Investor and Turnaround Manager Assessment of Government Use of Financial Statements

Federation of European Accountants

Public Sector Accounting Roundtable

Sovereign debt crisis: How can accounting be (part of) the solution?

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JAPONICA PARTNERS

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Presenting Organizations

- CIPFA
- City of Hannover, Germany
- European Parliament
- Eurostat
- EY
- Federation of European Accountants
- French Ministry of Finance
- Japonica Partners
- Netherlands Court of Audit
- Slovak Republic Ministry of Finance
- Taxpayers Association of Europe
- Università degli Studi di Napoli Parthenope

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Overview

1. **Benefits:** True and fair standards set by independent professional body, without political exceptions, are a cornerstone of western democracy.
2. **Opportunity Costs:** The costs of not using financial statements, especially change in net worth, in post-facto decision making are staggering.
3. **Key Stakeholders:** Use key financial statement/ GDP metrics to educate public and build a government financial/accounting quality index for rating agencies. And, select competent management based on merit and experience.

1. Benefits of International Accounting Standards for Government

What is Western Democracy Government Financial Transparency?

Western democracy government financial **transparency** is about giving your voting citizens the necessary financial information on a timely basis in order for there to be **accountability** for government officials financial actions.

Goals of Western Democracy Government Financial Transparency

1. Build trust and confidence
2. Better use of taxpayers money
3. Improve government ROA and net worth
4. Combat corruption
5. Global comparability and consistency
6. Accuracy and auditability
7. Citizen friendly

Greece and Peer Balance Sheet Debt and Net Debt: 2013-2015

	Greece and Peer 2015 Data:							
		Greece	Greece % of Peer Avg.	Peer Average	Portugal	Ireland	Spain	Italy
1.	Balance Sheet Debt	€ 125			€ 208	€ 190	€ 1,054	€ 2,175
2.	Financial Assets	€ 52			€ 64	€ 75	€ 304	€ 329
3.	**Balance Sheet Net Debt**	**€ 72**			**€ 144**	**€ 115**	**€ 749**	**€ 1,846**
4.	GDP	€ 176			€ 179	€ 215	€ 1,081	€ 1,636
5.	Balance Sheet Debt / GDP	71%	65%	109%	116%	88%	97%	133%
6.	Financial Assets / GDP	30%	100%	30%	36%	35%	28%	20%
7.	Balance Sheet Net Debt / GDP	**41%**	**52%**	**79%**	**80%**	**54%**	**69%**	**113%**
8.	Future Face Value of Debt	€ 312			€ 231	€ 201	€ 1,072	€ 2,172
9.	Future Face Value / GDP	177%	156%	114%	129%	94%	99%	133%
	Greece Historical Data:							
		2013	2013 Revised	2014	2015		2013 Revised - 2015	
							Delta	*% Change*
10.	Balance Sheet Debt	€ 124	€ 124	€ 124	€ 125		€ 0	0%
11.	Financial Assets	€ 91	€ 97	€ 71	€ 52		-€ 45	-46%
12.	**Balance Sheet Net Debt**	**€ 33**	**€ 27**	**€ 53**	**€ 72**		€ 45	167%
13.	GDP	€ 182	€ 180	€ 178	€ 176		-€ 4	-2%
14.	**Balance Sheet Debt / GDP**	**68%**	**69%**	**70%**	**70.8%**		2%	
15.	Financial Assets / GDP	50%	54%	40%	30%		-24%	
16.	**Balance Sheet Net Debt / GDP**	**18%**	**15%**	**30%**	**41%**		**26%**	
17.	Future Face Value of Debt	€ 319	€ 319	€ 317	€ 312		-€ 8	-2%
18.	Future Face Value / GDP	175%	177%	179%	177%		0%	

GREECE 2013 BALANCE SHEET NET DEBT WAS INDEPENDENTLY VERIFIED BY A BIG-FOUR ACCOUNTING FIRM ON 15 AUGUST 2014.

Notes: Estimate as of August 2016.

Greece Debt Service is 50% of EZ Peers versus a GFN (which Includes Non-Debt Flow Assumptions) of 123%

GFN ignores highly concessional EZ 3rd Programme 2016 - 2018 funding support.

	Debt Service % of GDP	IMF Gross Financing Needs (GFN) % of GDP
Greece	6%	19%
Portugal	11%	20%
Ireland	9%	9%
Spain	13%	17%
Italy	15%	17%
Peer Average	12%	15%
Greece % of Peer Average	**50%**	123%

Notes: Debt Service is 2016 estimate based on Bloomberg, EC, and IMF data; Greece adjusted for deferred interest on EFSF co-financed loans, interest income on bank CoCos, and SMP/ANFA rebates. GFN as used includes assumptions about building cash buffers, payables reductions, fiscal balance, annualizing T-bill roll-overs, and paydown of IMF loan balance, and ignores highly concessional EZ 3rd Programme funding support (estimated total remaining 2016-2018 funding of €61 billion).

MGDD vs ESA: Rescheduling

Manual on Government Deficit and Debt

Implementation of ESA 2010

VII.3.3.2 Rescheduling of a loan

22. There is no real guideline for trea0ing such a case in ESA 2010. Mention is only made of debt restructuring in ESA 2010 20.236 which states the same principle related to the difference in value (without specifying that it is in nominal terms). It is mentioned in 2008 SNA but in a rather descriptive way indicating only in 20.107 b that it "may or may not result in a reduction in present value terms" whereas there is no mention of a possible capital transfer. Therefore, this manual brings a necessary clarification and in useful practical guidance for national accountants.

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Chapter 5: Valuation

5.19 Financial transactions are recorded at transaction values, that is, the values in national currency at which the financial assets and/or liabilities involved are created, liquidated, exchanged or assumed between institutional units, on the basis of commercial considerations.

5.20 Financial transactions and their financial or non-financial counterpart transactions are recorded at the same transaction value. There are three possibilities:

(c) neither the financial transaction nor its counterpart transaction is a transaction in cash or via other means of payment: the transaction value is the current market value of the financial assets and/or liabilities involved.

5.21 The transaction value refers to a specific financial transaction and its counterpart transaction. In concept, the transaction value is to be distinguished from a value based on a price quoted on the market, a fair market price, or any price that is intended to express the generality of prices for a class of similar financial assets and/or liabilities. However, in cases where the counterpart transaction of a financial transaction is, for example, a transfer and therefore the financial transaction may be undertaken other than for purely commercial considerations, the transaction value is identified with the current market value of the financial assets and/or liabilities involved.

ESA 2010

Debt operations

20.221 Debt operations can be particularly important for the general government sector, as they often serve as a means for government to provide economic aid to other units. The recording of these operations is covered in Chapter 5. The general principle for any cancellation or assumption of debt of a unit by another unit, by mutual agreement, is to recognise that there is a voluntary transfer of wealth between the two units. This means that the counterpart transaction of the liability assumed or of the claim cancelled is a capital transfer. No flow of money is usually observed, this may be characterised as a capital transfer in kind.

Other debt restructuring

20.236 Debt restructuring is an agreement to alter the terms and conditions for servicing an existing debt, usually on more favourable terms for the debtor. The debt instrument that is being restructured is considered to be extinguished and replaced by a new debt instrument with the new terms and conditions. If there is a difference in value between the extinguished debt instrument and the new debt instrument, it is a type of debt cancellation and a capital transfer is necessary to account for the difference.

MGDD vs ESA: Concessional Loans

Manual on Government Deficit and Debt

Implementation of ESA 2010

V.6.1 Background of the issue

1. As a part of public policy activities, governments provide loans at a lower interest rate than the market rate observed at the time of loan issuance (sometimes called "concessional loans").

V.6.2 Recording of low interest rate loans at inception

6. In this context, the interest has to be recorded on the basis of the contractually agreed interest rate. Consequently, no implicit benefit for the debtor is recorded in national accounts.

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ESA 2010

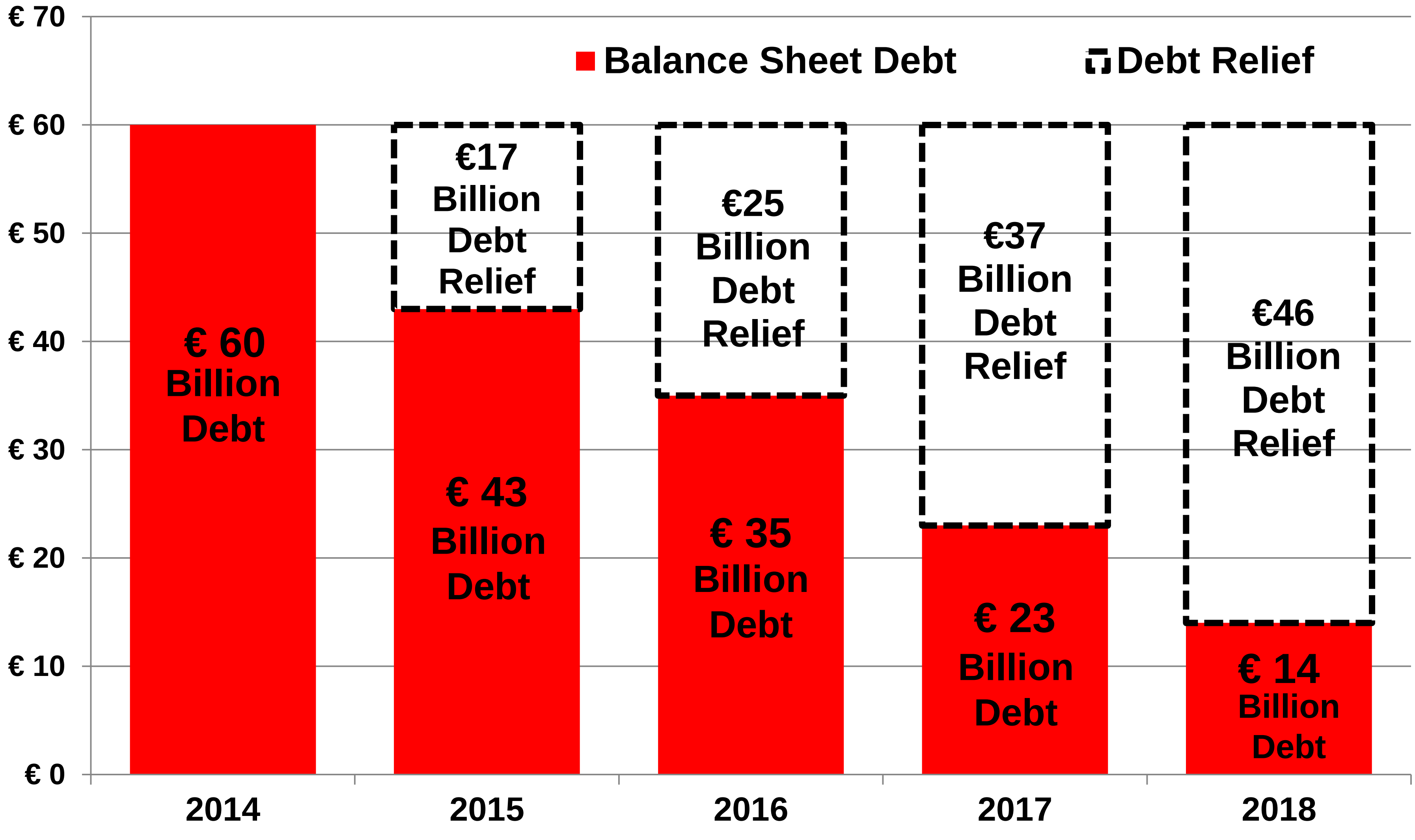
20.241 Debt issued on concessional terms. There is no precise definition of concessional loans, but it is generally accepted that they occur when units of the general government sector lend to other units in such a way that the contractual interest rate is intentionally set below the market interest rate that otherwise would apply. The degree of concessionality can be enhanced with grace periods, frequencies of payments, and a maturity period favourable to the debtor. Since the terms of a concessional loan are more favourable to the debtor than market conditions would otherwise permit, concessional loans effectively include a transfer from the creditor to the debtor.

20.242 Concessional loans are recorded at their nominal value just as other loans, but a capital transfer is recorded as a memorandum item at the point of loan origination equal to the difference between the contract value of the debt and its present value using a relevant market discount rate. There is no single market interest rate that should be used to measure the capital transfer. The commercial interest reference rate published by the OECD may be applicable when the loan is issued by one of its member countries.

2. Opportunity Cost of Not Using International Accounting Standards

ESM Third Programme for Greece has €46 Billion in Debt Relief

(€, Billions)



Note: Estimate as of 31 December 2015.

In 2015, Greece Net Worth Increased €17 Billion from Third Programme Debt Relief on €21.4 Billion of Loans

During 2015, ESM made five concessionary loans to the CCC-rated Greece government for a total of €21.4 billion. The loans have an interest rate equal to AAA/Aa1-rated ESM cost of funds, which is less than 1%, not the yield-to-maturity of 7% to 8% on the longest maturity publicly traded Greece government bond. The loans have maturities out to 2059, 18-year grace periods, and weighted average lives of 32.5 years. Approximately, €16 billion of the proceeds were used to repay maturing debt and €5.4 billion to purchase financial assets of domestic banks, most of which was invested in 8% interest CoCos.

Before Third Programme					**Post-Third Programme**			
Assets		**Liabilities / Net Worth**			**Assets**		**Liabilities / Net Worth**	
Financial Assets	€ 0.0	Debt	€ 16.0		Financial Assets	€ 5.4	Debt	€ 4.4
		Total Liabilities	€ 16.0				Total Liabilities	€ 4.4
		Net Worth	-€ 16.0				Net Worth	€ 1.0
Total Assets	€ 0.0	Total Liabilities and Net Worth	€ 0.0		Total Assets	€ 5.4	Total Liabilities and Net Worth	€ 5.4

Note: As of 31 December 2015. The €21.4 billion of ESM loans are reported on the balance sheet at initial recognition value (also known informally as present value) which is amortized cost under international accounting rules and increase (accrete) to maturity value (known informally as future face value) each accounting period. The subsequent accretion impact to net worth is reduced by appreciation in the financial assets and debt relief from inflows of ESM funds.

€100+ Billion in Value Destroyed Since 2012 OSI/PSI

- Government Financial Assets: Equity and fixed income losses.
- Government Non-Financial Assets: losses from increases in investor required rate of return.
- Debt Buyback: Unwise debt buybacks based on flawed accounting contributed to liquidity crisis.
- Bank Forced GGB Sale: Destruction of bank equity as financial assets on forced sale of GGBs.
- Revenue Loss: Inaccurate debt data depressed economy.
- Borrowing Costs: Inaccurate debt data increased borrowing costs.
- Repos: Forced intra-government repo funding.
- Swaps: Reduced bank collateral through forced GGB swaps.
- Timing Games: Tax installments, arrears, IRR schemes.

BOG Governor FT 13 June 2016 Editorial: Comments Contrary to Financial Facts

Debt Relief:

1. “At the same, our European partners have yet to deliver on their commitment to provide further debt relief.”
2. “The same [no debt relief] happened on May 24 this year…”
3. “It should be stressed that the Eurogroup postponed the decision for debt relief in spite of the following: that the Greek government had honored its commitments…”
4. “Lower final fiscal targets and debt relief are the incentives that will keep the Greek economy and society going.”
5. “a rather moderate debt relief that does not inflict losses on lenders” [maturity extensions and capitalized interest deferment installments].

Fiscal Performance:

1. “there have been several unheralded successes – maintaining fiscal discipline...”
2. “…in 2014, after Greece achieved, with considerable pain, a primary balance of €1.5bn in 2013.”
3. “Greek banks, following successive (and successful) recapitalizations…”
4. “Greece has weathered the perfect storm…”
5. “the most serious threat to financial stability: NPL.”

3. Educate Key Stakeholders on Benefits of Using International Accounting Standards

Key Balance Sheet Metrics for Global Benchmarks

(2001 to 2015)

SN		Rank #1	Rank #8	Median	Explanation
1.	**Net Worth Value Creation Ratio**	NWI 69% of GDP	23%	199%	Change in GDP per unit change in Net Worth start point to end point.
2.	**Net Worth Return on Asset Ratio**	4%	-38%	-7%	Average annual change in net worth as a % of total assets.
3.	**Net Worth % of GDP - Latest**	38%	-158%	-62%	Latest period end net worth as a % of latest year GDP.
4.	**Net Worth Annual % Change**	19%	-13%	-4%	Average annual percentage change in net worth during period.
5.	**Total Liabilities Value Creation Ratio**	1156%	16%	75%	Change in GDP per unit change in Total Liabilities start point to end point.
6.	**GDP Change to Debt Change Ratio**	535%	52%	151%	GDP increase per unit of debt increase start point to end point.
7.	**Net Debt % of GDP - Latest**	3%	64%	30%	As reported balance sheet net debt as a % of GDP.

Notes: 2001 to 2015 data or all available data from this period.

Net Worth Value Creation Ratio: Full period change in GDP divided by change in Net Worth.

Net Worth Return on Asset Ratio: Change in net worth as a percentage of assets.

Net Worth as % of GDP - Latest: Latest period end (2014 or 2015) net worth divided by corresponding year GDP.

Net Worth Annual Percentage Change: Annual change in year end net worth.

Total Liabilities Value Creation Ratio: Change in GDP divided by Change in Liabilities

GDP to Debt Value Creation Ratio: GDP increase as a % of debt increase.

Net Debt % of GDP - Latest: Latest period end (2014 or 2015) net debt (debt less financial assets) derived from respective government balance sheets divided by corresponding year GDP.

Net Worth Change Comparison: Select Sovereigns 2011 - 2014/15

1. Greece Net Worth increased 44% from 2011 to 2015 compared to Benchmark Median decrease of 23%.
2. Greece Net Worth as a % of GDP increased 60 percentage points compared to Benchmark Median decrease of 7 percentage points.

		Greece	Benchmark Median	Australia	Canada	France	Israel	New Zealand	Swiss	UK	US
1.	Net Worth - 2011	-415		-103	-550	-2,149	-1401	81	-40	-986	-14,785
2.	Net Worth - 2014/15	-231		-309	-612	-2,770	-1727	92	-38	-1,620	-18,222
3.	Net Worth % Change	44%	-23%	-200%	-11%	-29%	-23%	14%	5%	-64%	-23%
4.	Net Worth % of GDP - 2011	-200%		-7%	-33%	-104%	-150%	39%	-6.4%	-57%	-95%
5.	Net Worth % of GDP - 2014/15	-131%		-19%	-31%	-130%	-158%	38%	-5.8%	-87%	-102%
6.	NW/GDP % Point Change	69	-7	-12	2	-26	-8	-1	0.6	-30	-6

Notes: Data from respective government financial statements, EC AMECO, Eurostat, and IMF. France and Switzerland Net Worth adjusted for pension commitments. UK Net Worth adjusted for undervaluation of infrastructure assets. UK and Canada GDP data is prior year due to 31 March fiscal year end. For back-up on 2015 Greece government working draft balance sheet, see USC Global Leadership Summit presentation titled "Greece Government Working Draft Balance Sheet and Analysis of Third Programme Debt Relief" (mostimportantreform.info/uscsummit.html). Greece 2011 figures are backwards developed estimates, which is an economics methodology (not a methodology based on international accounting or audit standards).

Relative Weightings of Sovereign Rating Frameworks

Moody's			S&P	
Four Factors	**Weight**		**Five Factors**	**Weight**
#1. Economic Strength	12.5%		**#1. Political Score**	25%
#2. Institutional Strength	12.5%		**#2. Economic Score**	25%
#3. Fiscal Strength	25%		**#3. External Score**	17%
#4. Susceptibility to Event Risk	50%		**#4. Fiscal Score**	17%
			#5. Monetary Score	17%

Fitch			DBRS	
Four Factors/Variables	**Weight**		**Six Factors**	**Weight**
#1. Macroeconomic Policies and Performance	10.3%		**#1. Fiscal management and Policy**	16.67%
			#2. Debt and liquidity	16.67%
#2. Structural Features	47.4%		**#3. Economic structure and performance**	16.67%
#3. Public Finance	25.4%		**#4. Monetary policy and financial stability**	16.67%
#4. External Finances	16.9%		**#5. Balance of payments**	16.67%
			#6. Political environment	16.67%

Proposed Adding a 20% Weighting to a Sovereign Financial Management Index

Total Ranking: 0-20 (Poor), 20-30 (Fair), 30-40 (Good), 40+ (High)

		Weighting	Ranking
Qualitative Factors		50%	
	Rankings: 0 (Worst), 1 (Poor), 2 (Fair), 3 (Good), 4 (Best)		
1.1	Accounting Principles	7%	
1.2	Audit	7%	
1.3	Budget	7%	
1.4	Financial Statements	7%	
1.5	Fiscal Management	7%	
1.6	Fiscal Oversight	7%	
1.7	Human Capital	7%	
Quantitative Factors		50%	
	Quartile Rankings: 1 (Bottom), 2 (Second), 3 (Third), 4 (Top)		
2.1	Net Worth Value Creation Ratio	7%	
2.2	Net Worth Return on Asset Ratio	7%	
2.3	Net Worth % of GDP - Latest	7%	
2.4	Net Worth Annual % Change	7%	
2.5	Total Liabilities Value Creation Ratio	7%	
2.6	GDP Change to Debt Change Ratio	7%	
2.7	Net Debt % of GDP - Latest	7%	
Total:		100%	

Wrap-Up

Professional Turnaround Manager
100-Day Accomplishments

(A) Verifiable estimate of 2015 Greek government major balance sheet items.

(B) Presentations using correctly calculated, under international rules, Greece and peer government debt numbers, especially balance sheet net debt, annual debt service, net interest payments, debt projections, and debt relief.

(C) Presentations to rating agencies.

(D) Presentations to sovereign wealth funds.

Professional Turnaround Manager for Greece
June 2016 Update

- **Advertisements:** FT, NYT, and Greek (Q1 2016).
- **Qualifications:** globally respected, turnaround successes, finance and accounting experience, rating agency and SWF relationships.
- **Responsibilities:** opening balance sheet, major changes in net worth, SWFs, rating agencies.
- **Terms:** open-ended term of service (two years expected). Pro bono compensation.
- **Politically acceptable:** no one is replaced, no legal power, no perks, no sovereignty issues.
- **Vetting Process:** Q2+ 2016.
- **Candidates:** top ten shortlist Summer 2016.
- **Designation Announcement:** Summer 2016.

Designate a World-Class Professional Turnaround Manager (PTM) for Greece

Globally Recognized Impeccable Integrity

Successful Growth Turnarounds

Unparalleled Knowledge of Greece Government Financials

100-Day Plan Skills

Skills to Produce Best Practice Balance Sheet ASAP

Professional Turnaround Manager Qualifications

Trust and Confidence of Sovereign Wealth Funds

Rating Agency Framework and successes

Capital Markets Broad Knowledge

Managed Over 5,000 Employees

Pro Bono Compensation

Correctly Calculating Greece Debt Numbers: Select Readings

"Greece's New Agreement with Europe: This Time Different?" Intereconomics. September/October 2015. **Pelagidis, Theodore and Kazarian, Paul B.**

"Greece's Debt Sustainable?" Harvard Business School Case Study. June 2015. **Serafeim, George**

"Greece's Bailout Package: Missing IPSAS?" The Accountant. September 2015. **Tornero, Carlos**

"The Curious Case of the Rules for Calculating Debt Relief: A Technical Note on EU Accounting for Debt, Especially Restructured and Concessional Debt." Sep 2015. **Ball, Ian**

"What if Greece got massive debt relief but no one admitted it? (Part 2)" Financial Times. 9 June 2016. **Klein, Matthew C.**

See also: www.MostImportantReform.info