Australian Government
Department of Finance

FINANCE ADVICE PAPER

General Principles for Recognition of Expenditure in Budget Aggregates

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Introduction

This paper outlines the principles used in the presentation of government expenditure in the Australian Government Budget Financial Statements and the Consolidated Financial Statements.

The key budget aggregates discussed in this document are consistent with the Uniform Presentation Framework (UPF)[1] adopted by the Australian, State and Territory governments for the presentation of government financial information. The UPF is based on AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, which harmonises Government Finance Statistics (GFS) and Australian Accounting Standards (AAS).

Budget Aggregates[2]

The major budget aggregates presented in Australian Government financial reports include:

Acronym	Aggregate	Explanation	Calculation
UCB	Underlying Cash Balance	A cash measure that shows whether the government has to borrow from financial markets to cover its recurrent operations and capital activities[3].	UCB is equal to net cash receipts from operations *(excluding net Future Fund earnings)*, less net capital investment *(including by finance lease).*
HCB	Headline Cash Balance	A cash measure that shows whether the government has to borrow from financial markets to cover its recurrent operations, capital activities and investments in financial assets for policy purposes.	HCB is equal to UCB plus net Future Fund earnings, plus net cash flows from investments in financial assets for policy purposes *(e.g. NBN Co, Snowy Hydro, and student loans)*.
NOB	Net Operating Balance	An accrual measure that shows whether the government has to borrow from financial markets to fund its recurrent operations.	NOB is equal to total revenue from transactions less total expenses from transactions. NOB excludes expenditure on the acquisition of capital assets, but includes non-cash costs including accruing superannuation entitlements and the consumption of capital (depreciation).
FB	Fiscal Balance	An accrual measure that shows whether the government has to borrow from financial markets to cover its recurrent operations and capital activities.	FB is equal to NOB less net capital investment.
	Net Debt	A common measure of the strength of the government's financial position and comprises selected financial assets and liabilities.	Net debt is equal to the sum of interest bearing liabilities *(deposits held, government securities, loans and other borrowing)*, minus the sum of cash and deposits, advances paid and investments, loans and placements.

[1] http://archive.treasury.gov.au/documents/1371/HTML/docshell.asp?URL=2008_UPF-03.asp
[2] Statement 10 of 2018-19 Budget Paper No 1 (Australian Government Budget Financial Statements) includes definitions and detailed explanations of the key budget aggregates.
[3] Capital activities refers to net acquisition of non-financial assets.

Impacts of Expenditure on Budget Aggregates

Grants

- A ‘grant’ is an arrangement for the provision of financial assistance to an external recipient by the Australian Government. These may include research grants, grants that provide for the delivery of services, grants that help fund infrastructure or grants that help build capacity.
- The Australian Government does not receive a financial benefit in exchange for a grant.
- While the recipient controls the funding, the Australian Government may place conditions on the use of funds, such as those imposed on Specific Purpose Payments to State Governments.
- Current grants fund operational spending by the recipient; capital grants are used by the recipient for asset or liability transactions. For example, grants to State and Territory Governments include both capital and current amounts.
- Grants increase operational expenditure, having a negative impact on UCB, HCB, NOB and FB. The cash spent to make the grant has a negative impact on net debt.

Purchase of Non-Financial Assets

- Non-financial assets are a store of economic value, which provide benefits through their ongoing use in the provision of goods and services. These include land and buildings, infrastructure and intangibles, such as computer software.
- As purchases of non-financial assets are capital expenditure, they worsen UCB, HCB and FB, but have no impact on NOB. The cash spent to acquire the non-financial asset has a negative impact on net debt.

Prepaid Grants/ Prepaid Purchase of Goods or Services

- Prepayments are amounts received by the recipient in advance of delivering a related good or service.
- A grant or purchase of goods and services may be prepaid. In this case, the Australian Government records a reduction in cash and a corresponding asset (being the prepayment). There is no immediate impact on NOB or FB.
- Prepaid grants or purchases of goods and services have a negative impact on UCB and HCB. The reduction in cash spent to make the grant has a negative impact on net debt.
- When the conditions for the grant are met or the good/service received, the prepayment is reversed and the expense is recorded with a negative impact on NOB and FB.

Public Policy Commercial Loan[4]

- In order to establish a public policy commercial loan, a loan agreement on commercial terms must exist, listing a repayment period and interest rate. It must also be probable that the funds will be repaid for the full payment to be considered a loan.
- A loan is a financial asset transaction, therefore only the interest revenue has an impact on UCB, NOB, FB or net debt, the interest impact being positive.
- Most Australian Government loans are for public policy reasons, which has a negative impact on the HCB when advanced, and a positive impact when repaid.
- A loan write-off by agreement with the borrower is an expense because the Australian Government has made a decision to reduce its loan value. This will have a negative impact on NOB and FB, but has no impact on the current UCB or HCB as there is no cash flow associated with an expense write-off.
- The write-down/write-off (other than by agreement with the borrower) of a loan reduces the value of the financial asset. This adjustment is reported as an 'other economic flow' in the operating statement with no impact on UCB, HCB, NOB or FB. Loss of future interest as a result of the loan write-down/write-off has a negative impact on future UCB, HCB, NOB and FB.

Public Policy Concessional Loan

- Similarly to a public policy commercial loan, a loan agreement, listing a repayment period and interest rate is required to establish a public policy concessional loan, and it must be probable that the funds will be repaid in full.
- A 'concessional loan' refers to a loan made at a reduced interest rate, longer term and/or other terms that are more favourable than those found commercially.
- The difference between the nominal value of the loan and the fair value of the market based loan component is the concessional expense component.
- Similar to public policy commercial loans, the principal payments and receipts for public policy concessional loans impact HCB, but not UCB. The concessional expense has a negative impact on NOB and FB at the commencement of the loan, which is then unwound as revenue over the loan term, with a positive impact on NOB and FB. Interest revenue has the same impact on aggregates as does a commercial loan.
- As the fair value of the public policy concessional loan asset is lower than the amount of the loan advanced, there is a negative impact on net debt.
- The largest public policy concessional loan is the assistance provided to students through the Australian Government's Higher Education Loan Program.

[4] Statement 9 of 2018-19 Budget Paper 1 (Statement of Risks) provides a list of material government loans.

Equity Investment

- An equity investment occurs where the Australian Government becomes an owner or part owner of a business, usually through the purchase of shares in an entity outside the GGS[5] (for example, Public Financial Corporations (PFC), Public Non-Financial Corporations (PNFC) or private sector entities).
- When it makes equity investments, the Australian Government maintains a degree of control over its investment as a shareholder, facilitating the achievement of public policy goals and protecting the investment itself.
- For an investment to be fully regarded as equity, it should expect to earn a rate of return at least equal to the long-term inflation rate and there should be a reasonable expectation that the investment will be recovered. If these conditions are not met, the payment may be partially or fully recorded as a 'grant' expense.
- If the rate of return drops below the long-term inflation rate, then future payments may be classified as grants, but there is no retrospective reclassification of previous equity investments.
- As these are transactions in financial assets, there is no impact on UCB, NOB or FB.
    - The same principle applies to equity sales (such as the sale of Medibank Private) – these are financial asset transactions, with no impact on UCB, NOB or FB.
- As equity investments are not interest-bearing, they are excluded from net debt. The cash spent to fund equity investments has a negative impact on net debt.
- Dividends received on equity investments have a positive impact on UCB, HCB, NOB, FB and net debt.
- Many Australian Government equity investments are for public policy purposes, and these investments have a negative impact on the HCB.
    - The main exception is the Future Fund investment in shares for investment purposes.
- Any reduction in the value of an equity investment is reported as an 'other economic flow' in the operating statement with no impact on UCB, HCB, NOB or FB. Any future reductions in dividends will negatively impact future UCB, HCB, NOB and FB.
- The Australian Government's investment in a PFC, PNFC or private sector entity is measured at fair value using discounted cash flows, net assets or market value of the company in accordance with accounting standards.
- Examples of equity investment include the Australian Government funding of Australia Post, NBN Co and the Moorebank Intermodal Company.

[5] GGS refers to General Government Sector (non-market government operations).

Summary Table – Impacts of Expenditure on Budget Aggregates

Transaction	Nature	Key Budget Aggregates				
		UCB (Deficit)	**HCB** (Deficit)	**NOB** (Deficit)	**FB** (Deficit)	**Net Debt**
Current Grant	Non-repayable transfer.	↑	↑	↑	↑	↑
Capital Grant	Non-repayable transfer.	↑	↑	↑	↑	↑
Purchase of non-financial assets	Exchange transaction.	↑	↑	–	↑	↑
Prepaid grant	Cash is paid in advance and asset created.	↑	↑	–	–	↑
Prepaid purchase of good or service	Cash is paid in advance and asset created.	↑	↑	–	–	↑
Public Policy Commercial Loan	Requires a loan agreement, specifying repayment period and interest rate. There must be an expectation of repayment.	–	↑	–	–	–
Public Policy Concessional loan	Requires a loan agreement, specifying repayment period and interest rate. There must be an expectation of repayment Concession comprises either reduced interest rate, longer term and/or other terms that are more favourable than those found commercially.	–	↑	↑	↑	↑
Equity	Ownership interest in non-GGS entity, where government will earn a minimum return of long-term inflation. There should be a reasonable expectation that the investment will be recovered.	–	↑	–	–	↑

Note:
'↑' = Increases the deficit (Arrows would need to be reversed if UCB, HCB, NOB or FB were in surplus);
'–' = Have no impact.