

Senate Finance and Public Administration Legislation Committee

ANSWERS TO QUESTIONS ON NOTICE

Finance and Administration Portfolio

Department of Finance and Administration

Estimates Hearings 2002-2003 – 28 May 2003

Question: F25

Outcome 1 - Sustainable Government Finances, Output 1.1.2 - Financial Reporting

Topic: Market Valuation of Debt

Hansard Page: F&PA 349

Senator Conroy asked:

The AOFM annual report states that the market value of debt as at 30 June 2002 was \$6.3 billion higher than the face value of debt—that is the market value of \$60 billion less face value of \$53.7 billion. Can you confirm that the full \$6.3 billion has been recognised in net worth.

Answer:

The Australian Office of Financial Management provided an answer to this question in their appearance at the Senate Economics Estimates Committee hearing on 5 June 2003 (see pages E 480-481 —*Legislation* Thursday, 5 June 2003 ECONOMICS, copy attached).

E 480

Senate—Legislation

Thursday, 5 June 2003

Mr Murray—there are things like deposits held and whatever. I do not know, but certainly—as just confirmed—wherever there is a market value available, that is what we—

Senator CONROY—I appreciate you have indicated there could be some qualification.

Mr Murray—I do not want to mislead you, that is all.

Senator CONROY—No, I appreciate that. The AOFM annual report for 2001-02 states on page 41 that the market value of debt as at 30 June 2002 was \$60 billion and the face value was \$53.7 billion. In other words, the market value was \$6.3 billion higher than the face value. Is that correct?

Mr Murray—Yes.

Mr Comley—I suspect we know where you are going, Senator, and we can give you an explanation of—

Senator CONROY—I will keep going, because I would not want you to answer a question I have not asked, Mr Comley. You know what bad form that is! You will be in real trouble if you do that, so let me save you potential embarrassment by trundling on through my questions. I am sure you have anticipated me, but let me trundle away. I would like to turn to table B4 on page 2-17 of Budget Paper No. 1 2003-04. Footnote A states that the opening net worth includes a reduction in the net worth of \$2.5 billion due to the adoption of market valuation of debt. Does that mean that the opening net worth of the government has fallen by \$2.5 billion, because the government has now valued debt at market prices and recognised a \$2.5 billion increase in government debt? Is that a fair way to describe it?

Mr Murray—Senator, that is correct. Back-casting to 1999-2000, I can say that is correct.

Senator CONROY—Thank you. The footnote also states that this change has been, as you said, back-cast to 1999-2000. What increase in debt has been recognised in each of the financial years 1999-2000, 2000-01 and 2001-02?

Mr Murray—Do you mean from historic costs to—

Senator CONROY—You say you have back-cast it for a number of years.

Mr Murray—Yes.

Senator CONROY—What was the individual number put into those years?

Mr Murray—Senator, I refer you to box No. 1 on page 2-12, 'Market valuation of net debt'. The figures are in table 6.

Senator CONROY—Budget Paper No. 1. Page 2-12, was it?

Mr Murray—Yes.

Senator CONROY—They are net debt figures. I was talking about gross debt, and those are net debt figures; would they be different?

Mr Murray—Between gross debt and net debt?

Senator CONROY—Yes.

Mr Murray—They are. These are the net figures.

Senator CONROY—I know we are talking about net worth—the \$2.5 billion I have just been talking about in terms of government debt. You consider that to be a net debt figure?

Mr Murray—That is the net debt figure, Senator. Of course, the definition of net debt is—

Senator CONROY—I have had that at considerable length. It excludes two-thirds of liabilities. I do not want to go there again.

Mr Murray—I just wanted to point out where it was, Senator.

Senator CONROY—Thank you for drawing my attention to that table. As I previously noted, the AOFM annual report states that the market value of debt, as at 30 June 2002, was \$6.3 billion higher than the face value of the debt. Can you confirm that the full \$6.3 billion has been recognised and, if so, where?

Mr Comley—You are comparing the market value with the face value. Historical cost book value is not the same concept as face value. Book value is equal to the face value plus the unamortised issue premium, plus the accrued interest still to be paid on that debt within the accounting period. So there is a difference between book value and face value.

Senator CONROY—Is that significant in terms of—

ECONOMICS

Thursday, 5 June 2003

Senate—Legislation

E 481

Mr Comley—It is significant enough to reconcile the \$6.3 billion in this table and the \$2.5 billion difference you were looking at in the other table. In fact, it explains the difference.

Senator CONROY—Okay.

Mr Comley—So those three components of book value are the three components for a Treasury fixed coupon bond—that is, for a nominal bond. There is also an additional component for Treasury index bonds which we call the KT value. With the Treasury index bond, through time it will have a face value and then, as inflation increases, we increase the value we will repay at the end of that period. At any point in time, that KT amount is the amount you have essentially accrued because CPI has changed from the time you issued the bond. That component is also part of the book value of the debt but it is not part of the face value. Those three components in the case of the Treasury fixed coupon bond, and the four components in the case of the index bond, reconcile the difference between the \$6.3 billion difference in table 3 on page 41 of the AOFM annual report and the difference in the net debt series between historic cost and market value on page 2-12 of the budget paper.

Senator CONROY—Thank you for that, Mr Comley.

Mr Murray—When you put those extra amounts in, it lifts you from that face value to the actual carrying value at historic cost, to approximately \$57.6 billion. That is the gross AOFM debt.

Mr Comley—There is a little bit of rounding, but it is essentially the \$2.5 billion.

Senator CONROY—I want to go back a couple of steps, because you have jumped well ahead of my questions. Could you explain why the revaluation has been included over four years and not just reflected in full in 2002-03?

Mr Comley—My understanding is that it is the way the GFS accounting standards apply a change in methodology. The GFS accounting standards are different from those of AAS. The GFS approach is to assume that the methodology always existed and therefore reflect the numbers that would have been in those years if that methodology had existed throughout the whole period. That is in contrast to AAS31 where, if you have a methodology change—if, for example, on 30 June you decide to change your methodology—and if you change the balance sheet, you have to have a corresponding revenue or expense item that fully hits on that day. It is purely a reflection of the different way the accounting standards treat a methodological change.

Senator CONROY—I had a lengthy debate with Finance about superannuation treatment and they actually did not do it that way. I will not draw you into it at this point. I may quote you back to them, but I will not draw you into it any further.

Mr Murray—Could I just clarify that, Senator. Clearly here we have market values available on those balance dates, so we are not talking about actuarial revaluations that may relate to various years. From historic data, we can go back and calculate these amounts. The government did decide that 1999-2000, with the introduction of accrual accounting and properly constructed accrual balance sheets, was the appropriate date to take those revaluations back to with a view to being as transparent as possible, recognising that there would be a discontinuity, if you like, in the net debt series. But, of course, you have all of the historic series as well.

Senator CONROY—Can you explain why, when you did other revaluations—although 'revaluations' is probably the wrong word when I want to talk about Telstra and superannuation—they are reported as separate line items in the body of the table, but the revaluation of debt at market prices has not been reported as a line item but simply as a change in the opening net worth?

Mr Murray—Are you referring to table B4?

Senator CONROY—Yes.

Mr Murray—That is, the general government sector statement of other economic flows. It is because we back-casted it, Senator. If we had just started in the year 2002-03, then there would have been a line adjustment. I do note, however, that when you get then to your closing net worth it has made no difference. If you read table B4 in conjunction with our table 6, you get a complete picture of what has been happening.

Senator CONROY—Except that we have had to have a correction issued by the department of finance and Senator Minchin; they have issued corrected figures for B4 and B2. At the risk of throwing us into chaos, I thought I might now, given Mr Comley has the tables handy, return to the fray. Can we start with 1998-99?

Mr Comley—Sure. Which page would you like me to consult?