TASK FORCE ON HARMONISING PUBLIC SECTOR ACCOUNTS
Topic 5.1: government guarantees of borrowing

Please find below my comments on the draft paper prepared by the International Task Force on Harmonising Public Sector Accounts (TFHPSA) in relation to the treatment of government guarantees in national accounts.

Overall, the paper:

- provides a very useful overview of options for the recording and recognition of government guarantees;
- clearly identifies that the application of IPSAS 19 would be the ideal solution; and
- proposes to adopt the Eurostat Task Force method of re-routing but does not provide sufficiently the rationale to support this method.

Specific comments are as follows:

Issue: As mentioned in paragraph 1.1 of the paper, the issue is to improve national accounts by ensuring that government guarantees are recognised to better reflect the economic circumstances and potential costs for government. In addition, paragraph 1.1 states that "National accounts are sometimes criticised because some types of guarantees, that seem to be clear government liabilities, are not reflected in the government's balance sheet."

Part 1.2: Ideal solution for harmonisation with public sector accounts

The paper recognises that updating SNA so that its treatment aligns with IPSAS 19 government guarantees recognition criteria is the ideal solution. I concur with this and it is my view that the disadvantages of the IPSAS 19 method outlined in the paper should be considered as points for discussion rather than the rationale for rejecting this option. More specifically:

a) <u>countries where the government accounts do not apply the IPSAS 19 method</u>: This is a practical issue that should not deter from selecting a principle-based method. The current SNA review gives us the opportunity to adopt the best option. IPSAS 19 method is principled base and is part of an international accounting framework and should therefore be seriously considered as an option for improving the recognition of government guarantees in national accounts.

b) <u>would involve recording the changes in provisions as redistributive transactions:</u> Table 2.1 indicates that the SNA93 insurance provision already applies IPSAS 19 principle by recognising provision changes as transaction categories. In addition, the unwinding of the discount method could be deemed to be an interest payment, being therefore a redistributive transaction, as it reflects the time value of money.

I note that the probability criteria could be difficult to apply as it introduces judgement into the recognition process. However, I still believe that it is appropriate to recognise guarantee costs earlier, being when it is probable that a guarantee will be called rather than at the time the guarantee is called. In my view, this approach also reflects best the transactions related to a government guarantee as it does not attempt to change the substance of the transactions.

Part 1.3: The Eurostat Task Force method

There is doubt as to whether the Eurostat method of re-routing would sufficiently address the issue outlined in part 1.1 of ensuring that government guarantees in the national accounts are recognised to better reflect the economic circumstances and potential costs for government. This is due to the following:

- it limits its scope to non-tradable one-off guarantees;
- the recognition criteria of "very likely to be called" would delay the recognition near the timing of the cash outflow;
- the impact on the deficit/surplus is only when the guarantee is called rather than when it is probable that the government will incur the costs; and
- the recognition of an asset at the time the guarantee "is very likely to be called" would fail the probability test under the accrual regime and would then be expensed.

In addition, I believe that this method changes the substance of the transaction from the government being a guarantor to the government becoming a deemed borrower and a deemed lender.

Part 2: Summary for methods for recording guarantees

The paper presents a good summary of the five methods.

I note that the derivative option is only available for guarantees traded on a market and consequently probably not relevant for the public sector.

Part 3: description of options for recording guarantees in an updated SNA93;
Part 4: Accounting tables;
Part 5: Diagrams: accounting for guarantees; and
Annex 2: Types of guarantees

These sections provide useful information to assist the reader in understanding each of the options presented.

Part 3.5: Impute annual subsidies to purchase annual insurance policies
It could be argue that this option would lead to a very similar result as the IPSAS 19 approach. Mr Peter Harper's comments on this paper emailed to Jeff Golland on 13 July 2004 outlines the "insurance" option transactions that would align closely to the application of IPSAS19 method.

In this instance the difference between the two options is that the "insurance" method would record an amount when the probability of a guarantee being called is less than 50%. It is important to note that the IPSAS 19 treatment of a group of similar guarantees may have a similar impact to the "insurance" option as described by Mr Harper.

In addition, the IPSAS 19 probability guidance of 50% needs to be viewed in the context of the International Financial Reporting Standards (IFRS), which includes the application of the concepts of prudence and conservatism.

Annex 6: Existing guidance in SNA93 and ESA95

The discussion on SNA93 text regarding contingent assets and derivatives, and the IPSAS 19 on provisions supports IPSAS 19 in the context of ESA95. I note that the rerouting option would also be consistent with ESA95.

Conclusion

The IPSAS 19 method is preferred. My reasons for this conclusion are:

- it is a principle-based method;
- this approach reflects the actual transactions;
- it recognises the costs and the liability earlier, which is when it is probable that the guarantee will be called; and
- it captures all type of government guarantees.

I appreciate the opportunity to provide comments on this draft paper and I hope that the above comments are useful.

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