I. INTRODUCTION

1. As part of the framework to update macroeconomic statistical guidelines, an international Task Force on Harmonization of Public Sector Accounting (TFHPSA) has been created to promote harmonization between international accounting and statistical standards in the area of public sector. The TFHPSA (chaired by the IMF, OECD Secretariat) has been recognized by the Inter-Secretariat Working Group on National Accounts (ISWGNA) as the forum to provide guidance in the area of public sector statistics for the ongoing revision of the 1993 System of National Accounts (1993 SNA).

2. The scope of the TFHPSA is the public sector and its mandate is to:
   - Identify differences that exist between the various accounting and statistical standards in the treatment of economic events, and the recording of assets and liabilities;
   - Identify areas where harmonization between these various standards is considered feasible and desirable, and to take action to effect the necessary amendments;
   - Identify areas where harmonization between these various standards is not considered feasible or desirable, and to develop reconciliation statements, as needed; and
   - Make recommendations to the ISWGNA, for amending the 1993 SNA, in the area of public sector statistics.

3. The inaugural meeting of the Task Force is scheduled for February 11, 2004. Participants will comprise senior statisticians and senior accounting policy officials of interested countries and international organizations. A preparatory meeting of the TFHPSA Steering Group\(^1\) took place at OECD Headquarters on 3 October 2003, to determine the scope and organization of the work to be undertaken by the TFHPSA. In particular, the meeting established two Working Groups:

   - **Working Group I**, chaired by the IFAC-PSC, to focus on harmonization issues between the IMF’s Government Finance Statistics Manual 2001 (GFSM 2001) and International Public Sector Accounting Standards (IPSAS). The goal is to identify and document differences and classify them according to the processes envisaged for harmonization. These processes include: clarification; action by the PSC and the IMF; action by the ISWGNA and the IASB (see below section III of this note).

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\(^1\) The Steering Group of the Task Force comprised representatives of the IMF, the OECD, the International Federation of Accountants—Public Sector Committee (IFAC-PSC), Eurostat, the European Central Bank (ECB), Australia and the United Kingdom.
• **Working Group II**, chaired by the OECD, to focus on harmonization issues between *GFSM 2001* and *1993 SNA/ESA 1995* (*European System of National Accounts 1995*). In particular, the Working Group II will examine a GFS list of issues and make recommendations for clarification, interpretation or change to the *1993 SNA* (see below section II of this note).

4. The two Working Groups will meet in February 2004 ahead of the TFHPSA meeting. The TFHPSA will ensure close coordination of the two Working Groups: issues identified by each Working Group as relevant to the other Working Group (or other fora) will be referred to the TFHPSA for further action as required.

II. **WORKING GROUP II: GFS LIST OF ISSUES FOR THE SNA UPDATE**

A. **Working Group II Activities**

5. During its October 3, 2003 meeting, the Steering Group of TFHPSA assigned Working Group II the main task of advising it in the context of the SNA review and agreed to:

   I. Address a first list of five priority issues, to be discussed on its first meeting on February 9-10, 2004:
      
      1. Super-dividends, capital injections, and reinvested earnings;
      2. Privatizations and restructuring agencies, and securitization;
      3. Contingent assets (state guarantees), constructive obligations, and provisions;
      4. Public-private sectors delineation; and
      5. Tax revenue, uncollectible taxes, tax credits.

   II. Keep abreast of on-going work in other fora on GFS-related topics (military expenditure; leasing, concessions and similar arrangements—Public Private Partnerships--; natural resources exploitation; pensions; etc.); and

   III. Tackle new issues as needed, in particular when raised by a TFHPSA participant.

6. The above issues illustrate the usefulness of including in the *SNA* a specific chapter on the general government and the public sector, similar to the existing chapter on the Rest of the World in the *1993 SNA*. Such an addition will culminate the efforts already achieved through the *GFSM 2001* to keep fiscal statistics in harmony with developments in the System of National Accounts. The *GFSM 2001* has already attracted interest from economists, as well as from accountants (see GFS-IPSAS convergence project of Working Group I of the TFHPSA). Eurostat has produced a large and growing volume of jurisprudence on *ESA 1995* fiscal data.

7. A public sector chapter of the SNA will: (1) present the enhanced *GFSM 2001* framework: revenue, expense, net operating balance, net transactions in nonfinancial assets, financing, revaluations, other changes in volume, stocks of assets and liabilities; (2) show the links with SNA categories; (3) spell out analytically useful subcategories and groupings; and (4) expand on some GFS specific issues (e.g. sector classification, categorization,
consolidation). This may imply adapting the GFSM for the minor expected revisions. The TFHPSA will supply the ISWGNA AEG with background material and drafts as required.

B. List of Priority Issues

Item 1: Super-dividends, capital injections, and reinvested earnings

8. These issues relate to the relationship between public corporations and governments, and more generally between corporations (and quasi-corporations) and their controlling shareholders whether or not they are government [i.e. the income—revaluation boundary]. Public corporations frequently pay lump sums to government, exceeding their operating profits for the year in question (superdividends). In contrast, they can receive capital injections in cash or in kind (including via debt assumption/cancellation) with no expectation of future profits. What should be the criteria for classifying these transactions as financial or non-financial? The ESA 1995 manual on government deficit and debt as well as the GFSM 2001 provide some useful guidelines. Some of the elements that need to be discussed are:

- Should distributions of superdividends or lump sum payments be classified as financial transactions? Otherwise governments would be able to manipulate the timing of their revenues, irrespective of the time of the underlying event (the profit accrued);
- Should capital injections (generally) be booked as non-financial transactions (even though they are always net worth neutral for the corporation in question and also for government)? Prudence suggests that these transactions should be expensed because they cover past or future losses of public corporations, which have failed to be (or will not be) accrued as expenses (subsidies) in the books of government;
- One approach - more systematic - would be to accrue the profits and losses of all public corporations in the books of governments, hence extending to public corporations the “reinvested earnings” (D.43) treatment currently applicable in the 1993 SNA to foreign direct investment (SNA 7.119-7.122). The changes in government net worth resulting from public corporations profits and losses that currently flow via the revaluation accounts would flow via the income accounts. This corresponds to the treatment used by accountants when applying the equity method of consolidation. The same would apply to quasi-corporations; and
- The recording of dividends as nonfinancial transactions in the 1993 SNA/GFSM 2001 leads to anomalous revaluation entries at time of dividend distribution. It also risks underestimation of income in the national accounts when buybacks substitute for dividends.

Although consideration is being given as to whether the current treatment of reinvested earnings on foreign direct investment should be retained.
**Item 2: Privatizations and restructuring agencies, and securitization**

9. These issues relate to **privatization agencies/ Restructuring agencies/ securitization** [i.e. the government—financial intermediation boundary]. The sectorization of the following entities requires discussion:

- *Ad hoc* structures specialized in managing portfolios of assets or debts;
- Privatization agencies established to manage portfolios of assets (financial or nonfinancial) to be disposed of;
- Restructuring agencies (sometimes called “bad banks”) that acquire non-performing loans or other impaired assets from banks (public or private) in distress at above the market price, allowing the latter to exhibit a satisfactory solvency ratio (Cooke ratio\(^3\)); and
- Special purpose vehicles (SPV) created by governments, possibly registered abroad, which borrow on the market and acquire so called “assets” from governments, such as flows of future revenue (tax).

Are such entities financial intermediaries, government units, or simply ancillary units? Another issue is the recording of their transactions with government, such as the passing of privatization proceeds or of realized losses (see item 1 above).

**Item 3: Contingent assets (state guarantees), constructive obligations, and provisions**

10. These issues relate to **contingent assets, liability provisions and constructive obligations** [economic asset boundary]. The economic asset boundary may be relaxed slightly to accommodate contracts which have a market value or which could be transferable.

- Governments sometimes provide guarantees that are likely to be called and, accordingly have a substantial market value at the time of creation;
- Business accounting recognizes as liabilities, obligations that, whilst not legally enforceable, are nevertheless expected to result in outflows: constructive obligations and provisions (other than on assets). For example, pension obligations may well be *de facto* constructive obligations, but this alone should not necessarily prevent expensing them; and
- The *1993 SNA* does not recognize provisions (except consumption of fixed capital) because they are not interactions between units, but instead are seen as events internal to a unit. Provisions attached to economic assets of the balance sheet could be conceived as a valuation issue. But recognition of other provisions as liabilities would require finding counterpart holders of the assets—which may be more difficult.

Could not the notion of “past events” for defining liabilities in business accounting be also incorporated in the SNA?

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\(^3\) The Cooke ratio for banks is the equity position as a percentage of risk-weighted assets (Basel accords).
Item 4: Public-private sectors delineation

11. These issues relate to public sector and general government sectorization boundaries, especially the notion of control and market/non-market criteria.

- The control criterion is essential to business accounting, as it defines the boundary for consolidation. In 1993 SNA, the notion of control, which defines the public sector boundary, is more elusively defined. Weak areas refer to special purpose vehicles (SPV), notably created in the context of Public Private Partnerships (PPP) or securitization. Another difficulty relates to how “control” is determined (including the link with the “financed” concept): for example, the sectorization of government-financed universities as units of government, non-profit institutions servicing households or market producers?

- Another issue relates to the market versus non-market criteria. The notion of “economically significant price” is perceived by some as vague. Some tend to equate the government/public corporation to their legal status (is it an incorporated entity)? The ESA 1995 has established a rigid rule of 50% of costs to be covered by sales. Is a rigid rule useful? Is 50% high enough? What should be included as costs (ESA 1995 excludes interest)? What is the criterion for sale recognition: when is a payment by government a transfer or a purchase of service (the case of hospitals or schools)?

- Another issue is the link between the market/nonmarket boundary and the commercial/noncommercial boundary (quasi-fiscal operations); and

- The general government boundary defined by statisticians may be used by accountants.

Item 5: Tax revenue, uncollectible taxes, tax credits

12. These issues relate to the recording of taxes (tax credits, valuation of taxes, time of recording).

- Tax credits. OECD Government Revenue statistics and GFSM 2001 are in agreement to treat a tax credit as expense (instead of being deducted from revenue) only for amounts that are actually paid by tax authorities to the tax payer. However, due to technological developments, some governments increasingly apply automatic deductions from tax payer’s bills (netting tax credits from the tax payer’s obligations), actions tantamount to benefits. The source data may not allow separate recording of expenses, reducing international comparability. What would be the criteria and mechanisms for expensing tax credits? Tax allowances are also close substitutes for tax credits;

- Valuation of taxes. Taxes not expected to be paid should not be allowed to improve the government’s operational results. An estimated uncollectible amount based on experience (e.g., using a “ratio” technique based on coefficients of collection observed ex post) should be deducted from the gross amount under the accrual principle (“net recording”). An alternative method allowed by Eurostat, with identical impact on the deficit, consists of recording that same amount (or the difference between accrued taxes and taxes actually collected) as a capital transfer (“gross recording”). Accountants record provisions, as a matter of prudence, against tax revenues. The 1993 SNA is imprecise as to the treatment of the uncollectible amount. The ESA 1995 was amended, by way of legal act, to derecognize the uncollectible amount but allowing the gross recording (capital transfer) option. GFSM 2001 is more prescriptive than the 1993 SNA and
precludes the capital transfer option. One issue is whether this uncollectible amount should be deducted from revenue (GFSM 2001 preference) or should the option to show an expense also be recommended, as in the amended ESA 1995. A second issue is whether all unpaid taxes should be treated just like uncollectible taxes or whether some unpaid taxes could transit via the other change in volume accounts. A third issue is the method of valuation, including the recording of a tax item actually paid but well after the period of income; and

- **Time of recording.** The accrual principle calls for recording taxes when the obligation to pay arises, which can be interpreted as when the economic event or activity takes place. The issue is not controversial for taxes on production. For taxes on income and wealth the issue is open to debate. Some argue that the time of the assessment is preferable for households as it would be this moment that affects their behavior. Regarding taxes on corporations, should one also envisage negative taxes: for quarterly data or for taking account of “carry forwards”? Another issue is the criteria and recommendations, for accruing a tax (paid once a year) over the period instead of booking it at one point in time.

C. **Other Issues of GFS Interest**

13. There is substantial interest concerning the recording of property income on indexed instruments.\(^4\) **Property income on indexed instruments [income—revaluation boundary].** The current situation, where changes in principal are recorded as interest (D.41), creates an asymmetrical treatment between foreign exchange indexed bonds and foreign currency denominated bonds. In addition:

- The treatment of debt indexed to other volatile prices also seems to be a problem, with negative interest recording and a questionable revaluation—income boundary; and

- From a wider perspective, the fiscal accounts are sensitive to the currency in which governments borrow (domestic versus foreign currencies), while by arbitrage the real cost of those debts would be close or the same. This may warrant revisiting the current treatment of foreign currency bonds. It also relates to the more general question as to whether property income should capture real or nominal interest flows. This issue is especially important for governments because of their policy focus on a headline transaction balance. In this context, the SNA provides an accounting disincentive for many governments to borrow in local currency.

14. While other issues are of interest for GFS, with potential impact on the SNA Review, some are not a priority in the short run. The TFHPSA will keep abreast of the other GFS-related topics that the ISWGNA has already sponsored in separate fora. Groups that have been closed covered interest accrual (on fixed coupon instruments) and inflation accounting. Work continues on: military expenditure (capitalizing military equipment purchases and

\(^4\) Also of interest to balance of payments
expensing consumption of fixed capital); leasing, concessions and similar arrangements, such as Public-Private-Partnerships, buy-operate-transfer (BOT) schemes, mobile phone licenses, etc.; mineral exploration expenditures and subsoil assets (question of the sale of exploitation licenses); social protection (especially employer insurance (pension) schemes, as well as social security and social assistance); bad loans; and public debt definitions, valuation and recording.

15. Other related areas that may be clarified in a revised SNA could be: clarification of the definition of “government unit”, consolidation, revisions, the recording of equity liabilities (including “tracking shares” that are shares that pay dividends based on earnings on the operations of part of a corporation—GFS application: privatization vouchers) and mutual funds and defined contribution schemes. The priority of these topics could be considered by the TFHPSA as the work on the SNA review proceeds.

III. WORKING GROUP I: HARMONIZATION OF IPSASs, GFSM 2001, AND ESA 1995

16. Working Group I of the TFHPSA will meet on February 6-7, 2004 to consider a list of current differences between the International Public Sector Accounting Standards (IPSASs) and the GFSM 2001 and the ESA 1995 and to propose a possible process by which these differences could be addressed.

17. The differences have been identified and presented by category in a matrix (“Matrix 1”). The sequence of the categories broadly reflects the decision process adopted in developing financial reports for an entity. First the boundary of the entity is identified (category 1), then decisions are made about definition (categories 2, 3, and 4), recognition (category 5), and measurement (category 6). Finally financial statements are prepared (categories 7 and 8). These categories are described more fully below:

1. The scope of the entity and sector reporting:
   This category relates to the boundary of the entity that is the focus of each framework and the consequences for consolidations/accounting for controlled entities and disclosures about sectors. The reporting entities of the GFSM 2001 framework are general government and other public sector entities. The IPSASs’ reporting entity is the public sector; they do not recognize the general government sector as a reporting entity.

2. Ownership relationships:
   This category relates to how each framework treats the relationship between a reporting entity and its owners and how ownership interests are measured.

3. Financial instruments:
   This category relates to how each framework treats financial instruments.

4. Recognition of assets versus expenses:
   This category relates to the capitalisation policies adopted under each framework.

5. Recognition versus non-recognition by a counterparty/symmetry:
   This category relates to the time of recognition of assets and liabilities and the time of recording by both counterparties to a transaction under each framework.
6. **Measurement of assets and liabilities**:  
This category relates to the measurement bases adopted under each framework.

7. **Time series**:  
This category relates to how each framework treats the current reporting period relative to prior reporting periods, and therefore the time periods in which items are recognised (that is, the reporting periods to which items are attributed).

8. **Financial statements, with an emphasis on performance reporting (for the reporting entity and/or sectors thereof)**:  
This category relates to the form and content of the financial statements published under each framework and what conceptual similarities can be identified between the frameworks. This category also includes consideration of shifting segment reporting to functional reporting according to COFOG.

18. **Matrix 1** includes a proposed tentative “convergence process” for each issue within each broad category. The processes are described as:

1. Clarification by IMF of GFS;
2. Clarification by PSC of IPSASs;
3. Action by IMF to amend GFS;
4. Action by PSC to amend IPSASs;
5. Action by ISWGNA to amend SNA;
6. Action by IASB to amend IASs/IFRSs;
7. Retain the difference, possibly to be disclosed as a reconciling item;
8. No further action required; or
9. Further action required to identify the extent of any difference between GFS and IPSASs before a convergence process can be identified.

19. As the project progresses, it may be possible to design a strategy for not only reducing/removing the current differences but also for ensuring that further differences do not emerge in the future. Consideration will have to be given to the development of a reconciliation statement for differences that remain.