



## Summary:

# Transparency of the Central Government Annual Report 2014

## Audit background

The Swedish NAO has audited the Central Government Annual Report for 2014. The annual report is an extensive document that under the provisions of the Budget Act (2011:203) must include a follow-up of the budgetary policy targets, the outcome of all appropriations and income headings and a balance sheet and income statement.

In this report the Swedish NAO indicates a number of areas where the Central Government Annual Report can be improved. The annual report is an important communication from the Government that assists the Riksdag in exercising its financial and parliamentary control as described in the Instrument of Government. The Swedish NAO therefore considers it important that the Government continues to improve reporting to the Riksdag and takes into consideration the findings and recommendations presented in this performance audit report.

## Audit findings

The findings of the Swedish NAO's audit are presented in an auditor's report, and this performance audit report that contains observations, conclusions and recommendations from the audit work. As presented in the auditor's report, submitted to the Riksdag through the report 2014/15:RR4, in the opinion of the Swedish NAO the central government annual report for 2014 in all material respects was prepared in accordance with the provisions of the Budget Act. As in the previous year the opinion does not include the question of whether the annual report gives a true and fair view. The central government annual report is governed by the Budget Act, which defines the contents, overall accounting and valuation principles, scope and format of the annual report. The Budget Act also specifies that central government bookkeeping and accounting should be carried out in accordance with generally accepted accounting principles and the accounts must

give a true and fair view of operations, the financial position and performance and the management of central government assets.

The Swedish NAO, as in the previous year, has decided to issue an opinion that the annual report has been prepared in accordance with the Budget Act and thus does not use the term true and fair view in the statement of opinion. An opinion concerning true and fair view requires that the annual report has been prepared in accordance with an accounting framework designed for the the purpose of achieving a true and fair view. Unlike generally accepted frameworks in the form of IFRS,<sup>1</sup> IPSAS<sup>2</sup> or the Ordinance concerning the Annual Reports and Budget Documentation (2000:605) the Budget Act is not in itself such a framework. The audit of the central government annual report for 2014 has also revealed a number of areas in which transparency of accounting can be improved so that the annual report could provide more of a true and fair view:

#### **Principles for changed appropriation charges**

One new feature in 2014 was that the provisions of the Budget Act on financing of expected losses on state loans with credit risk started to be applied for new student loan lending. On the other hand no charge will be made to appropriations for expected losses referring to the stock of student loans for the time before 2014. In those cases appropriations are charged only when the loss is realised. Recognised impairment loss for doubtful receivables (expected losses) for this part of the stock amounts to about SEK 28 billion.

The basis for changed accounting policies for the central government budget is normally that they are to be applied in the future, while there is no regulation of the principles that are to apply to previous transactions and events, for example previous lending that built up the stock of study loans. One parallel that can be drawn is to the transition to accruals-based principles in 2009 when the transition effects were financed during the year of transition from a separate appropriation, apart from the agencies' holiday pay liabilities, which were dealt with according to previous principles. All in all this gives uncertainty as to what applies to future changes in appropriation charges.

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<sup>1</sup> International Financial Reporting Standards are accepted international accounting standards, adopted by the International Accounting Standards Board (IASB).

<sup>2</sup> International Public Sector Accounting Standards (IPSAS) are accounting standards issued by the IPSAS Board for preparation of financial statements (annual reports) in the public sector. These standards are based on International Financial Reporting Standards (IFRS).

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### **Broken chain of responsibility – agencies with shared responsibilities**

Within central government there are examples of shared responsibility between agencies for payments, commitments and accounting. The Government can decide to lay responsibility for administration, accounting and payments with one or more agencies. The division of responsibility from decision – payment – accounting, a “broken chain of responsibility” may have negative consequences for accounting, governance and follow-up unless the division of responsibility is clear to all parties and the flow of information between the parties is regulated and formalised.

This year during the current audit of the annual report it was noted that payments were made to the African Development Bank and the Asian Development Bank for a number of years. Any change in value of these holdings was not considered by the reporting agency, as these holdings were not reported at all.

The same applies to the central government’s holdings in the Multilateral Investment Guarantee Agency and the Inter-American Development. In the opinion of the Swedish NAO the accumulated value of these four holdings does not impact the overall opinion.

### **Follow-up of fiscal policy targets**

As regards the Government’s follow-up of the fiscal policy targets in the central government annual report for 2014 the Government’s clear statement that net lending deviated from the target level is welcomed. However, it is not clear how the Government has reached this conclusion, and the indicators used in the follow-up have been changed in comparison with the previous year’s annual report without any motive being given for the change. In addition there is no comparison with the forecasts in the Budget Bill for 2014 in which the Government wrote that there are no systematic deviations in fiscal policy that could impact future achievement of targets. The Government has not given any explanation for what happened in 2014 that resulted in the general government net lending target not being met. As regards the Government’s follow-up of the expenditure ceiling it is clear that this was not exceeded, but it is not made clear that the account of how the budget margin was used is based on estimates and forecasts, not actual outcome.

### **Accounting for net wealth and risks**

The statement of financial position presented in the annual report shows a balance sheet total for central government of SEK 1 533 billion and net wealth of SEK –413

billion. In Note 41 to the balance sheet the Government shows the differences in relation to the balance sheet for central government presented in the National Accounts. The differences are partly due to different definitions of what is included in central government and to different accounting policies. The effects of these differences, however, are very great and the National Accounts report central government net wealth that is SEK 1 258 billion greater than in the annual report.

For the purpose of increasing the transparency and relevance of the annual report the Swedish NAO would like to draw attention to possibility of improving the accounts with an analysis of central government assets and net wealth and of the risks associated with the major assets on the balance sheet. An analysis that for example shows the differences between different valuations of central government assets would give the Riksdag and other stakeholders greater understanding of the significance of net wealth. This would improve the possibilities of assessing the central government financial position and would give more of a true and fair view.

The Government gives a brief account of central government commitments in the financial sector at the end of chapter 5 of the annual report. Taking into account the new resolution framework, according to the National Debt Office there is little probability of central government suffering major losses.

The Swedish NAO notes that Finansinspektionen has estimated the value of the central government implicit guarantee for the major banks to be about SEK 14 billion in 2014.<sup>3</sup> From experience a financial crisis entails a major burden on public finances if and when a crisis occurs.

The central government commitment in the financial sector therefore implies a material risk. A more extensive account of the central government implicit guarantee would contribute to increased transparency in the annual report.

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<sup>3</sup> Finansinspektionen, FI analys Nr 1, "Den implicita statliga garantin till systemviktiga banker", 28 April 2015.

## The Swedish National Audit Office's recommendations

After its audit of the Central Government Annual Report for 2014 the Swedish NAO would like to make the following recommendations to the Government:

- The normative framework for preparing the Central Government Annual report should be clarified, since the Budget Act is not a framework primarily set up with the aim of ensuring that the financial statements and other accounting provide a true and fair view.
- The charge on appropriations of transition effects should be regulated on principle to avoid ad hoc treatment.
- The Swedish NAO recommends that the Government ensures satisfactory internal control for commitments where there is shared responsibility between agencies. The Swedish NAO further recommends that the Government ensures the completeness and value of central government holdings of shares and participations.
- In the annual report the Government should comment on the differences between the assessed fulfilment of objectives for general government net lending and the corresponding assessment in the Budget Bill for the year in question.
- Since the formulation of the surplus target entails taking the economic situation into account this should be reported when following up the target.
- To facilitate external audit the Government should not choose different indicators when reconciling the general government net lending target from year to year. If the Government changes the method for follow-up this should be stated and clearly explained.
- The Government should report how the sub-sectors of the public sector contribute achieving the net lending target when the historical ten-year average is used.
- When following up the expenditure ceiling the Government should explain that the data on the use of the budget margin is based on estimates and not actual outcomes.
- The Government should consider improving the description in the annual report of central government net wealth and how it should be interpreted with regard to the valuations of central government assets that the Government reports in various contexts.

- The Government should consider giving an overall presentation in the annual report of the risks associated with both assets and liabilities in the central government balance sheet.
- The Government should consider reporting the size of the implicit guarantee to the financial sector.