

# Insights into Using Government Financial Statements to Understand Government Financial Performance

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“Amsterdam ... the world center  
of accounting expertise”

Quote from The Reckoning by Prof. Jacob Soll

“Amsterdam ... the world center  
of accounting expertise in 1585”

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# Government financial statements of eight governments

# Net Worth as a Percentage of GDP

<b>Global Benchmark</b>	<b>Latest</b>
New Zealand, Government of	38%
Swiss Confederation	-5%
Australia, Commonwealth of	-19%
Canada, Government of	-31%
United Kingdom <i>(Whole of Government)</i>	-93%
United States Government	-101%
France, Republic of	-130%
Israel, Government of the State of	-158%

# Government Net Worth Per Citizen

*(Local currency converted to Euros)*

<b>Country</b>	<b>Latest Net Worth per Citizen (EUR)</b>	<b>5-Year Change per Citizen (EUR)</b>
New Zealand, Government of	€ 12,579	-€ 410
Swiss Confederation	-€ 3,971	€ 567
Australia, Commonwealth of	-€ 8,787	-€ 7,252
Canada, Government of	-€ 11,493	-€ 1,746
United Kingdom <i>(Whole of Government)</i>	-€ 33,907	-€ 21,740
France, Republic of	-€ 43,349	-€ 14,585
Israel, Government of the State of	-€ 49,815	-€ 16,384
United States Government	-€ 52,536	-€ 13,692

# Net Worth Annual Percentage Change

		Historical Average	2011-2014 Average
	<b>Global Benchmark</b>		
1	Australia, Commonwealth of	14%	-62%
2	Canada, Government of	-1%	-4%
3	France, Republic of <i>(Central Government)</i>	-8%	-8%
4	Israel, Government of the State of	-6%	-8%
5	New Zealand, Government of	19%	-2%
6	Swiss Confederation	3%	1%
7	United Kingdom	-13%	-13%
8	United States Government <i>(Central Government)</i>	-8%	-7%

What financial statements are considered high-quality?

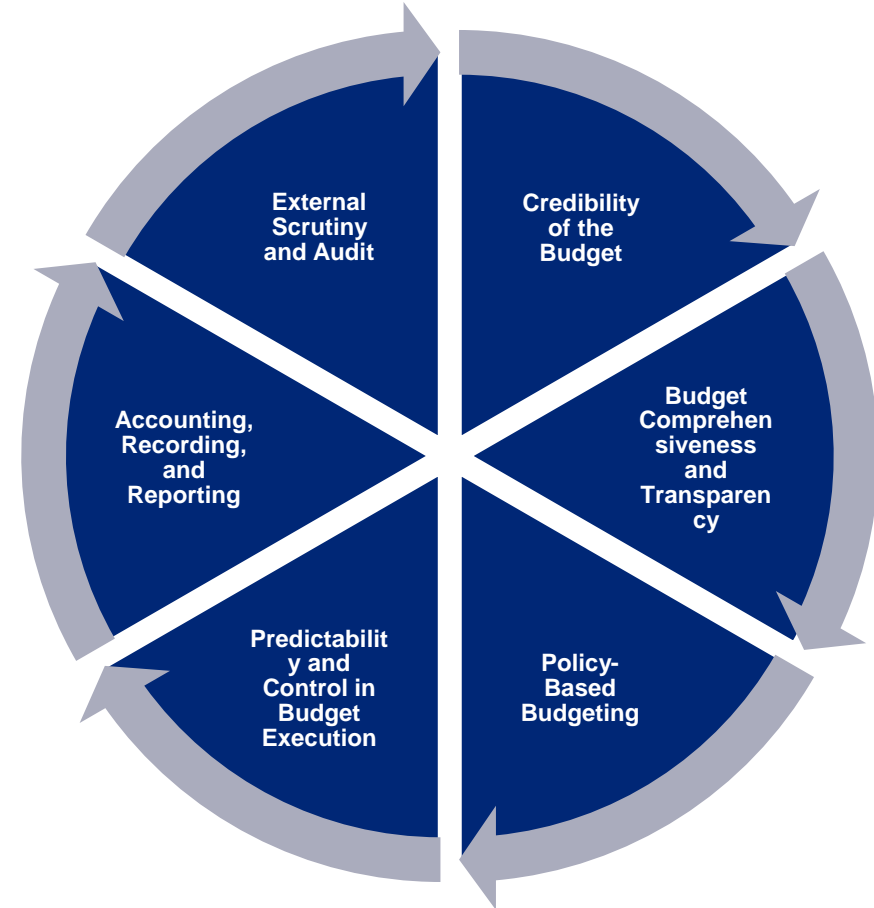


# Public Expenditure and Financial Accountability (PEFA)

- PEFA is an internationally recognized methodology that provides for an integrated tool to assess Public Financial Management (PFM) performance.
- Multi-donor partnership between World Bank, European Commission, and UK's Department for International Development (DFID) and others
- PEFA enables comparison of PFM performance between countries and in time.

# PEFA assessments focus on six key PFM elements

- Framework consists of 28 indicators in 6 segments
- Accounting, Recording, and Reporting segment includes an indicator **Quality and Timeliness of Financial Statements**



## PI25(i) Completeness of the financial statements

- A. A consolidated government statement is prepared annually and includes **full information on revenue, expenditure and financial assets/liabilities**.
- B. A consolidated government statement is prepared annually. They include, **with few exceptions, full information** on revenue, expenditure and financial assets/liabilities
- C. A consolidated government statement is prepared annually. Information on **revenue, expenditure and bank account balances may not always be complete**, but the omissions are not significant.
- D. A consolidated government statement is **not prepared** annually, OR **essential information is missing** from the financial statements OR the financial records are **too poor to enable audit**.

## PI25(ii) Timeliness of submission of the financial statements

Submitted for external audit:

- A. Within **6** months
- B. Within **10** months
- C. Within **15** months
- D. **After 15** months or not at all

## PI25(iii) Accounting standards used

- A. **IPSAS or corresponding national standards** are applied for **all** statements.
- B. **IPSAS or corresponding national standards** are applied for **some** statements.
- C. Statements are presented in **consistent format** over time with **some disclosure of accounting standards**.
- D. Statements are **not presented in a consistent format** over time or **accounting standards are not disclosed**.

What country characteristics potentially affect the quality of government financial reporting?

## What country characteristics potentially affect the quality of government financial reporting?

- Democracy (The Economist Intelligence Unit publishes an index)
- GDP per inhabitant
- Size of the population
- Tax burden as % of GDP

# Democracy Index (Economist Intelligence Unit)

- 60 indicators in five segments:
  - Electoral process and pluralism
  - Civil liberties
  - Functioning of government
  - Political participation
  - Political culture
- Scale of 0 to 10
- Index values place countries in one of four regimes:
  - Full democracies: scores 8-10
  - Flawed democracies: scores 6-<8
  - Hybrid regimes: scores 4-<6
  - Authoritarian regimes: scores <4



## **Democracy Index 2015** Democracy in an age of anxiety

A report by The Economist Intelligence Unit



Data

# Data

- 68 countries with one assessment per country
- Database is not a random sample:
  - PEFA focuses on donor recipients
  - Secretive governments are unlikely to request PEFA assessment
- Quality scores: ordinal score A, B, C, and D
- Democracy index: continuous score 1-10

## PEFA Assessments of government financial statements

<b>Score</b>	<b>Quality</b>	<b>Timeliness</b>	<b>Accounting standards</b>
<b>A</b>	16	43	12
<b>B</b>	19	13	9
<b>C</b>	28	6	42
<b>D</b>	11	12	11
<b>Total</b>	<b>74</b>	<b>74</b>	<b>74</b>

# Economist Democracy Index 2015

<b>Score</b>	<b>Number in sample</b>
<b>Full democracies (score 8-10)</b>	10 (15%)
<b>Flawed democracies (scores 6-&lt;8)</b>	31 (45%)
<b>Hybrid regimes (scores 4-&lt;6)</b>	13 (19%)
<b>Authoritarian regimes (scores &lt;4)</b>	14 (21%)
<b>Total</b>	<b>68 (100%)</b>

Source: The Economist Intelligence Unit (EIU)

## Relationship between government financial statements quality and democracy

<b>Score</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>Total</b>
<b>Full democracy</b>	5	2	2	1	<b>10</b>
<b>Flawed democracy</b>	8	8	9	6	<b>31</b>
<b>Hybrid regime</b>	0	3	10	0	<b>13</b>
<b>Authoritarian regime</b>	2	4	4	4	<b>14</b>
<b>Total</b>	<b>15</b>	<b>17</b>	<b>25</b>	<b>11</b>	<b>68</b>

# Statistical methodology

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- Ordinal regression using the PLUM procedure in SPSS
- Dependent variable (quality score of financial statements) is A, B, C, D which is ordinal, not cardinal
- Explanatory variable (democracy index: political participation) is a covariate (continuous)

# Results



Conclusion: Democracy (political participation) is a significant explanatory variable of the quality of government financial statements

### Parameter Estimates

Parameter	Hypothesis Test			
	Wald Chi-Square	df	Sig.	Exp(B)
Threshold				
[PI25iFSQuality=A ]	18,811	1	,000	,111
[PI25iFSQuality=B ]	9,043	1	,003	,236
[PI25iFSQuality=C ]	,558	1	,455	,705
Politicalparticipation	8,854	1	,003	,759
(Scale)				

Preliminary findings

# Conclusions

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- Degree of political participation does contribute significantly to the explanation of the quality of government financial statements
- Improving government financial statements should go hand in hand with improving political participation, because they are not an aim in itself: they serve accountability and decision-making

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