The Benefits to Portugal of Implementing the "New Zealand Model" of Public Financial Management

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ISCTE IUL Instituto Universitário de Lisboa

ISCTE Business School INSTITUTO UNIVERSITÁRIO DE LISBOA

IPPS ISCTE Public & Nonprofit Education

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Public Financial Management Overview

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The Benefits to Portugal of Implementing the "New Zealand Model" of PFM

SECTION A

Public Financial Management Overview

1. What is the “New Zealand Model” of Public Financial Management?
2. Why Should Governments Base Decision-Making Processes on an Accrual Accounting System?
3. Who are the Potential Role Models in Public Financial Management?

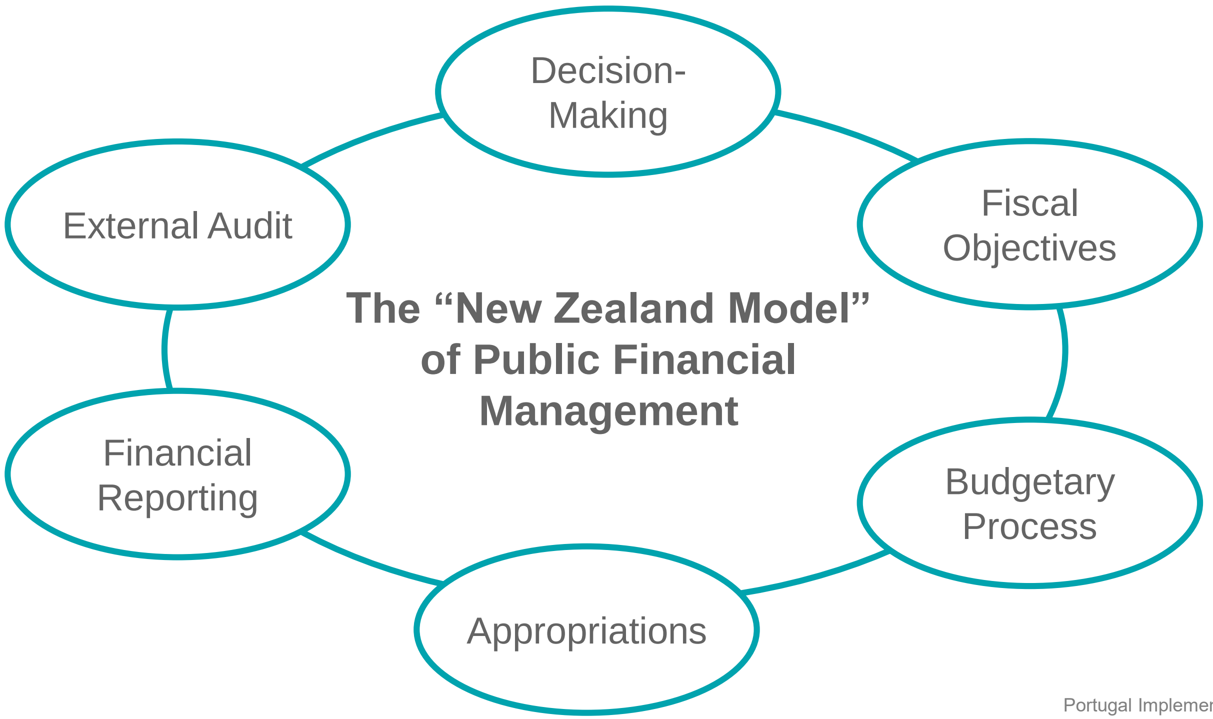
1. What is the “New Zealand Model” of Public Financial Management?

The “New Zealand Model” of Public Financial Management

The “New Zealand Model” of Public Financial Management (PFM) deals with all aspects of resource mobilization and expenditure management in government.

PFM refers to the set of laws, rules, systems and processes used by sovereign nations (and sub-national governments), to mobilise revenue, allocate public funds, undertake public spending, account for funds, and audit results.

The "New Zealand Model" should be understood, used, and communicated as a full system to improve government performance (and position) and not solely as a project to improve accounting.



The "New Zealand Model" of Public Financial Management is a Process to Improve Government Financial Performance and Position (Not a Bureaucratic Accounting Project)

- Significant improvements in government financial performance and position cannot occur unless all the system components use common measures of what constitutes financial performance and position, as defined in internationally agreed upon public sector accounting standards: (i) financial management decision-making – align revenue decision with expenditure decisions, (ii) fiscal objectives for performance and position, (iii) the budgetary process, (iv) legislative appropriations, (v) financial reporting and (vi) external audit.
- Without all the system components being based on a set of common measures, incentives will be unclear and inconsistent, decision-making will be confused, accountability will be weakened, and performance will necessarily suffer as a result.
- For example, using resources to produce a service (one aspect of performance) is not the same as using them to acquire an asset.

How Does the State Reform? Examples of Using the "New Zealand Model" to Improve Management Performance

Improving Decision-Making:

- Allow decision makers to see the economic reality of complex financial transactions and decisions;
- Provide insights into prospective liabilities;
- Assist in ranking financial impact of various alternatives;

Improving Results:

- Provide accurate information to better manage financial and fixed assets;
- Increase the efficiency of public finance decisions: less costs, less taxes, and better public services.

Implementation of Accrual Accounting System is the Foundation of Decision-Making in the "New Zealand Model"

#1: First step is to improve knowledge of financial performance and risk using government consolidated financial statements, especially the balance sheet.

#2: Second step is for capable management to use the knowledge to improve government financial performance and risk management.

There are potentially trillions of Euros in opportunities in Europe for increasing net worth and GDP by closing government balance sheet management performance gaps.

2. Why Should Governments Base Decision-Making Processes on an Accrual Accounting System?

Government Balance Sheet Status in the EU

- Consolidated balance sheets are the exception not the rule.
- Single-entry accounting (in contrast to double-entry) is the most common.
- Knowledge and use of consolidated financial statements as a management tool to improve performance and minimize risk is almost non-existent.
- Limited management capability exists to realize better balance sheet performance.
- Significant performance gaps exist between potential balance sheet performance and current status.

Rationale for Using Accrual Accounting For All Functions of Government

Decision-making, fiscal objectives, budgeting, appropriations, reporting, and external audit on an IPSAS accrual basis means that the Government's financial management system:

1. Reflects economic reality in a more complete and relevant manner than using cash numbers, enabling better fiscal and management decision-making;
2. Ensures that the six major components of the "New Zealand Model" PFM system are based on the same concept of resources and their stocks and flows, meaning the system is coherent and integrated, and the six components are mutually reinforcing;
3. Creates correct and consistent incentives for managers – avoiding the negative consequences of budgeting and/or appropriating on a cash basis and reporting on an accrual basis; and
4. Enables better accountability of the Government to the Parliament and the electorate, enhancing trust and confidence.

The Need to Go Back to the Foundations of Accounting

In order to improve knowledge of financial performance and risk, governments should make use of the key accounting principles:

1. Accrual rather than cash.
2. Double entry rather than single entry autonomous ledgers.
3. International accounting standards (applied properly) to reflect economic reality rather than politically determined rules.
4. Independent audit of financial statements under international rules rather than expense audits.
5. Used during decision-making and reporting rather than reporting only.

It is Essential that Governments Use Change in Net Worth (also known as Taxpayers' Equity) as a Fiscal Objective in Decision-Making and Performance Assessment

Total Assets [-] Total Liabilities = Net Worth

(Governments do have a net worth, which is a measure of Taxpayers' Equity, and it changes over time.)

- Net Worth definition is Total Assets minus Total Liabilities.
- All entities have a Net Worth including governments.
- Government Net Worth is also known as Taxpayers' Equity.
- Government Net Worth and changes in Net Worth are much more robust numbers than the single balance sheet line item of debt.

What are the Traits of Government Consolidated Financial Statements?

	“Functional Areas”	
	Financial Performance	**Risk**
Knowledge *(Stage 1)*	To have true and fair **internationally comparable knowledge of government financial performance**, the balance sheet, the supporting consolidated financial statements, and notes are the starting point for decision-making and accountability.	The balance sheet at the core of consolidated financial statements provides **standardized and quantified knowledge of risks** (especially large, complex, and expanding liabilities) and helps expose masking of financial risks.
Management *(Stage 2)*	Capable management using three balance sheet related decision-making tools (T-accounts, financial statements, and performance gaps) **can improve financial performance and changes in net worth, and minimize errant decisions**.	Early risk management of potential asset impairment or opaque liabilities is an effective process to **reduce costs by limiting or avoiding the materialization of these risks and strengthens accountability**.

The Status Quo: Destructive Populism

- Governments see cooking the books after the outcome as the goal, rather than better financial management.
- Fictional fabrication of government numbers is the norm.
- Media, many think tanks, rating agencies, and mainstream economists have a counter-productive understanding of international accounting standards and economic reality.
- Citizens have almost zero education in understanding a balance sheet, their own or their government's.

The Alternative: Effective Management and Communication of Government Balance Sheets Prepared in Accordance with International Accounting Standards (IPSAS)

The Focus on Headline Debt (FV) and Cash Deficits Cultivates Destructive Short-Termism and Misleading Reporting Schemes: Examples

- Focus on debt at future value (FV) and cash balances are two of the most easily manipulated financial numbers.
- Focus on FV ignores changes in Taxpayers' Equity, which is vastly more meaningful.
- Focus on FV and cash increases pressure to sell government assets rather than increase value through better management.
- Focus on cash balances increases pressure to spend more money on vote buying (consumption) and less on capital expenditures (e.g., infrastructure).

Market Forces Profit from Volatility and Risk Assessment Swings

Hedge Funds

- Increases trading profits
- Increases frequency of trading
- Create relational profit anomalies
- Improves CDS profit opportunities

Investment Banks

- Wider bid-ask spreads
- Increases the price of liquidity
- Increases trading commissions

Media

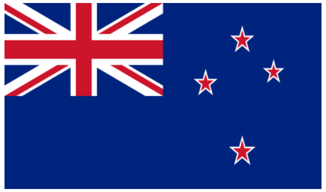
- Volatility sells papers and generates profitable internet activity

3. Who are the Potential Role Models in Public Financial Management?

(Working Draft

The "New Zealand Model" and Government Benchmarks with Financial Statements Prepared in Accordance with International Accounting Rules

The "New Zealand Model"



IPSAS

Prosperity Index : 1^{st}
Credit Rating: AA

UK

IFRS

Prosperity Index : 11^{th}
Credit Rating: AA

CA

IPSAS-like

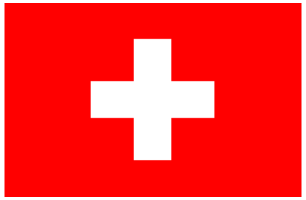
Prosperity Index : 5^{th}
Credit Rating: AAA

AU

IFRS-like

Prosperity Index : 6^{th}
Credit Rating: AAA

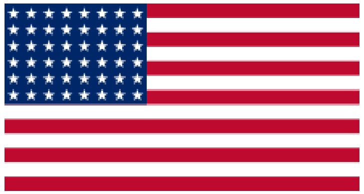
CH



IPSAS

Prosperity Index : 4^{th}
Credit Rating: AAA

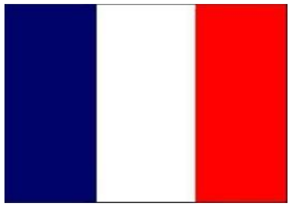
US



US GAAP

Prosperity Index : 17^{th}
Credit Rating: AA+

FR



IPSAS/IFRS

Prosperity Index : 18^{th}
Credit Rating: AA

IL

IPSAS

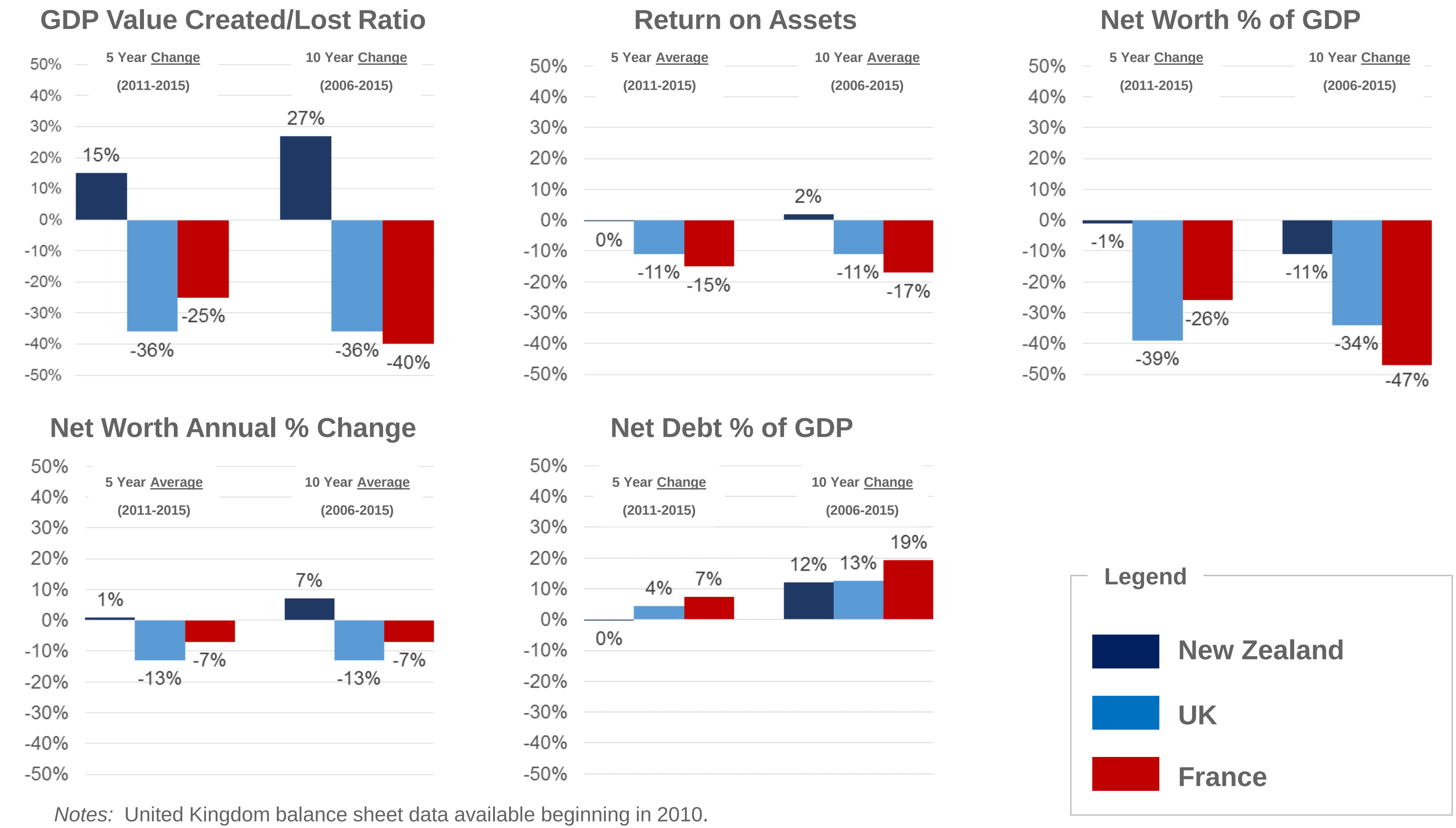
Prosperity Index : 40^{th}
Credit Rating: A+

Notes: Prosperity Index based on the Legatum Prosperity Index 2016 and Credit Rating based on the S&P rating

(Working Draft)

New Zealand's Successful Implementation of PFM Has Without Doubt Contributed To Better Financial Performance Compared to Peers: Fiscal Objectives

(2006 - 2015 as available)



Notes: United Kingdom balance sheet data available beginning in 2010.
Base Year: NZ: 2005, UK: 2010, FR: 2006

(Working Draft)

What % of World GDP Uses International Accounting Standards for Reporting?

	Government Accrual Financial Statements	General Government Expenditure	Public Company Expenditure	Government Exp. plus Public Co. Expenditure	GDP
Subtotal OECD (Non-Asian) Countries with Financial Statements	12	$11,606	$26,001	$37,607	$30,874
Total OECD (Non-Asian) Countries	32	$17,753	$26,001	$43,754	$42,798
Percent with Financial Statements	38%	65%	100%	86%	72%

Notes: OECD countries excluding Asia. (a) IMF World Economic Outlook, Apr 2015 database (Accessed on 13 Jul 2015), 2014 data. GDP in current prices (USD) and General Government Expenditure based on % of GDP. Use of full asset depreciation and government pension expense varies. (b) Bloomberg data, 2014 (accessed on 6 Aug 2015). Includes cost of revenue/goods sold and operating expenses.

SECTION B

The Benefits to Portugal of Implementing the "New Zealand Model" of PFM

4. The "New Zealand Model" of Public Financial Management Initiative to Strengthen Portuguese Positive Brand
5. Portugal to Become the 1st Nation in the World to Implement the "New Zealand Model" of Public Financial Management
6. Portugal Background Observations
7. Insights from Global Leaders' Advice to Portugal
8. What Rating Agencies Say About Portugal
9. The Importance of the Portugal Public Sector Balance Sheet
10. The Public Financial Management Approach – Illustrative Examples

4. The "New Zealand Model" of Public Financial Management Initiative to Strengthen Portuguese Positive Brand

Portugal has Made Efforts to Strengthen its Positive Brand in Terms of Trust and Confidence

Portugal looks to 2017 with trust and confidence.

"We can only be optimistic about 2017 as to the signal that this represents in terms of confidence in Portuguese public finances," said the Prime Minister, António Costa, in a press statement about today's decisions of the European Commission concerning the acceptance of the proposal of State's budget to 2017, the no suspension of the European funds and the confirmation that Portugal will go out of the excessive deficit procedure at the end of the year.

Source: Portuguese government official website (16 Nov 2016).

5. Portugal to Become the 1st Nation in the World to Implement the "New Zealand Model" of Public Financial Management

Portugal to Become the 1st Nation in the World to Implement the "New Zealand Model" of Public Financial Management

Adopt International Accounting for Decision-Making, Fiscal Objectives, Budgeting, Appropriations, Reporting, and External Audit

Portugal implements the "New Zealand Model" of Public Financial Management, which includes accrual accounting as specified in internationally agreed upon public sector accounting standards (IPSAS), to improve financial performance and position.

1. Use for decision-making in measuring impact on consolidated financial statements;
2. Legal specification that the fiscal objectives of the government include net worth, operating balance, revenues, expenses, and net debt, all of which comply with internationally agreed upon public sector accounting standards;
3. Specify its planned financial performance and year-end position on an IPSAS basis (i.e. budget on an accrual basis);
4. Formalize accrual-based financial plans in parliamentary appropriations (i.e. gives the accrual budget numbers legislative force); and
5. Report on an IPSAS basis in its financial statements at year-end, including reporting against budget and appropriations; and
6. Auditing an IPSAS based financial statement will improve government trust and confidence.

6. Portugal Background Observations

Portugal Background Observations: Documents Analyzed

As background for our Portugal specific commentary, we have reviewed 2015, 2016, and 2017:

- Rating reports from all four credit rating agencies (Moody's, S&P, Fitch, and DBRS)
- Research reports from seven investment banks
- Debt agency investor presentations and publications
- Invest in Portugal government publications
- IMF Article IVs and transparency reports

Portugal Background Observations: Findings

Uniquely Positive Findings:

1. Portugal has a rich culture of respect for accounting and accountability.
2. Portugal has one of - if not the - highest per capita number of certified public accountants according to international standards in the world.
3. Medium and small enterprises use IFRS-based accounting and micro enterprises use IFRS-simplified.
4. There is a public information campaign to educate citizens on the importance of the "New Zealand Model" of PFM.

Challenging Findings:

1. No discussion of balance sheet, other than future value of debt.
2. Little to no discussion of assets or non-financial liability management other than cash.
3. No discussion of status and plans of financial controls and processes.
4. No discussion of government human capital management or professional team and skills building.
5. Very little discussion of efforts to improve government financial transparency to win the trust and confidence of all key stakeholders, including voters.
6. No disclosure of government's Taxpayers' Equity, annual changes, or impact of the government's largest financial decisions (e.g., €500 million plus decisions).

7. Insights from Global Leaders’ Advice to Portugal

Global Leaders' Advice to Portugal on Public Financial Management

Ian Ball

Chair of CIPFA International and former chief executive of the International Federation of Accountants

"Portugal can capture the benefits of the 'New Zealand Model' with successful implementation of the full system of public financial management (PFM)."

Vincent Truglia

Former Co-Head of Sovereign Ratings Unit at Moody's

"It is very reasonable for Portugal to merit a solid investment grading with credible progress in implementing the 'New Zealand Model' of PFM."

George Serafeim

Associate Professor of Business Administration at Harvard Business School

"The Portugal government has the opportunity to create substantial value by using the 'New Zealand Model' of PFM to better financial performance and financial position."

Global Leaders' Advice to Portugal on Public Financial Management

Sheila Fraser

Former Auditor General of Canada

"Improving the financial performance and financial position of government is greatly enhanced with a system of quality PFM."

Andrew Likierman

Dean of London Business School and former Head of UK Government Accountancy Service

"To realize significant financial benefits, internationally agreed upon accounting standards should be used as part of a full system of PFM and not only for reporting."

David Walker

Former managing director of public reporting at the Audit Commission

"Portugal can improve the management of its assets and liabilities with a full system of PFM."

Global Leaders' Advice to Portugal on Public Financial Management

Dag Detter

Co-author of The Public Wealth of Nations and former investment banker

"Huge value can be created by using the 'New Zealand Model' of PFM to maximize the value of government assets and minimize related government liabilities."

Paul B. Kazarian

Founder, Chairman, and CEO of Japonica Partners

"Effective implementation by Portugal of the 'New Zealand Model' of PFM will provide significant rewards by improving the trust and confidence of key participants in the global capital markets."

Jacob Soll

Professor at the University of Southern California

"History show us that good accounts lead to great countries, bad accounts lead them to destruction, which provides strong support for Portugal to use the 'New Zealand Model.'"

Jorge Núñez Ferrer, Ph.D.

CEPS Senior Research Fellow and public financial management specialist

"PFM, while undervalued, is totally essential for prosperity and stability."

8. What Rating Agencies Say About Portugal

Latest Credit Rating Agency Reports on Portugal: A Focus on Public and Private Debt

DBRS (21 October 2016) - BBBL

- High public debt
- Low potential growth
- Fiscal pressures, including delayed implementation of integrated public accounting system
- High corporate sector debt and NPLs

Moody's (17 January 2017) - Ba1

- High government and external debt burden
- Moderate economic growth with high private sector leverage
- Weak banking system

S&P (17 March 2017) - BB+

- High public sector debt
- High private sector debt
- Weak banking system

Fitch (16 February 2017) - BB+

- High public debt
- High private debt
- Weak growth performance
- Legacy problems in financial system

9. The Importance of the Portugal Public Sector Balance Sheet

In Absence of Portugal General Government Balance Sheet, a Working Draft Estimate of Over €700 Billion in Total Assets and Liabilities

(€, Billions; as of 31 December 2015)

Balance sheet Item	Amount	% of Total Assets and Liabilities	% of GDP
Financial Assets	€ 66	9%	37%
Non-Financial Assets	€ 145	20%	81%
Total Assets	**€ 211**	**29%**	**118%**
Financial Liabilities	€ 208	29%	116%
Non-Financial Liabilities	€ 304	42%	169%
Total Liabilities	**€ 512**	**71%**	**285%**
Net Worth	**€ -301**	**-42%**	**-168%**
Total Assets and Liabilities	**€ 723**	**100%**	
GDP	**€ 179**		

Notes: Working draft balance sheet is an illustrative best estimate prepared under the direction of the working group based on IMF, EC, and Eurostat data. Assumes 10% increase in NFA and 33% increase in pension liabilities from 2012 to 2015.

Eurostat: Portugal General Government Financial Assets - Year-End 2015

(€, Millions)

Balance Sheet Item	Consolidated	% of GDP	Non-Consolidated	% of GDP
Currency and deposits	€18.178	10%	€28.431	16%
Short-term debt securities	€137	0,1%	€1.051	0,6%
Long-term debt securities	€3.273	2%	€20.138	11%
Short-term - Loans	€472	0,3%	€2.836	2%
Long-term - Loans	€8.942	5%	€36.833	21%
Listed shares	€900	0,5%	€900	0,5%
Unlisted shares	€11.960	7%	€10.591	6%
Other equity	€17.127	10%	€17.127	10%
Investment fund shares/ units	€2.768	2%	€2.776	2%
Insurance, pensions and stand. guar.	€18	0,0%	€18	0,0%
Fin. Deriv. and empl. stock options	€2.538	1%	€2.538	1%
Total Financial Assets	**€66.314**	**37%**	**€123.239**	**69%**
GDP	**€179,379**			

Notes: Financial assets data from Eurostat (excludes accounts receivable); GDP from EC AMECO database; accessed 18 October 2016.

Portugal and Peer Balance Sheet Debt and Net Debt (IPSAS/IFRS): 2016

(€, Billions)

Working Draft Estimate

Balance Sheet Item	Portugal	Cyprus	Greece	Ireland	Italy	Spain
Balance Sheet Debt	€219	€16	€132	€189	€2,219	€1,094
Financial Assets	€73	€7	€48	€75	€339	€312
Balance Sheet Net Debt	**€146**	**€8**	**€84**	**€114**	**€1,880**	**€782**
GDP	€185	€18	€176	€266	€1,671	€1,115
Balance Sheet Debt / GDP	119%	88%	75%	71%	133%	98%
Financial Assets / GDP	40%	41%	27%	28%	20%	28%
Balance Sheet Net Debt/ GDP	**79%**	**47%**	**48%**	**43%**	**113%**	**70%**
Future Value of Debt	€241	€19	€317	€200	€2,219	€1,112
Future Value / GDP	**131%**	**108%**	**180%**	**75%**	**133%**	**100%**

Notes: Financial assets estimates based on Eurostat data (excludes accounts receivable); GDP and Future Value of Debt from EC AMECO database; accessed 13 February 2017.

Working Draft Estimate Portugal Balance Sheet GDP Value Created/Lost Ratio and ROA: 2012 – 2015

(€, Billions)

Balance Sheet Item	2012	2015	€ Change	% Change
Total Assets	**€207**	**€211**	**€4**	**2%**
Total Liabilities	**€433**	**€512**	**€79**	**18%**
Net Worth	**-€226**	**-€301**	**-€75**	**-33%**
GDP	**€168**	**€179**	**€11**	**6%**

GDP Value Created/Lost Ratio *(Change in GDP +/- Change in NW) / GDP (Latest)*	**-36%**
GDP Value Created/Lost Ratio (Annualized) *(Change in GDP +/- Change in NW) / GDP (Latest) / Number of Years*	**-11.9%**
Return on Assets (ROA) *Change in Net Worth / Total Assets (Latest) / Number of Years*	**-11.8%**

Notes: Working draft balance sheet prepared under the direction of the working group. GDP Value Created/Lost Ratio is cumulative over the period; Return on Assets annualized due to data limitations.

Performance Gap Framework: Portugal Summary Fiscal Objectives

(€, Billions)

		GDP Value Created/Lost Ratio				Return on Assets	
SN	Balance Sheet Item	Ratio	NW Increase	GDP Increase	Value Created/ Lost	Ratio	Net Worth Change
1	Portugal (Estimated)	-11.9%	-€25	€4	-€21	-11.8%	-€25
2	Portugal at New Zealand Benchmark	5%			€9	2%	€4
3	Performance Gap	17%			€30	14%	€29
4	GDP (2015)				€179		€179
5	**Performance GAP % of GDP**				**17%**		**16%**

Notes: Working draft estimates prepared under the direction of the Working Group. 2015 GDP of €179.4 billion (EC AMECO accessed 15 October 2016). Portugal ratios based on 2012-2015 estimates. Benchmark (New Zealand) Ratios based on 2005-2015 data. Benchmark Value Created and Net Worth Change calculated by applying Benchmark (New Zealand) Ratios to Portugal GDP and Total Assets respectively.

EU Member State Total Expenditures Average 46% of GDP

#	Country	Total Expenditure % of GDP
1	Finland	58%
2	France	57%
3	Denmark	56%
4	Greece	55%
5	Belgium	54%
6	Austria	52%
7	Hungary	51%
8	Italy	51%
9	Sweden	50%
10	**Portugal**	**48%**
11	Slovenia	48%
12	Croatia	47%
13	Slovakia	46%
14	Netherlands	45%

#	Country	Total Expenditure % of GDP
15	Germany	44%
16	Malta	43%
17	Spain	43%
18	United Kingdom	43%
19	Czech Republic	43%
20	Luxembourg	42%
21	Poland	41%
22	Bulgaria	40%
23	Cyprus	40%
24	Estonia	40%
25	Latvia	37%
26	Romania	36%
27	Ireland	35%
28	Lithuania	35%
	Average	**46%**

Source: EC AMECO database; 2015 data (5 July 2016).

10. The Public Financial Management Approach – Illustrative Examples

Cash Flow Focus vs. PFM Focus: Illustrative Examples

Seven illustrative examples highlighting the financial impact and consequences using a cash flow focus versus a PFM focus (sources of funds from borrowing):

Asset Management:

1. Impact of Proper Real Estate Valuation
2. Impact of Financial Assets Appreciation
3. Impact of Investment in Bank Holding Company
4. Impact of Increase in Value of Assets Prior to Sale
5. Impact of Government Investment in Commercial Enterprise

Liability Management:

6. Impact of Correct Valuation of Debt
7. Impact of One Year Retirement Age Increase

Cash vs. PFM Decision-Making

1.

Example: Impact and Consequences of Proper Real Estate Valuation

- Illustrative example of fair valuation of real estate available for sale resulting in increase of €12.5bn.

	Cash Flow Focus	PFM Focus
Impact	Debt: No impact Fiscal Balance: No impact	Net Worth: **Increase €12.5bn** Assets: **Increase €12.5bn** Net Debt: No impact Debt: No impact Fiscal Balance: **Increase €12.5bn**
Consequences	▪ Asset deterioration ▪ Missed opportunities ▪ Encourage mismanagement	▪ Win trust and confidence with PFM ▪ Asset appreciation with better management ▪ Reduce expenditures

2. Cash vs. PFM Decision-Making

Example: Impact and Consequences of Financial Assets Appreciation

- Illustrative example of an appreciation of financial assets by €6bn.

	Cash Flow Focus	PFM Focus
Impact	Debt: No impact Fiscal Balance: No impact	Net Worth: **Increase €6bn** Assets: **Increase €6bn** Net Debt: **Decrease €6bn** Debt: No impact Fiscal Balance: **Increase €6bn**
Consequences	▪ Asset deterioration ▪ Missed opportunities ▪ Encourage mismanagement	▪ Win trust and confidence with PFM ▪ Asset appreciation with better management ▪ Reduce expenditures

Cash vs. PFM Decision-Making

3.

Example: Impact and Consequences of Investment in Bank Holding Company (Financial Asset)

- Illustrative example of an equity investment of €2bn and an appreciation of financial assets by €1bn.

	Cash Flow Focus	PFM Focus
Impact	Debt: **Increase €2bn** Fiscal Balance: **Decrease €2bn**	Net Worth: **Increase €1bn** Assets: **Increase €3bn** Net Debt: **Decrease €1bn** Debt: **Increase €2bn** Fiscal Balance: **Increase €1bn**
Consequences	▪ Asset deterioration ▪ Missed opportunities ▪ Encourage mismanagement	▪ Win trust and confidence with PFM ▪ Asset appreciation with better management ▪ Reduce expenditures

Cash vs. PFM Decision-Making

4.

Example: Impact and Consequences of an Investment and Increase in Value of Non-Financial Assets Not Available for Sale

- Illustrative example of an investment of €5bn and an appreciation of €1bn during the holding period of the asset.

	Cash Flow Focus	PFM Focus
Impact	Debt: **Increase €5bn** Fiscal Balance: **Decrease €5bn**	Net Worth: **Increase €1bn** Assets: **Increase €6bn** Net Debt: **Increase €5bn** Debt: **Increase €5bn** Fiscal Balance: No impact
Consequences	▪ Asset deterioration ▪ Missed opportunities ▪ Encourage mismanagement	▪ Win trust and confidence with PFM ▪ Asset appreciation with better management ▪ Reduce expenditures

5. Cash vs. PFM Decision-Making

Example: Impact and Consequences of Government Investment in Commercial Enterprise

- Illustrative example of government investment of €3bn in a commercial enterprise.

	Cash Flow Focus	PFM Focus
Impact	Debt: **Increase €3bn** Fiscal Balance: **Decrease €3bn**	Net Worth: No impact Assets: **Increase €3bn** Net Debt: **Increase €3bn** Debt: **Increase €3bn** Fiscal Balance: No Impact
Consequences	▪ Asset deterioration ▪ Missed opportunities ▪ Encourage mismanagement	▪ Win trust and confidence with PFM ▪ Asset appreciation with better management ▪ Reduce expenditures

Cash vs. PFM Decision-Making

6.

Example: Impact and Consequences of Correct Valuation of Debt

- Illustrative example of correct valuation of debt under internationally agreed upon accounting standards.

	Cash Flow Focus	PFM Focus
Impact	Debt: No Impact (€241bn; 131% of GDP) Fiscal Balance: No Impact	Net Worth: **Increase €22bn** Assets: No Impact Net Debt: **Decrease €22bn** (€146bn; 79% of GDP) Debt: **Decrease €22bn** (€219bn; 119% of GDP) Fiscal Balance: No Impact
Consequences	▪ Overstate debt ▪ Borrowing on less attractive terms ▪ Lower credit ratings	▪ Win trust and confidence with PFM ▪ Better borrowing terms ▪ Higher credit ratings

7. Cash vs. PFM Decision-Making

Example: Impact and Consequences of One Year Retirement Age Increase

- Illustrative example of a decrease of €2bn in pension liabilities resulting from an increase of 1 year in retirement age starting 3 years from time of decision.

	Cash Flow Focus	PFM Focus
Impact	Debt: No impact Fiscal Balance: No impact	Net Worth: **Increase €2bn** Assets: No impact Net Debt: No Impact Debt: No Impact Fiscal Balance: **Increase €2bn**
Consequences	▪ Hide liability exposure ▪ Missed opportunities ▪ Encourage mismanagement	▪ Win trust and confidence with PFM ▪ Reduce future expenses ▪ Improve financial position

Supplementary Information

(Working Draft)

Summary - Key Balance Sheet Metrics: New Zealand vs. United Kingdom and France

(2006 - 2015 as available)

Metric	Country	5 Year Change or Average (2011-2015)	10 Year Change or Average (2006-2015)
GDP Value Created/Lost Ratio *(Change)*	New Zealand	**15%**	**27%**
	United Kingdom	-36%	-36%
	France	-25%	-40%
Return on Assets (ROA) *(Average)*	New Zealand	**-0.4%**	**2%**
	United Kingdom	-11%	-11%
	France	-15%	-17%
Net Worth % of GDP *(Change)*	New Zealand	**-1%**	**-11%**
	United Kingdom	-39%	-34%
	France	-26%	-47%
Net Worth Annual % Change *(Average)*	New Zealand	**1%**	**7%**
	United Kingdom	-13%	-13%
	France	-7%	-7%
Net Debt % of GDP *(Change)*	New Zealand	**-0.1%**	**12.1%**
	United Kingdom	4.3%	12.5%
	France	7.4%	19.3%

Notes: United Kingdom balance sheet data available beginning in 2010.
Base Year: NZ: 2005, UK: 2010, FR: 2006

Summary - Key Balance Sheet Metrics: New Zealand vs. United Kingdom and France

(2006 - 2015 as available)

Metric	Country	10 Year Change or Avg	2015	2014	2013	2012	2011	2010	2009	2008	2007	2006
GDP Value Created/Lost Ratio	NZ	*Change* 27%	49%	42%	33%	27%	34%	38%	39%	42%	35%	22%
	UK	-36%	-26%	-15%	-10%	3%	10%	-	-	-	-	-
	FR	-40%	-45%	-45%	-29%	-38%	-20%	-21%	-11%	2%	-4%	-
Return on Assets (ROA)	NZ	*Avg* 2%	4%	4%	4%	-9%	-6%	-2%	-3%	4%	7%	18%
	UK	-11%	-15%	-11%	-19%	-11%	2%	-	-	-	-	-
	FR	-17%	-7%	-38%	-17%	-44%	-6%	-29%	-24%	9%	-32%	-
Net Worth % of GDP	NZ	*Change* -11%	38%	34%	32%	28%	40%	49%	52%	56%	53%	50%
	UK	-34%	-102%	-93%	-86%	-71%	-63%	-68%	-	-	-	-
	FR	-47%	-130%	-130%	-113%	-123%	-104%	-105%	-95%	-82%	-88%	-83%
Net Worth Annual % Change	NZ	*Avg* 7%	14%	15%	17%	-26%	-15%	-5%	-6%	9%	15%	55%
	UK	-13%	-16%	-13%	-24%	-16%	3%	-	-	-	-	-
	FR	-7%	-2%	-16%	7%	-20%	-3%	-14%	-12%	4%	-12%	-
Net Debt % of GDP	NZ	*Change* 12%	4%	5%	7%	8%	4%	-2%	-5%	-11%	-9%	-8%
	UK	13%	43%	41%	39%	40%	39%	31%	-	-	-	-
	FR	19%	58%	57%	55%	53%	51%	48%	-48%	41%	39%	39%

Notes:
GDP Value Created/Lost Ratio is cumulative change in GDP plus/minus cumulative change in net worth divided by latest year GDP. Return on Assets (ROA): Change in net worth as a percentage of assets. Net Worth as % of GDP - Latest: Latest period end net worth divided by corresponding year GDP. Net Worth Annual % Change: Annual change in year end net worth. Net Debt % of GDP - Latest: Latest period end net debt (debt less financial assets) derived from government balance sheet divided by corresponding year GDP.

The State Reform to Strengthen the Capacity of Public Financial Management

Local Accounting

Local Balance Sheet Accounting

Financial Planning and Budget

Financial objectives based on accrual accounting

Central Public Revenue

Cash Basis vs Accrual Basis

State 'Entity' Account System

Decision-making based on accrual accounting

Electronic Invoicing

Integration of financial billing systems on the Public Financial Management

Central System for Accounting and National Accounts

Balance Sheet perspective of National Accounts

Central cash Management

Cash Management based on Accrual accounting