers wish to buy.

Possible changes:

- Should there be more convergence (which seems feasible) in the definition of control between the statistical guidelines and the International Public Sector Accounting Standards?

- Should the SNA provide clarification and elaboration of the definition of economically significant prices?
- Should the SNA provide more specific guidance on the classification of units? (see issues 4.2 on privatization)

5. Contingent assets and guarantees

Guarantees provided by governments may sometimes have a substantial market value (that is if they are likely to be called). It is a concern that government may carry out substantial subsidizing schemes that would remain unaccounted for until settlement. To the extent that guarantees are likely to be called, one issue is the time of recording. Should they be accounted for (expensed) at the time the guarantees are provided (in the form perhaps of an insurance service or of a derivative) or only when called. It should be noted that guarantees are one form of contingent assets and that contingent assets are not recognized in the balance sheet.

Current treatment

The *1993 SNA* does not generally recognize contingent assets and liabilities, including guarantees. At the time the guarantees are called, *SNA 93* records a capital transfer (*GFSM 2001* could at times record a financial transaction for called guarantees on credit of public corporation).

Possible changes

- Should guarantees be expensed before time of call? Should it be at time of grant or spread over the lifetime of the guarantee?

- Should the treatment follow a financial derivative treatment or come closer to insurance?