

Appendix B: External Reporting Standards and Budget Concepts

EXTERNAL REPORTING STANDARDS

The Commonwealth *Charter of Budget Honesty Act 1998* requires that the Mid-Year Economic and Fiscal Outlook (MYEFO) be based on external reporting standards, and that departures from applicable external reporting standards be identified.

The major external standards used in the MYEFO are the Australian Bureau of Statistics (ABS) accrual Government Finance Statistics (GFS) framework and Australian accounting standards, including Australian Accounting Standard No. 31 *Financial Reporting by Governments* (AAS31).

The GFS reporting framework is a specialised statistical system designed to support economic analysis of the public sector. It allows comprehensive assessments to be made of the economic impact of government and is consistent with international statistical standards. The major budget aggregates are drawn from the GFS framework.

AAS31 requires governments to prepare accrual-based general purpose financial reports, including in relation to the assets they control and any liabilities incurred, their revenues and expenses, and cash flows. This reporting is intended to provide a consolidated overview of the financial performance and position of government, including in the area of financing and investing activities.

Table B1 highlights some of the differences between the GFS and AAS31 reporting standards, while Tables B2 and B3 reconcile the major GFS and AAS31 fiscal aggregates.

The GFS and AAS31 financial statements in the MYEFO are consistent with the ABS GFS framework and accounting policies in AAS31 respectively, except where explicitly identified below.

The GFS framework requires that flows and stocks are valued at current market prices (or where these are not observable, a suitable proxy indicator). While this is the case for flows in the operating statement and the cash flow statement, not all assets and liabilities in the GFS balance sheet are currently valued at current market prices. This is principally because Australian accounting standards allow asset and liability valuation methods other than current market prices (such as historical cost). In the early years of accrual budgeting the focus has been on preparing robust GFS operating and cash flow statements. Refinements to the GFS balance sheet valuations of assets and liabilities will be considered over time, in consultation with the ABS, as the new framework is bedded down.

The Commonwealth revenue and expenses estimates in Parts I to V and Appendix C do not include GST collections and equivalent payments to the States. Under the

Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (the IGA), all GST revenue is appropriated to the States and Territories and thus is not available for expenditure by the Commonwealth. Because the Commonwealth collects GST as an agent for the States and Territories, it is not shown as Commonwealth revenue. Estimates of GST revenue are provided in Table B2.

Additional information on the consistency of the MYEFO with AAS31 is provided in Appendix C (see Note 1 to the financial statements).

Reconciliation of GFS and AAS31 aggregates

There is a general consistency of treatment between GFS and accounting standards. The GFS and AAS31 definitions of the scope of the public sector agree in almost all cases, with AAS31 recommending the same segmentation of the public sector into general government, public non-financial corporations (PNFC) and public financial corporations (PFC) sectors. The general government sector and PNFCs together make up the non-financial public sector (NFPS).

Transactions are generally treated in a similar manner by GFS and accounting standards; however, where GFS is a framework designed to facilitate macro-economic analysis, AAS31 is designed as a standard for general purpose financial reporting. The different objectives of the two systems lead to some variation in the treatment of certain items.

In particular, revaluations of assets and liabilities are classified differently under the AAS31 and GFS standards. Major revaluations include: writedowns of bad and doubtful debts (excluding those that are mutually agreed); changes in the valuation of superannuation liabilities; and foreign exchange gains and losses.

Under AAS31 reporting, valuation changes may affect revenues or expenses. However, under GFS reporting revaluations are not considered to be transactions (that is, they are considered to be other economic flows) and accordingly do not form part of revenues or expenses. Therefore, most revaluations are not taken into account in the calculation of the GFS net operating balance or fiscal balance.

In addition, since the 2000-01 Budget the ABS has revised the GFS treatment of defence weapons platforms, which has introduced another difference between the two standards (see Box 2 in Part V for details).

Some of the major differences between the GFS and AAS31 treatments of transactions are outlined in Table B1. Further information on the differences between the two systems is provided in the ABS publication *Information Paper: Accruals-based Government Finance Statistics* (Cat. No. 5517.0).

Table B1: Selected differences between AAS31 and GFS reporting standards

Issue	AAS31 Treatment	GFS Treatment
Provisions for bad and doubtful debts and asset writedowns	Treated as part of operating expenses.	Treated as revaluations, except for mutually agreed writedowns, and therefore removed from operating expenses.
Profit/loss on sale of assets	Treated as part of operating revenues/expenses.	Treated as revaluations and therefore removed from operating revenues/expenses.
Interest flows related to swaps and other financial derivatives	Treated as operating revenues and expenses.	Treated as financing transactions and so not included in operating revenues and expenses.
Public debt net interest	Premiums and discounts on the repurchase of debt are included in public debt net interest expenses at the time of repurchase, regardless of whether the stock is cancelled at that time. Issue premiums and discounts are amortised over the life of the stock.	Repurchase premiums and discounts are treated as economic revaluations at the time the debt is repurchased (provided it is valued at historical cost). The GFS cash flow statement includes repurchase premiums or discounts in the year that the repurchased stock is cancelled or matures.
Commonwealth general government sector investments in public corporations	Investments in public corporations are valued at historic cost in the balance sheet.	Investments in public corporations are valued at current market value. For publicly listed corporations, the share price is used to calculate market value. For non-listed corporations, the current value of net assets is used.
Acquisition of defence weapons platforms	Treated as capital expenditure. Defence weapons platforms appear as an asset on the balance sheet. Depreciation expense on assets is recorded in the operating statement.	Treated as an expense. Defence weapons platforms do not appear as an asset on the balance sheet and no depreciation is recorded in the operating statement.
Finance leases	Treats finance leases as if an asset were purchased from borrowings ie. the lease payment is split into an interest component (which is shown as an operating expense) and a principal component. The asset and the liability are recorded on the balance sheet. However, this convention does not apply to the cash flow statement, which does not record the acquisition of the asset or the liability.	As per the accounting standard, except that the GFS cash flow statement includes the acquisition of the asset and the liability.

Table B2 reconciles GFS revenue and expenses with their AAS31 counterparts.

Table B2: Reconciliation of GFS and AAS31 revenue and expenses

	2000-01 \$m	2001-02 \$m	2002-03 \$m	2003-04 \$m
GFS revenue (Appendix D)	183932	189112	198573	212465
<i>less</i> GST revenue for States and Territories	26303	28029	29083	30737
GFS revenue (Parts I, II, III and IV)	157630	161083	169490	181728
<i>plus</i> foreign exchange gains	71	3	0	0
<i>plus</i> other economic revaluations	0	0	0	0
<i>plus</i> profit on the sale of assets	2701	138	69	291
<i>plus</i> swap interest received	2389	2608	2762	2796
<i>plus</i> revenue allocated to GFS expenses	184	170	168	168
AAS31 revenue (Appendix C)	162973	164001	172488	184983
GFS expenses (Appendix D)	179172	186173	192084	199317
<i>less</i> GST grants to States and Territories	26303	28029	29083	30737
GFS expenses (Parts I, II, III, IV and V)	152869	158144	163001	168579
<i>plus</i> revaluations/writedowns from superannuation	447	522	511	618
<i>plus</i> net writedown of assets/bad and doubtful debts	892	701	725	740
<i>plus</i> foreign exchange losses	810	0	0	0
<i>plus</i> other economic revaluations	304	47	0	0
<i>plus</i> loss on the sale of assets	3	1	0	0
<i>less</i> costs of asset sales	0	218	218	0
<i>less</i> other property expenses	0	0	0	0
<i>plus</i> swap interest paid	2554	2703	2824	2795
<i>plus</i> defence weapons platforms depreciation	1653	1761	1959	2073
<i>less</i> defence weapons platforms investment	2676	3438	3944	4259
<i>plus</i> revenue allocated to GFS expenses	184	170	168	168
AAS31 expenses (Appendix C)	157039	160392	165026	170715

Table B3 reconciles the accounting operating result to the GFS net operating balance and the fiscal balance (GFS net lending).

The reconciliation can be divided into two parts. The first part shows classification differences between the AAS31 operating result before extraordinary items and the GFS net operating balance. (These classification differences are simply the sum of those shown in Table B2 above.)

The second part of the reconciliation shows the adjustment for net capital investment required to derive the fiscal balance from the GFS net operating balance. Net capital investment is measured as net purchases of property, plant and equipment, plus net investment in other non-financial assets less depreciation.

Table B3: Reconciliation of AAS31 net operating result and fiscal balance

	2000-01 \$m	2001-02 \$m	2002-03 \$m	2003-04 \$m
AAS31 operating result before extraordinary items	5934	3609	7462	14268
Net classification differences	-1173	-670	-973	-1119
GFS net operating balance	4761	2939	6489	13149
<i>less</i> purchase of property, plant and equipment and intangibles	4748	5132	5700	6290
<i>less</i> assets acquired under finance leases	0	0	0	0
<i>less</i> other non-financial assets	-63	-1	-1	0
<i>less</i> increase in inventories	125	153	109	425
<i>plus</i> defence weapons platforms investment	2676	3438	3944	4259
<i>plus</i> proceeds from sales of property, plant and equipment and intangibles	4388	817	707	636
<i>plus</i> depreciation and amortisation	1392	1374	1437	1501
Fiscal balance (GFS net lending)	8407	3285	6769	12829

BUDGET CONCEPTS

The major budget aggregates are based on the ABS accrual GFS framework. The following section provides a brief overview of this framework and explanation of the major fiscal aggregates. Additional information on the accrual GFS framework is available in the ABS publication *Information Paper: Accruals-based Government Finance Statistics, 2000* (Cat. no. 5517.0)

Accrual GFS framework

The accrual GFS framework is based on an integrated recording of flows and stocks. Flows reflect the creation, transformation, exchange, transfer or extinction of economic value. They involve changes in the volume, composition or value of a unit's assets, liabilities and net worth. Stocks refer to a unit's holdings of assets, liabilities and net worth at a point in time.

Two types of flows are distinguished: transactions and other economic flows.

- Transactions represent flows that come about as a result of mutually agreed interactions between units or within a single unit. (A single unit action is treated as a transaction because the unit is viewed in these cases as acting in two separate capacities simultaneously. For example, an owner of a fixed asset also consumes its services meaning that consumption of fixed capital can be treated as a transaction.) Despite their compulsory nature, taxes are transactions that are deemed to occur by mutual agreement between the government and the taxpayer.
- Other economic flows represent changes to stocks that do not result from a transaction. Other economic flows arise from changes to stocks caused by price movements (revaluations), including interest and exchange rate movements, and phenomena such as discoveries, depletion and destruction.

GFS operating statement

The operating statement presents details of transactions in GFS revenues, GFS expenses and the net acquisition of non-financial assets (net capital investment) for an accounting period.

GFS revenues are broadly defined as transactions that increase net worth and GFS expenses as transactions that decrease net worth.

Net acquisition of non-financial assets equals gross fixed capital formation, less depreciation, plus changes (investment) in inventories and plus other transactions in non-financial assets.

Fiscal balance (or GFS net lending/borrowing) is an analytical balance in the GFS operating statement. It is calculated as revenues less expenses less the net acquisition of non-financial assets. It measures in accrual terms the gap between government

savings plus net capital transfers and investment in non-financial assets. As such, it measures the contribution of the Commonwealth general government sector to the balance on the current and capital accounts in the balance of payments.

A fiscal balance surplus indicates that the Commonwealth is placing financial resources at the disposal of other sectors (that is, the Commonwealth is lending). A fiscal deficit indicates that the Commonwealth is utilising the financial resources of other sectors (that is, the Commonwealth is borrowing). Thus, fiscal balance can be viewed as a global indicator of the financial impact of Commonwealth Government operations on the rest of the economy.

Balance sheet

The balance sheet shows stocks of assets, liabilities and GFS net worth. Net debt is also reported in the balance sheet.

Net worth for the general government sector is defined as assets less liabilities. (For the public financial corporations and public non-financial corporations sectors the formula becomes assets less liabilities less shares and other contributed capital.) Net worth is an economic measure of wealth. It reflects the contribution of the Commonwealth to the wealth of Australia.

Net debt is defined as the sum of selected financial liabilities (deposits held; advances received; and borrowing) minus the sum of selected financial assets (cash and deposits; advances paid; and investments, loans and placements). Net debt measures the indebtedness of the Commonwealth.

Cash flow statement

The cash flow statement identifies how cash is generated and applied in a single accounting period. 'Cash' means cash on hand (notes and coins held and deposits held at call with a bank or other financial institution) and cash equivalents (highly liquid investments that are readily convertible to cash on hand at the investor's option and overdrafts considered integral to the cash management function).

The cash flow statement reflects a cash basis of recording (rather than an accrual basis) where the information has been derived indirectly from underlying accrual transactions and movements in balances. This, in effect, means that transactions are captured when cash is received or when cash payments are made. Cash transactions are specially identified because cash management is considered an integral function of accrual budgeting.

The underlying cash balance (GFS surplus/ deficit) is an analytical balance in the cash flow statement. For the general government sector it is calculated as:

	Net cash flows from operating activities
<i>plus</i>	net cash flows from investments in non-financial assets
<i>less</i>	acquisitions of assets acquired under finance leases and similar arrangements

The underlying cash balance is the cash based equivalent of the fiscal balance. It is a broad indicator of the Commonwealth's cash flow requirements. An underlying cash surplus reflects the extent to which cash is available to the Commonwealth to either increase its financial assets or decrease its liabilities (assuming no revaluations and other changes occur). An underlying cash deficit measures the extent to which the Commonwealth requires cash, either by running down its financial assets or by drawing on the cash reserves of other sectors.

The underlying cash balance measure described here is conceptually the same as the underlying cash balance used in the former cash budgeting system. In practice, however, the underlying cash balance in the accrual framework is derived using different methodologies, which results in a break in the time series across the two systems.

Sectoral classifications

Data are presented by institutional sector. Institutional sector distinguishes between the general government sector, the public non-financial corporations (PNFC) sector and the public financial corporations (PFC) sector.

Budget reporting focuses on the general government sector. This sector provides public services that are mainly non-market in nature, and for the collective consumption of the community, or involve the transfer or redistribution of income. These services are largely financed through taxes and other compulsory levies, although user charging and external funding have increased in recent years. This sector comprises all government departments, offices and some other bodies.

The PNFC sector comprises bodies that provide goods and services that are mainly market, non-regulatory and non-financial in nature, financed predominantly through sales to the consumers of these goods and services. In general, PNFCs are legally distinguishable from the governments that own them. The PNFC sector includes Australia Post, airport corporations and railways.

Together the general government sector and the PNFC sector comprise the non-financial public sector.

The GFS coverage of the public sector also includes PFCs. These bodies are engaged in financial intermediation services or auxiliary financial services. They are able to incur financial liabilities on their own account. This sector includes the Reserve Bank of Australia.

The total public sector comprises all sectors of government — general government, the PNFC sector and the PFC sector.

