



Submission No. 14  
Received 6/5/13

**Australian Government**  
**Department of Finance and Deregulation**

Mr Peter Banson  
Committee Secretary  
Joint Committee on the National Broadband Network  
PO BOX 6021  
Parliament House  
Canberra ACT 2600

Dear Mr Banson

**Questions on Notice arising from the Public Hearing 19 April 2013**

I appeared before the Joint Committee on the National Broadband Network (JCNBN) at its public hearing in Sydney on 19 April 2013.

During the course of the hearing, I took on notice a question from the Chair of the Committee, Mr Rob Oakeshott MP, surrounding the Budget treatment of the National Broadband Network. Subsequent to this, the Committee asked on 29 April 2013 a Question on Notice in writing to the same effect (Question Number 19).

Please find attached a response to the questions and a paper prepared by Finance in consultation with the Australian Bureau of Statistics.

Should you wish to discuss the matters raised in further detail, please contact Mr Philip Smith, Assistant Secretary, NBN Policy and Shareholder Branch, on (02) 6215 1496.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Jan Mason', with a large, stylized flourish at the end.

Jan Mason  
Deputy Secretary  
Business, Procurement and Asset Management  
3 May 2013

**JOINT COMMITTEE ON THE NATIONAL BROADBAND NETWORK**

QUESTIONS ON NOTICE TO

THE DEPARTMENT OF FINANCE AND DEGREGLATION

**Mr Oakeshott (Chair, JCNBN)** asked Ms Mason, Deputy Secretary, Business, Procurement and Asset Management Group on 19 April 2013:

**‘CHAIR:** I will ask a question about finance. You can take this on notice. The issue of on-budget versus off-budget has been rolling around over the last couple of weeks. Could you provide advice to the committee in writing as to: where are the trigger points that we as a committee should be looking at regarding issues where a project goes from investment to cost? There has been a lot of talk about rate of return on investment, whether that is or is not the trigger, and wanting to get clarity from whoever is the accounting expert within the Commonwealth and who actually makes the call as to: what are the fundamentals behind the call that they make?’

**Ms Mason:** We will take that question on notice. As to the PNFC status of NBN Co., that is a call made by the Australian Bureau of Statistics.

**CHAIR:** Are you able to provide advice on their behalf or should we be directing the question to them?

**Ms Mason:** I think we can provide some written advice. We may need to draw, in turn, on advice from the Australian Bureau of Statistics.’

**And Question on Notice No. 19 asked on 29 April 2013:**

What accounting considerations do NBN Co apply when considering issues of on-budget versus off-budget reporting?

**Answer:**

Please see attached advice prepared by the Department of Finance and Deregulation, drawing on advice from the Australian Bureau of Statistics.



**Australian Government**  

---

**Department of Finance and Deregulation**

## **Classification of government-controlled entities in the Australian Government Budget**

### **Background**

1. Bodies that are separate legal entities from the Commonwealth are incorporated into the Australian Government Budget in ways that depend on their sectoral classification. The terminology 'on budget' and 'off budget' is not accurate. However the terms are sometimes used to distinguish between entities that are in the general government sector (GGS) and public corporations (both financial PFC - and non-financial - PNFC).
2. Note that all cash payments by the Australian Government from Consolidated Revenue are inherently 'on budget' in that they may only be made under an appropriation made by law under the *Australian Constitution*. This includes payments to public corporations. Appropriations are made in the annual appropriation acts or other acts containing appropriation provisions.
3. The distinction between the different types of entities arises from the sectoral classifications of Government Finance Statistics (GFS). GFS classifies all entities or 'units' in the economy into four broad sectors – households, corporations, not-for-profit units serving households, and general government units. The purpose of this classification is to facilitate macro economic analysis.
4. A number of attachments to this paper have been provided to assist. Attachment A to this paper is selected extracts from *Government Finance Statistics: Concepts, Sources and Methods 2005*. Attachment B is a copy of the relevant paper by the Australian Bureau of Statistics (ABS) *Standard Economic Sector Classifications of Australia*. Attachment C is a copy of the framework (decision tree) used to determine the relevant classification of an entity.<sup>1</sup>

---

<sup>1</sup> This decision tree is from the draft IMF GFS Manual 2012. ABS has advised that this decision tree contains the same provisions currently used to classify entities.

## Budget Treatment of types of entities

5. The Budget and the key fiscal aggregates are primarily prepared from the perspective of the GGS.
6. Key fiscal aggregates include all relevant transactions and balances of the GGS. They include all transactions between the GGS and public corporations, balances owing between the GGS and public corporations, and the value of government investments in public corporations.
7. The reporting of this information at aggregate level is in accordance with the external reporting standards specified by the *Charter of Budget Honesty Act*. The external reporting standards are Government Finance Statistics and Australian Accounting Standards, based on international equivalents and maintained independently of the government by the Australian Bureau of Statistics and the Australian Accounting Standards Board respectively<sup>2</sup>. Further information about the use of external reporting standards in the Budget is contained in Note 1 to Statement 9: Budget Financial Statements published in Budget Paper No. 1 each year.
8. At a disaggregated level further information may be available in the Portfolio Budget Statements of individual portfolios.
9. Information about actual (rather than budgeted) transactions and balances are contained in entity annual reports and, at an aggregate level in the Final Budget Outcome and Australian Government Consolidated Financial Statements.

## Classification of entities

10. Entities are classified to sectors by the Australian Bureau of Statistics, using the principles included in GFS. The usual practice with government-controlled entities is that the Department of Finance and Deregulation asks the ABS to make a classification of new entities.
11. To be classified as a public corporation, an entity must be an institutional unit, be controlled by government and be a market producer. The framework (decision tree) used is in Attachment C<sup>3</sup>.

---

<sup>2</sup> While the ABS and the AASB are agencies of the Australian Government, their activities in setting relevant standards are conducted independent of government influence.

<sup>3</sup> This decision tree is from the draft IMF GFS Manual 2012. ABS has advised that this decision tree contains the same provisions currently used to classify entities.

12. An institutional unit can own or exchange goods and assets in its own right; make economic decisions and engage in economic activities for which it is held directly responsible and accountable at law; enter into contracts and incur liabilities on its own behalf; and enter into contracts and incur liabilities on its own behalf. In most instances this limits classification to statutory authorities and companies, trusts etc. Agencies governed by the *Financial Management and Accountability Act*, such as departments and prescribed agencies, are not units separate from the government and thus cannot be classified as public corporations.

13. Classification of an entity as a public corporation depends on the nature of its operations and not its legal form. Thus a company or statutory authority does not automatically become a public corporation – the majority of these types of entities in the Commonwealth are classified to the GGS.

**14. In summary, a public corporation satisfies the following conditions:**

- a) legal entities that are created for the purpose of producing goods or services for the market (excludes entities that sell their output mainly within government);**
- b) charges economically significant prices for its goods and services such that it can maintain its own working capital and finance some or all of its capital investment ; and**
- c) may be a source of profit or other financial gain to its owners.**

**In other words, a public corporation is little different from a private commercial activity.**

**15. If a government entity does not satisfy these conditions then by default they are classified to the general government sector that is broadly defined as:**

- d) Government-controlled entities that fulfil the functions of government as their primary activity;**
- e) the primary function of this sector is to provide public services, which are mainly non-market in nature, and for the collective consumption of the community, or involve the transfer or redistribution of income; and**
- f) these services are largely financed through taxes and other compulsory levies.**

16. The ABS uses the above criteria to classify entities. In some circumstances this may require judgement. For example an entity may conduct a range of activities, some of which might be characteristic of a GGS entity, and some of which might be characteristic of a public corporation. The ABS considers the primary purpose of the entity and the substance surrounding the activity in coming to a decision.

17. As at 8 April 2013, very few government-controlled entities are classified as public corporations. The 'flipchart' of government bodies contained on the website of the Department of Finance and Deregulation shows that out of 195 entities, 15 are classified as public corporations. The classification of bodies is also reported annually in Table A1 of Statement 9: Budget Financial Statements published in Budget Paper No 1, and in the Australian Government Consolidated Financial Statements.
18. The detailed descriptions of the different sectors are contained in the ABS document *Government Finance Statistics: Concepts Sources and Methods* (2005), principally paragraphs in Chapter 2. This document is also colloquially known as the *ABS GFS Manual*. The key aspects of paragraphs from the document are reproduced at Attachment A.

### **How entities are classified**

19. The detailed policy applied by the ABS in classifying units in the economy, including GGS and public corporation units is set out in its publication *Standard Economic Sector Classification of Australia* (SESCA). The latest edition of SESCOA was published in 2008, although the ABS GFS manual – published three years before – retains reference to the 2002 version. As noted in the 2008 version there are not significant differences between the 2002 and 2008 versions when it comes to determining classification. The ABS expects to release a revised ABS GFS Manual in 2014.
20. SESCOA 2008 is attached in full, except the appendices, as Attachment B. The key concepts relevant to how the ABS classifies entities are included in Chapter 3: Key Concepts, notably:
  - Paragraph 3.19 *et seq* regarding market and non-market operators;
  - Paragraph 3.39 *et seq* regarding temporary changes in control or function; and
  - Paragraph 3.42 *et seq* regarding consistency across jurisdictions.
21. Paragraph 3.20 states that a primary indicator of a market producer is the expectation of the recovery of a considerable proportion of its production costs through sales income. Finance has observed that there are two aspects of this that ABS takes into account in coming to the sectoral classification of an entity.
  - First, is that there should be an 'expectation', and that an entity need not be profitable at all times. Paragraph 3.19 also states that the goal should be profit in the long run.
  - Second, is the interpretation of 'considerable proportion' in respect of recovery of production costs through sales income. This does not require full

recovery. However, it is noted that all active Australian Government public corporations fully recover or aim to fully recover production costs through sales income or equivalent.

22. In making a classification, the ABS requests any relevant documents relating to the entity. These will as a minimum include the entity constitution and a corporate/business plan, but may also include copies of significant contracts or other business documents that contain relevant information about the entity's operations. This would include information about expected profitability where a classification is required prior to a unit commencing operations.
23. The Department of Finance and Deregulation is grateful to the Australian Bureau of Statistics for its assistance in preparing this paper.

## Attachment A – Extracts from Government Finance Statistics: Concepts Sources and Methods, 2005<sup>4</sup>

2.28 Australia's standards for defining institutional sectors and subsectors are based on the SNA93<sup>5</sup> standards described in Appendix 1<sup>6</sup>. As previously noted, the Australian standard is the Standard Institutional Sector Classification of Australian (SISCA), which is out in *Standard Economic Sector Classifications of Australia 1998...or 'SESCA'*<sup>7</sup>. The SISCA standards are applied in the classification of public sector units in the GFS system in Australia.

2.29 As discussed in Appendix 1, SNA93 defines three types of institutional units that can qualify as falling within the public sector:

Government units, which are defined as 'unique kinds of legal entities established by political processes which have legislative, judicial or executive authority over other institutional units within a given area' (SNA93, para 4.104). Government units provide goods and services to individuals and the community at large; they redistribute income and wealth; and they engage in non-market production, which is production made available free or at prices that do not have a significant influence on the amounts that the producers are willing to supply or purchasers wish to buy.

Public corporations and quasi-corporations, which are legal entities, predominantly owned and controlled by government, that are created for the purpose of producing goods and services for the market and may be a source of profit or other financial gain to their owner(s). Corporations are created by a process of law that establishes them as entities independent from their owners. As discussed previously, a quasi-corporation is an unincorporated entity that operates as if it were a corporation.

Non-profit institutions (NPIs), which are legal or social entities, created for the purpose of producing goods and services, whose status does not permit them to be a source of income, profit or other financial gain for the units that establish, control, or finance them. Only non-profit institutions that are controlled and mainly financed by government can be included in the public sector.

2.30 The institutional sectors comprising the SISCA are as follows:

Non-financial corporations sector

---

<sup>4</sup> These are paragraphs extracted by the Department of Finance and Deregulation.

<sup>5</sup> System of National Accounts 1993. This has now been replaced by SNA08 for preparation of national accounts, but its provisions have not yet been incorporated into the Government Finance Statistics System.

<sup>6</sup> Not reproduced in this extract.

<sup>7</sup> The 1998 version has been updated several times, the most recent being SESCO 2008.



Financial corporations sector

General government sector

NPIs serving households sector

Households sector

2.31 Only the first three of these sectors are relevant in the GFS system because, as previously noted, the public sector comprises all units of the general government sector, all public non-financial corporations and quasi-corporations and all public financial corporations and quasi-corporations.

2.32 The composition of the three public sector components in terms of units is discussed below.

#### GENERAL GOVERNMENT

2.33 General government comprises all government units (as defined in paragraph 2.29) of the Commonwealth Government, each state and territory government, and each local government authority, as well as all resident non-market NPIs that are controlled and mainly financed by those governments.

2.34 Included in the sector are government-controlled unincorporated enterprises that engage in market production but do not qualify as quasi-corporations because their operations are too closely integrated with the operations of other government units and because they do not have a separate full set of accounts.

#### PUBLIC NON-FINANCIAL CORPORATIONS

2.39 This category comprises all resident government-controlled corporations and quasi-corporations mainly engaged in the production of market goods and/or non-financial services. Market goods and services are those that are sold at 'economically significant prices', which are prices 'that have a significant influence on the amounts that producers are willing to supply or on the amounts that purchasers wish to buy' (SNA93, para 4.24). Non-financial services are any services that do not qualify as financial intermediation or auxiliary financial services, both of which are defined in the section below relating to financial corporations. Examples of Australian public non-financial corporations include Telstra and Australia Post and the electricity, railway and port authorities of state and territory governments.

#### PUBLIC FINANCIAL CORPORATIONS

- 2.41 This category comprises all resident government-controlled corporations and quasi corporations mainly engaged in financial intermediation and provision of auxiliary financial services. Financial intermediation is defined as ‘a productive activity in which an institutional unit incurs liabilities on its own account for the purpose of acquiring financial assets by engaging in financial transactions on the market’ (SNA93, para 4.78). Financial intermediaries channel funds from lenders to borrowers by collecting funds from lenders and transforming or repackaging them in ways which suit the requirements of borrowers. Liabilities are incurred by accepting deposits and issuing bills, bonds or other securities. The funds are used to acquire financial assets, principally by making advances or loans to others but also by purchasing bills, bonds or other securities. Auxiliary financial activities are services that are closely related to, and designed to facilitate, financial intermediation. The activities may be performed as secondary activities, by financial intermediaries, or performed on an agency basis by specialists. Examples include securities brokers, flotation companies, loan brokers, agencies that guarantee bills by endorsement, and institutions that arrange hedging instruments such as swaps, options and futures.
- 2.42 Public financial corporations include institutions that undertake a central bank role, which includes monetary policy development, issuing national currency, acting as custodian of international reserves, providing banking services to government and regulating the financial system. Thus, the Reserve Bank of Australia and the Australian Prudential Regulation Authority (APRA) are both treated as public financial corporations. Also included as public financial corporations are government controlled banks, insurance companies, pension funds, and economic development corporations and financial auxiliaries owned by Australian governments.

**Attachment B – copy of SESCO 2008**

**Attachment C – copy of flowchart from Draft 2012 IMF GFS Manual**