Accrual Financial Reporting and Australian Fiscal Policy

Marc Robinson
School of Economics and Finance
Queensland University of Technology

ABSTRACT

Australian governments have recently moved from cash accounting to accrual accounting. In doing so they have made simultaneous use of two rival accrual accounting frameworks: AAS 31 and GFS. AAS 31 and GFS operating result measures differ significantly. To date, the AAS 31 framework has enjoyed primacy. This paper evaluates these two frameworks, and suggests that GFS is superior.

Accrual accounting has been accompanied at the national government level by the introduction of a new key fiscal policy measure: the 'fiscal balance'. This paper explains and evaluates this new fiscal measure. It concludes that, given the present fiscal policy of the Australian government, fiscal balance is a superior fiscal policy measure to the 'cash' budget balance measure which it replaced. However, from the alternative 'golden rule' policy standpoint, fiscal balance is not a [1]meaningful fiscal policy measure—although its stock counterpart, net financial liabilities, is.

1. The Move to Accrual Accounting

Over recent years, Australian Governments have progressively implemented accrual accounting in their general government (ie budget) sectors[1], replacing the traditional 'cash' accounting system which is still used by most governments around the world. This process culminated with the presentation of the annual government budget on a full accrual basis, a step which took place at the Commonwealth government level and in most of the States in 1999-2000.

The adoption of accrual accounting in the Australian public sector has been complicated by the simultaneous use by governments of two significantly different accrual accounting frameworks. The dominant framework is that derived from Australian Accounting Standard (AAS) 31. The other is the Government Finance Statistics (GFS) framework developed by the Australian Bureau of Statistics' (ABS). The GFS accrual framework is a reformulation in accrual concepts of a statistical series which prior to 2000 was principally based upon cash accounting concepts. GFS generally follows the international economic-analysis accounting frameworks developed by the International Monetary Fund and the United Nations.

[1] Accrual accounting was long ago applied to government business enterprises in Australia.

At the departmental level, AAS 31 is not merely the dominant, but the sole, accounting framework employed. Both frameworks are employed in annual government budget papers, but even there AAS 31 has pride of place. Each requires the presentation of financial reports both on a consolidated whole-of-government and on a sectoral basis. This paper focuses upon financial reporting for the budget sector of government (the so-called 'general government' sector).

There are minor terminological differences between AAS 31 and GFS. In the balance sheet, AAS 31 uses the term 'net assets' whereas GFS refers to 'net worth'. In terms of the operating statement, AAS 31 uses 'operating result', whereas GFS uses 'net operating balance'. However, the differences between AAS 31 and GFS go well beyond mere terminology (Treasury, 2000, Statement 8). In terms of the operating statement, the two frameworks differ in their treatment of abnormals, revaluations and a couple of other more minor items (ABS, 2000: 22-23).

In respect to abnormals, under AAS 31 a distinction has been drawn between the 'operating result before abnormals' and the 'operating result after abnormals'. By contrast, GFS has only one measure of the operating balance, which excludes nearly all items which AAS 31 treats as abnormals. In addition, the AAS 31 operating result before abnormals includes some minor items which GFS considers to be abnormals.

The difference between the operating result before and after abnormals can be quite large. In 1999-00, for example, the former was $9.5 billion and the latter was $22.9 billion (Treasury, 2000b: 22). The bulk of this difference was accounted for by increase in the balance sheet valuation of the Government's equity in Telstra (the dominant Australia telecommunications carrier) from book to anticipated market value, pursuant upon a planned full privatisation (Treasury, 1999a: 1.20, 9.36). The Commonwealth has, however, made no attempt to use the result after abnormals for public relations purposes. Indeed, it uses the term 'operating result' consistently to refer to the operating result before abnormals, a practice which will be followed in this paper. A potential concern, however, is that the accounting standards do not require the exclusion of abnormals from AAS 31 operating results reported for reporting periods after 1 July 2000 (ABS, 2000: 23). This unfortunately creates scope for abuse by unscrupulous governments.

The difference in the treatment of revaluations is that AAS 31 considers most revaluations to be expense or revenue items, whereas GFS excludes most revaluations from the operating statement. The ABS defines revaluations as "changes in stocks that arise from price movements" (ABS, 2000: 9), although it might be more complete to add that they may also arise from changes in expectations even where there is no market price which changes. An example of a revaluation which AAS 31 recognises in the operating statement is a change in the market value of debt which arises from altered expectations about forward interest rates and which does not reflect any underlying lending transaction. Another example is gains/losses arising from exchange rate movements. Other key revaluations which are treated as expenses or revenue in an AAS 31 operating statement include:

- Changes in the actuarial valuation of superannuation and similar obligations government employees (unrelated to the incurring of new liabilities),
- Write-downs of assets and bad or doubtful debts,

- Profit/loss arising from the sale of government equity in public enterprises at prices which differ from their balance sheet values.

Comparing the AAS 31 operating result before abnormals with the GFS net operating balance, the most important difference is certainly the treatment of revaluations. Because GFS excludes revaluations from the operating statement, it is approximately correct to say that the GFS net operating balance equals the AAS 31 operating result excluding revaluations. Given the sign conventions pertaining to revaluations, it is necessary to 'add' revaluations in order to exclude them. Thus

GFS Net Operating Balance = AAS 31 Operating Result + Revaluations

Quantitatively, the difference between these two measures can be quite significant. For the Commonwealth's 1999-2000 budget outcome, the GFS net operating balance was $13.4 billion, whereas the AAS 31 operating result was, as mentioned above, $9.5 billion. The difference was largely due to revaluations.

The appropriateness or otherwise of including revaluations in the operating result is therefore an important issue, and is discussed further below. It is an issue which gains added relevancy in the context of the development by the Commonwealth of a new key fiscal policy indicator.

2. From Cash Balance to Fiscal Balance

In the period immediately prior to the introduction of accrual accounting, the cash budget result was regarded by all Australian governments as the 'headline' fiscal policy measure. Without exception, all governments aimed to achieve balanced or surplus cash budgets. It was the cash budget balance which the federal Coalition government had in mind when, upon coming into office in 1996, it declared that its overarching fiscal rule was to 'achieve underlying[2] budget balance on average over the business cycle'.

The pursuit of a structurally balanced or surplus cash budget was coupled, at the Commonwealth level and in a number of the States, with a drive to eliminate, or reduce to very low levels, net debt. To achieve this latter objective, proceeds of an ambitious privatisation programme have been applied to debt reduction.

In the 1999-2000 Commonwealth budget a new 'headline' fiscal measure—the *fiscal balance*—was introduced. This new measure is regarded by the Commonwealth Treasury as 'the accrual counterpart of the underlying cash balance', and has been introduced in a context of fiscal policy continuity (Treasury, 1999b: 2). The Government has accordingly reformulated its primary fiscal rule to require 'fiscal balance, on average, over the course of the business cycle' (Treasury, 1999a: 1.14). The cash budget result continues to be given prominence, although perhaps more for reasons of continuity and market confidence than of principle.

[2] The 'underlying' budget balance was an adjusted version of the cash budget result in which privatisation receipts and other 'net advances' are treated as equivalent to borrowing (ie as 'financing transactions') rather than as equivalent to revenue. The practice of adjusting the cash budget balance for the impact of privatisation receipts was also adopted in most States by the mid-1990s.

Fiscal balance is officially defined as the AAS 31 operating result (before abnormals) plus revaluations, minus capital adjustments. The so-called 'capital adjustment' equals capital expenditure minus depreciation: in other words, net investment (or more precisely, net acquisition of non-financial assets[3]).

Fiscal balance is also in effect a concept in the GFS framework, although in that framework it is termed *net lending* (ABS, 1997: 9). Because the GFS net operating balance excludes revaluations it is not necessary in the GFS framework to eliminate revaluations in the derivation of net lending. Thus, viewing fiscal balance from a flow perspective, one can say in summary that (approximately)

Fiscal Balance = AAS 31 Operating Result - Net Investment + Revaluations
= GFS Net Operating Balance - Net Investment = GFS Net Lending

The exclusion of revaluations in the calculation of what the Commonwealth regards as the headline fiscal policy measure puts the spotlight on the question of the appropriateness of including revaluations in the AAS 31 operating result measure.

3. Fiscal Balance from a Stock Perspective

It is useful to consider how the new fiscal balance measure relates to the government balance sheet.

In the GFS balance sheet, the concept of 'net financial worth' has been introduced, such that

Net Financial Worth = Financial Assets - Liabilities

From which it follows that

Net Worth = Net Financial Worth + Non-Financial Assets

From this is follows that, if we ignore abnormals,

GFS Net Operating Balance = Δ Net Worth
= Δ Net Financial Worth + Δ Non-Financial Assets + Revaluations

Now

Net Investment = Δ Non-Financial Assets + Revaluations of Non-Financial Assets

So that since fiscal balance equals the net operating balance minus net investment, it follows that

Fiscal Balance = Δ Net Financial Worth (NFW)+ Revaluations of NFW

[3] Which, for the general government operating statement also deducts from capital expenditure net receipts from the sales of assets held by budget sector agencies.

So that if 'net financial liabilities' (NFL) is defined as a measure equal in absolute value, but opposite in sign, to net financial worth,

Fiscal Balance = - Δ Net Financial Liabilities - Revaluations of NFL

Whereas[4] in the cash accounting framework

Cash Budget Result = - Δ Net Debt - Revaluations of Net Debt

Thus whereas the stock counterpart of the cash budget balance is net debt (where the full 'articulation' of stock and flow is broken by revaluations), the stock counterpart of fiscal balance is net financial liabilities (again with revaluations breaking full articulation).

What is the difference between net financial liabilities and net debt? In stock terms, net financial liabilities is a considerably broader measure that net debt. NFL equals net debt plus a range of quasi-debt liabilities such as superannuation obligations to government employees, other employee entitlements and accounts payable and some analogous non-debt financial assets. And in the case of the general government balance sheet, the government's 'equity' in public enterprises is offset against net debt is measuring net financial liabilities. Thus Commonwealth general government net debt on 30 June 2000 was $53.1 billion, whereas net financial liabilities were $71.6 billion.

4. The Fiscal Policy Context

In evaluating the new fiscal balance measure, the appropriate starting point is the present Commonwealth Government's fiscal policy framework.

As noted above, in the former cash accounting context, the key elements of the Government's fiscal strategy were structurally balanced cash budgets and debt elimination. Why these fiscal strategy objectives? One reason was that they were seen as crucial to raising national savings. For more than a decade, Australian macroeconomic policy has been preoccupied the country's low savings ratio and large deficits on the current account of the balance of payments. The dominant view amongst policy makers has been that the appropriate fiscal response to this problem is that government should cease drawing upon private savings. This called for an end to (structural) budget deficits.

As for debt elimination, the Government takes the view that public debt is undesirable in terms of both intergenerational equity and fiscal sustainability (Costello, 2000: 1; Treasury, 2000: 1-23). More particularly, the Government has seen its policy framework as crucial to demonstrating fiscal responsibility so as to retain the confidence of the international financial markets.

These policy orientations have remained unchanged with the shift to an accrual framework. Indeed the primary motivation for the introduction of the new fiscal balance measure is that it is seen as more precise measure of 'the Government's contribution to net lending' (Treasury, 1999b: 2). And this is indeed quite correct. To use the cash budget result as a measure of government savings is in effect to count as part of savings any financial assets which are

[4] For simplicity we ignore any adjustments to the cash balance to eliminate net advances.

accumulated to fund increases in non-debt liabilities. This mistake is avoided if one uses the fiscal balance measure. Thus, given the Government's policy framework, the emphasis being given to the fiscal balance is entirely appropriate.

Logically, the stock counterpart of this ought to be a shift from a focus on net debt elimination to the elimination of net financial liabilities. This has, however, not happened. This may be best understood in political terms. Government leaders have invested a great deal of public relations effort into attacks on public debt, and the dry term 'net financial liabilities' does not lend itself to ready political marketing.

Although the fiscal policy framework has remained essentially unchanged, the introduction of accrual accounting has lead to the articulation of a new ancillary fiscal policy objective: that of 'improving the Commonwealth's net assets position over the medium to long term' (Treasury, 1999a: 1.15, 1.19). The rationale for this has not been made explicit.

National savings, intergenerational equity and fiscal sustainability are all *medium-term* fiscal policy concerns. What about short-run fiscal policy in the Keynesian demand management sense? It has traditionally been considered that cash surplus/deficit measures are more relevant here than accrual measures, and that may still be the dominant view in Australia (notwithstanding residual neo-Ricardian influences). However, in the context of the general loss of faith in short-run fiscal fine-tuning, there is little preoccupation with the relative stabilisation policy merits of the cash budget result vs the fiscal balance. In any event, the cash budget result is, at least for the time being, published alongside the fiscal balance.

5. An Alternative Fiscal Policy Perspective

It is somewhat striking that, having introduced accrual accounting, the Commonwealth at present appears to attach little policy relevance to the budget operating balance. The explanation of this lies partly in the fact that the adoption of accrual accounting in the Australian public sector has been driven overwhelmingly by its perceived microeconomic benefits as a tool for improving the efficiency and effectiveness of government. In line with this, nearly all Australian governments have not merely adopted accrual accounting, but have adopted a broader system of 'accrual output budgeting' which combines accrual accounting with a purchaser/provider model of budgeting.

In Britain, by contrast, the Blair government on coming to office adopted the 'golden rule' of public finance (UK Treasury, 1997), from the standpoint of which the operating balance is the most important measure of fiscal stance. The golden rule is first and foremost about intergenerational equity, particularly in the context of the distinction between current and capital expenditure[5]. On the one hand, it firmly eschews the use of borrowing to funds the costs of current government services. On the other hand, it defends the use of borrowings to spread the costs associated with capital expenditure over time in accordance with the distribution over time of the benefits which that capital expenditure generates. To spread the costs of capital expenditure in this manner makes sense not only in terms of intergenerational

[5] It is not suggested that the issue of intergenerational equity is as simple as this. However, even allowing for complexities such as intra-generational transfers within an overlapping generations context, the golden rule can still be defended as a most useful approximation and as considerably superior to a balanced cash budget rule (Robinson, 1997).

equity, but also as a means of achieving a degree of 'fiscal smoothing' with respect to irregularities in capital expenditure requirements. (Such irregularities can arise for a number of reasons such as discontinuities in population growth rates and the 'bunching' of required capital asset replacement expenditure (Robinson, 1996)).

In accounting terms, the golden rule requires that governments achieve a balanced accrual budget—in other words, a zero operating balance—on average over the course of the business cycle (Robinson, 1998). Given this, what can be said about the merits of the fiscal balance measure from a golden rule perspective? To start with the obvious, because the net operating balance equals fiscal balance plus net investment, the golden rule implies not that the (structural) fiscal balance should equal zero, but rather that it should be equal in magnitude but opposite in sign to net public investment.

What about fiscal sustainability? Fiscal sustainability might be defined as the avoidance of fiscal policy settings which, if maintained over time, would ultimately result in the burden of financial obligations rising to levels which would lead government to default, and which at some point prior to that would lead to a loss of confidence on the part of potential lenders. Advocates of the golden rule recognise that achieving a balanced accrual budget does not necessarily guarantee fiscal sustainability. It is conceivable that a government might balance the budget in accrual terms in the short run while at the same time accumulating unsustainable levels of debt to finance grandiose capital expenditure schemes. It is therefore necessary to set explicit fiscal sustainability rules. The standard approach to this has been to stipulate that the ratio of net debt/GDP should not exceed some specific moderate ceiling. This is, of course, what the British Government has done, cleverly labelling it the 'sustainable investment' rule (UK Treasury, 1999). It can be argued that, as long as the net debt/GDP ceiling is a moderate one, such a fiscal sustainability rule should be perfectly consistent with maintaining the confidence of the international money markets.

A moment's consideration suggests that the fiscal sustainability rule of this type is more appropriately specified in terms of net financial liabilities than in terms of net debt. On the assets side, the net financial liabilities measure includes non-monetary assets such as government holdings of publicly traded shares, which are arguably just as relevant to fiscal sustainability as are monetary assets. Equally, on the liabilities side, quasi-debt liabilities such as superannuation obligations to public servants imply under normal circumstances a level of commitment which makes an essential that they be taken into account in assessing fiscal sustainability.

Although net financial liabilities are (revaluations aside) the stock counterpart of fiscal balance, fiscal balance is not a useful fiscal sustainability indicator from a golden rule perspective. Setting a ceiling on the NFL/GDP ratio implies that it is acceptable for NFL to grow over time, as long as the trend rate of growth does not exceed that of GDP. This implies that, over the long haul, the fiscal balance will tend to be in structural deficit (albeit a small deficit). In the medium term, however, the application of the golden rule in the presence of irregularities in capital expenditure requirements might make it appropriate that during certain periods of time the fiscal balance should be in structural surplus[6].

[6] For example, during a period of markedly below-average required asset replacement expenditure.

What about national savings policy? Although it is a matter of vigorous macroeconomic debate, here we simply accept for the sake of argument the proposition that higher government savings leads to higher national savings and thence to improved current account outcomes. Even from this perspective, there are alternatives to the pursuit of fiscal balance. The context is that, while fiscal balance may measure government net lending, government *savings* is measured by the operating balance. This means that a policy of structural fiscal balance implies that, over the business cycle, government savings would equal government net investment. It is not obvious why government savings of this particular magnitude should be targeted. One obvious policy alternative might be for government to target a defined level of operating *surplus* instead of the usual golden rule approach of targeting operating balance. Such an approach would preserve the fiscal smoothing properties of the golden rule approach in dealing with irregularities in capital expenditure requirements.

It can therefore be concluded that, from a golden rule perspective, fiscal balance is not a useful fiscal policy variable unless one adopts a very specific policy with respect to the desired magnitude of government savings.

As noted above, the shift to accrual accounting has seen the adoption by the Australian government of an objective of *increasing* net assets over time. Disregarding revaluations, the golden rule approach of balancing the budget in accrual terms is, of course, equivalent to constant net assets rule. From this perspective, the pursuit of *increasing* net assets implies undue imposts upon current generations, and reflects what the Commonwealth Treasury itself correctly identified in 1995 as a misconceived 'presumption that increases in net worth are good' (Treasury, 1995: 5).

We turn now to a consideration of the differences between GFS and AAS 31 operating balance measures from a fiscal policy perspective. The proper definition of the operating balance is obviously of particular importance to proponents of the golden rule, because for them it is the operating balance rather than fiscal balance which serve as the headline fiscal policy measure.

6. The Treatment of Revaluations

Suppose one were to apply a golden rule policy framework while using an operating balance measure which, like AAS 31, deemed revaluations to be revenues and expenses. Or suppose, alternatively, that the zero fiscal balance rule were to be applied in a context where fiscal balance was defined in such a manner as *not* to exclude revaluations. The implications of this would be that such revaluations might need to be offset fully and immediately by adjustments to public sector consumption. For example, if a change in forward interest rate expectations led to a significant fall in the market value of public debt fell, it would then be permissible to immediately increase current expenditure by the full amount of the capital gain. Conversely, if there were a capital loss (e.g. due to major asset write-downs and write-offs of bad debts), it might be necessary to cut current expenditure forthwith so as to fully offset the loss.

By contrast, excluding revaluations from the operating balance or fiscal balance implies will generally have the effect of spreading the gain or loss over time. Although such revaluations would still have an immediate impact upon the balance sheet, changing net worth and generally (given the type of revaluations which AAS 31 recognises in the operating statement) changing net financial liabilities by the same amount. But the effect on the

operating statement will only be felt only over time through associated interest or other expense or revenue flows.

Take, for example, a profit/loss on the privatisation of a public enterprise. Suppose for argument's sake that the pre-privatisation book value of the government's equity in the enterprise *happened* to reflect its economic value if retained in public ownership (its 'value-in-use'), and the enterprise was then sold at a higher price. Whereas the AAS 31 approach would imply that the sale profit could be spent immediately, under the GFS approach the immediate impact of the sale profit would be to increase financial asset holdings with a correspondingly flow of interest earnings over time. Ceteris paribus, government consumption could increase permanently by the amount of those interest savings.

What is the appropriate treatment of revaluations? It is not possible to do full justice to this issue here, but a few remarks may be useful.

In justifying the exclusion of revaluations from the GFS net operating balance, the ABS observes (1997: 9) that 'revaluations are largely outside a government's direct control'. A key consideration here is presumably that in many instances the capital gains or losses to which these revaluations give rise are *windfall* (ie unexpected) in nature. To require immediate fiscal policy offsets to the unexpected is potentially to introduce a significant element of instability into revenue or expenditure policy.

Not only do revaluations give rise to windfall gains/losses, but some of these gains/losses are inherently volatile and reversible. For example, unrealised capital losses due to exchange rate depreciation this year might easily be matched by capital gains on an exchange rate rebound the following year. It would make very little sense to respond to such a situation by cutting current spending in the first year and then increasing it in the second.

These considerations suggest that there is a strong fiscal smoothing argument for excluding revaluations from both the operating statement and the fiscal balance. The point is analogous to Friedman's permanent income hypothesis: the rational consumer (and here we are talking about government in its consumption role) will set consumption expenditure by reference to 'permanent' as opposed to 'transitory' income.

From the intergenerational equity perspective, however, there is the additional question of whether it is fair that the full benefit or burden of a revaluation-driven capital gain/loss should be born immediately, or whether it should be spread over time in some other manner. To immediately spend any true windfall gains on consumption does not seem consistent with intergenerational equity. The same can be said in relation to privatisation profits, at least under a number of conceivable scenarios (e.g. if the privatisation profit arose either because of expected future price increases/wage reductions, or even simply because of unrealistic optimism on the part of the purchasers). The appropriate inter-temporal allocation of such gains and losses is a matter which ought, in principle, to be judged on a case-by-case basis. However, considerations of practicality and the need to limit the scope for discretionary manipulation of financial reporting probably mean that a general rule is preferable. If this is the case, it seems that a general rule of excluding revaluations is likely to be far more consistent with intergenerational equity than a policy of general inclusion.

This analysis suggests that, in general, the GFS approach of excluding revaluations makes good fiscal policy sense. Having said this, there appears to be at least one potential exception to this principle. This pertains to holding gains on debt (and other financial assets and liabilities) arising from inflation rather than changes in expected forward interest rates. The actual inflation rate equals the sum of expected inflation and unexpected inflation. Expected inflation tends to be built into nominal interest rates via the Fisher effect. Only holding gains (or losses) from the unexpected element of inflation can properly be regarded as windfall gains. It follows that, in principle, holding gains arising from expected inflation should indeed be recognised in the operating statement. In normal times, most of the inflation rate is expected rather than unexpected. Therefore, if it is considered impracticable to distinguish between expected and unexpected holding gains on monetary assets in financial reports, it probably makes sense to simply treat all holding gains on monetary assets as revenue.

This point is the flow counterpart of the familiar issue of inflation-adjusted fiscal rules. During the high-inflation period in the 1970s and 1980s, many economists pointed out that if balanced cash budgets were to be pursued, then one ought at least to recognise that inflation was eroding the real value of public debt, and that the budget result measure should be adjusted to include the associated capital gains. Analogously, although in a golden rule context it is true that (revaluations aside) the zero operating balance rule translates into a constant net worth rule, a moment's reflection indicates that the stock rule should properly be to maintain constant *real* net worth.

If, this exception aside, exclusion of revaluations from the operating result is sensible from a fiscal policy point of view, why is it that AAS 31 does not adopt this approach? No explanation has been offered by the relevant accounting authorities, but the reason is plain enough: a drive for consistency with private sector accounting practice. It arguably makes sense for businesses to recognise windfall capital gains/losses in the operating statement (at least if they are not volatile and reversible), even though this does not make sense for government. Businesses operate to generate profit for their shareholders. What shareholders choose to do with the income they receive can be left up to them, and is irrelevant to the accounting policies which the business uses to measure its profit. A lasting windfall gain is clearly part of profit, and it does not concern the business whether their shareholders spend any consequential income gains immediately or gradually. Governments, by contrast, are both income-earners and income-consumers. In the consumer role, governments need to concern themselves with the distinction between permanent income and windfall gains.

This underlines a broader point. Accrual financial reporting—the primary function of which in the private sector is to report profit—necessarily performs a significantly different role in the non-profit public sector. Public sector accrual methodology ought to reflect this, rather than a pursuit of consistency with 'generally accepted accounting standards' as if this were an objective in its own right.

7. Conclusion

In Australia the shift to an accrual accounting in core government has taken place in the context of fiscal policy continuity. The Commonwealth Government has introduced a new headline fiscal policy measure— 'fiscal balance'— which it views as the accrual counterpart of the cash budget result. This paper has explained and evaluated the policy relevance of this new measure. It concludes that, given the present Commonwealth Government fiscal policy

framework, fiscal balance makes good sense as a headline measure. However, from the alternative golden rule perspective, fiscal balance is not a meaningful fiscal indicator, although its stock counterpart—net financial liabilities—certainly is.

There are significant differences between the GFS and AAS 31 operating balance measures. The most significant of these concerns the treatment of revaluations. The analysis in this paper suggests that the GFS approach of excluding revaluations is to be preferred. There is, however, one exception to this conclusion—the treatment of holding gains on monetary assets arising from changes in the price level.

If, as suggested here, the exclusion of revaluations from the operating balance is generally correct, it follows that the decision of the Commonwealth Treasury to define its fiscal balance measure so as to exclude revaluations is quite appropriate. This does not deal with the problem at source.

Public sector accounting policy ought, finally, to reflect the functions and policy requirements of government, rather than pursuing consistency with the private sector for its own sake.

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