CAN ACCOUNTING SUPPORT THE EARLY REVELATION OF SUB-NATIONAL FISCAL RISKS?

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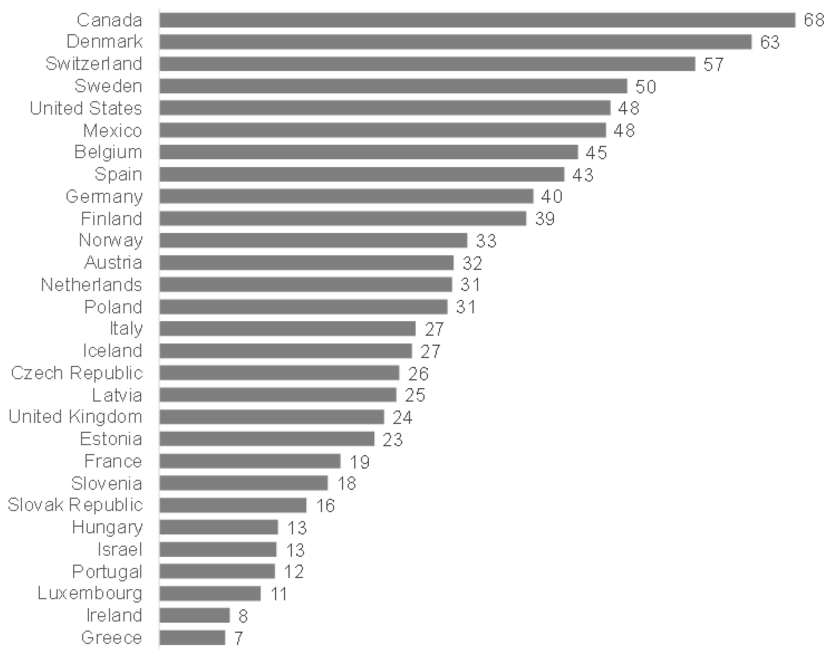
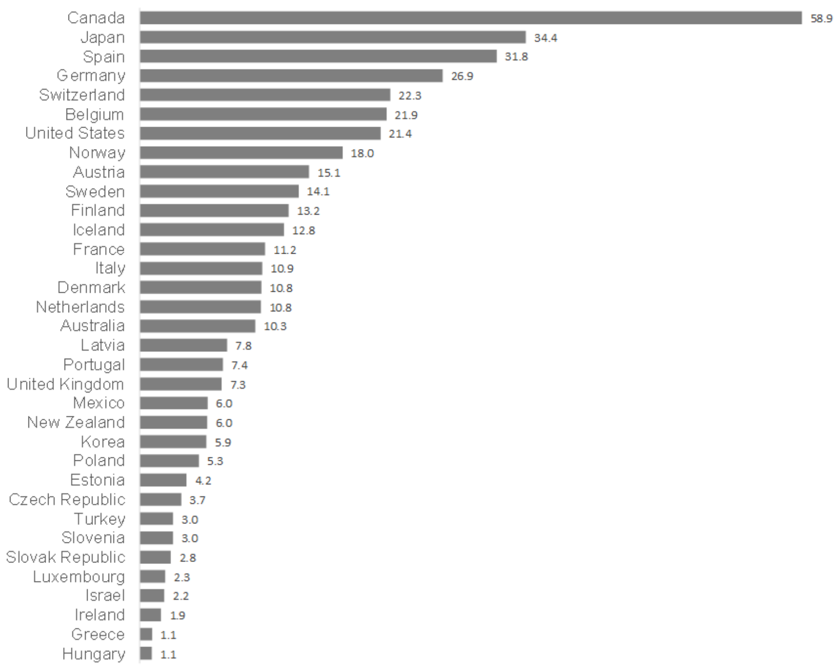
DES POLITIQUES MEILLEURES
POUR UNE VIE MEILLEURE

Why subnational finances matter

Spending of sub-national governments
(% of general government spending)



Debt of sub-national governments
(% of GDP)



Source: OECD Fiscal Decentralisation Database, Table 5 and 19, date from 2016 as accessed 7 July 2019.

Objectives of the OECD paper

- Aims at describing characteristics of sub-national governments' accounting frameworks and how accounting data can support the early revelation of sub-national fiscal risks.

- Follows previous OECD research, e.g., accruals reforms and practices in OECD countries and insolvency regimes for sub-nationals.

- Draws on questionnaire responses from 30 OECD countries and 3 Key Partners.

Agenda

1. Accounting frameworks
2. Monitoring practices
3. Case study of Brazil
4. Conclusion and future directions

ACCOUNTING FRAMEWORKS

Accounting standards are generally harmonised…

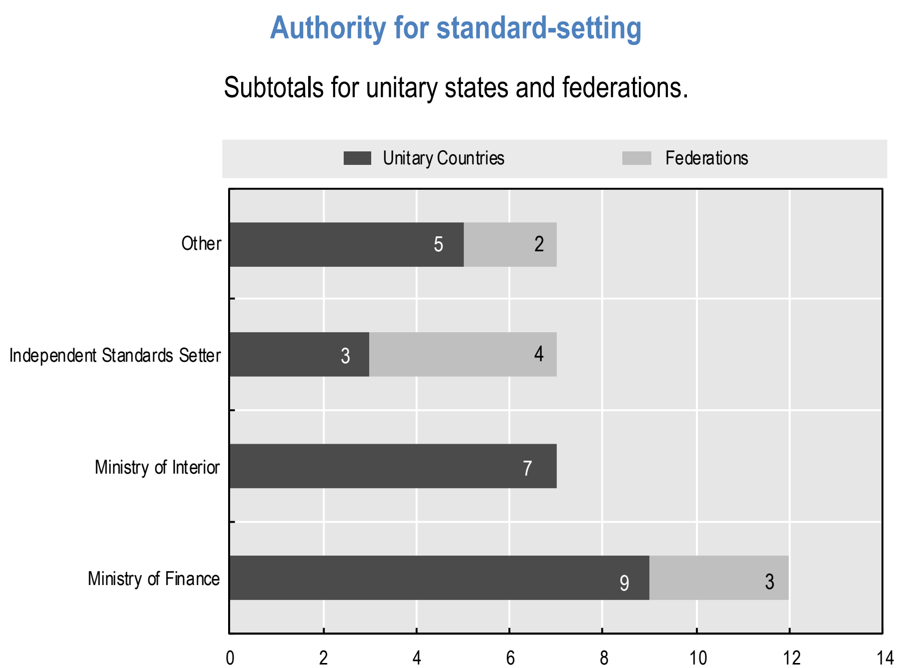
Consistency of standards across national and subnational governments

Subtotals for unitary states and federations

	Similar for national and all subnational	Similar for all subnational	Not similar
Unitary Countries	**10:** Czech Republic, Estonia, Latvia, Lithuania, New Zealand, Portugal, Slovak Republic, Turkey, United Kingdom, China	**12:** France, Greece, Iceland, Ireland, Israel, Japan, Korea, Luxembourg, Netherlands, Norway, Poland, Sweden	**2:** Italy, South Africa
Federations	**5:** Australia, Austria, Canada, Spain; Brazil	**2:** Switzerland, United States	**2:** Belgium, Germany

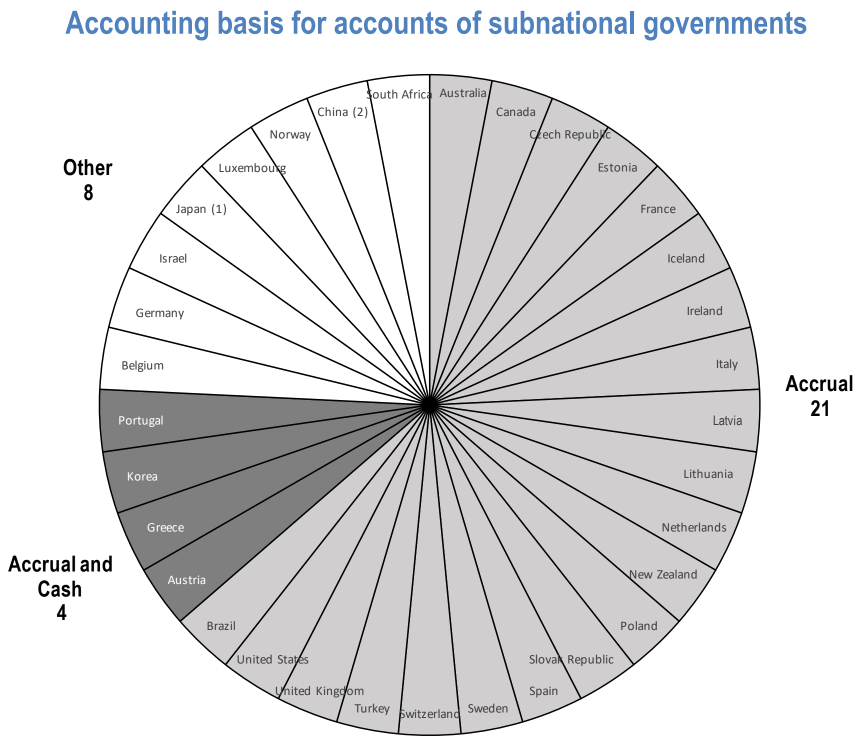
Note: For Italy, the harmonisation of standards within subnational government is only partially done.
Source: OECD Survey on Subnational accounting and monitoring of subnational finances (2019), based on answers to question 2: Is there one set of accounting standards for all governments or all subnational governments or do the standards vary, for example, by region or level of government?

… but the means for imposing standards are country-specific.



Source: OECD Survey on Subnational accounting and monitoring of subnational finances (2019), based on answers to question 6: Is there an institution in charge of establishing accounting standards for subnational governments?

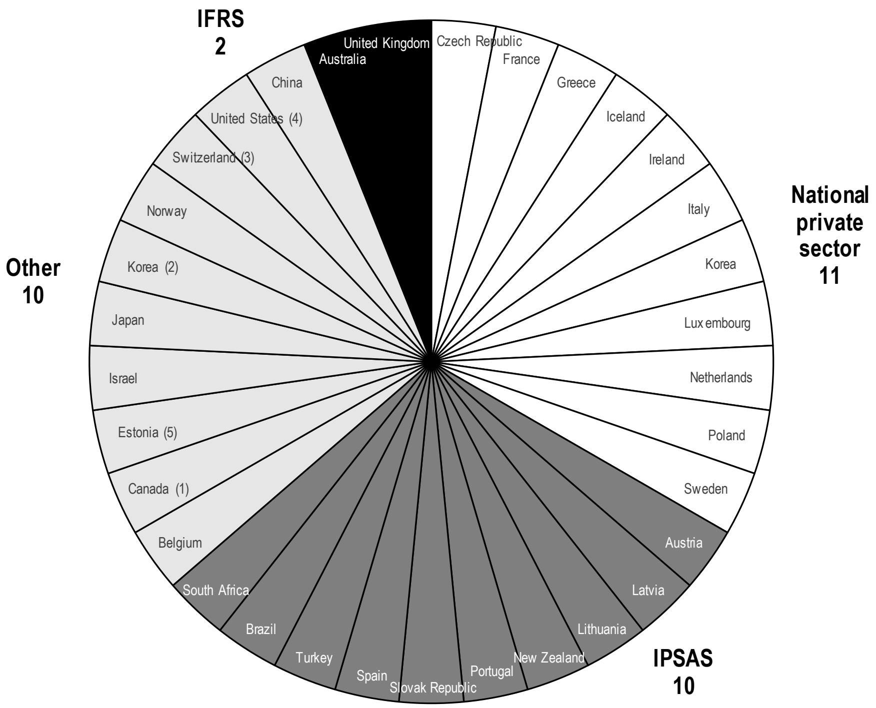
A large majority of subnationals prepare accrual accounts…



Note: (1) The Japanese Ministry of Finance strongly recommends that subnational governments prepare accrual financial statements in addition to their cash accounts; (2) China launched pilot exercises for implementing accrual accounting at the subnational level in 2016.
Source: OECD Survey on Subnational accounting and monitoring of subnational finances (2019), based on answers to question 3: What kind accounting standards do subnational governments follow in your country?

… but there is no shared definition or framework for accrual accounting

Reference framework for accrual-basis accounting standards



Note: (1) Canada has launched in 2019 a consultation on its international strategy, including the option to adopt IPSAS; (2) the Korean standards are aligned with those used in the United States; (3) Switzerland answered that the standards are not based on any of the frameworks listed; (4) in the United States, the standards are the pronouncements of the Government Accounting Standards Board; (5) Estonia answered that their standards include references to IPSAS, IFRS and the national private sector framework

Source: OECD Survey on Subnational accounting and monitoring of subnational finances (2019), based on answers to question 5: If subnational governments prepare accrual-based accounts, are the standards for these accounts based on other standards?

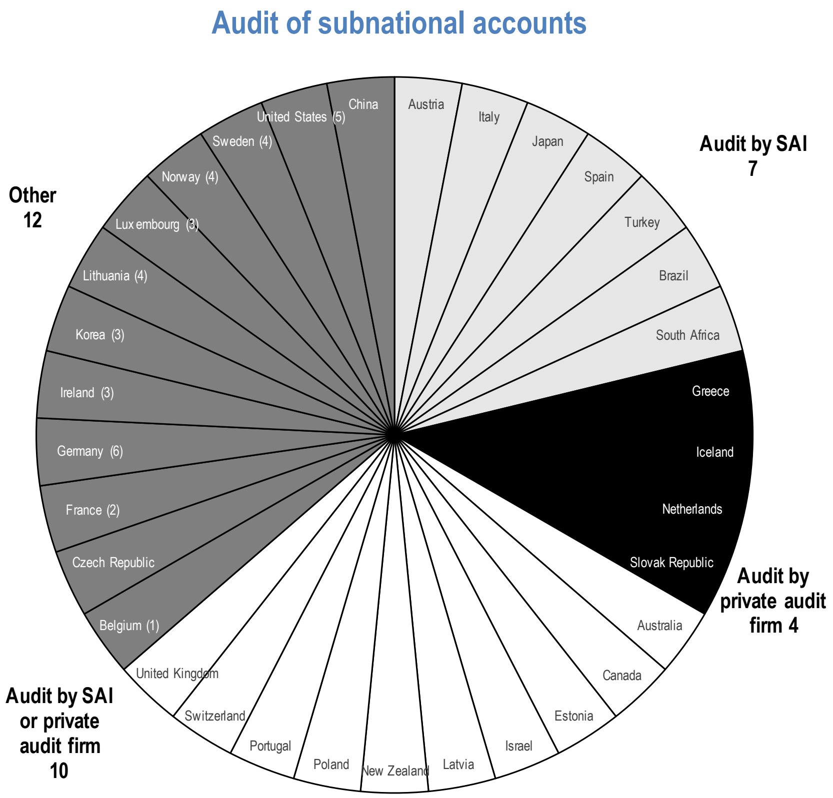
Reporting to central government is a requirement in virtually all countries

Reporting requirements towards national government

	Non-audited accounts	Audited annual accounts	No requirements
Unitary states	15	6	3
Federations	2	2	5
Total	17	8	8

Note: In some countries, such as Norway, a first set of non-audited data is communicated to the national statistical agency in the first quarter of the year. Time-lags are specified only when a reporting requirement to national government exists and for countries that provided this information in their answer to the survey. Time-lags are expressed in months; (2) In the United States, all state and local governments that receive more than $750,000 of federal assistance must submit a financial and compliance audit within 9 months after period end; (3) In Brazil, the Fiscal Responsibility Law establishes that the subnational governments have to send their accounting data of the last fiscal year until June 30, in order to the central government consolidate the public sector accounts. (4) In Norway, the accounts have to be submitted to the national government within one month of their adoption by the local government – ie. at the latest June 30th + 1 month.
Source: OECD Survey on Subnational accounting and monitoring of subnational finances (2019), based on answers to question 9. Are subnational governments required to submit their accounts to the national government?.

Independent audit is not yet a standard practice



Note: (1) In Belgium, state governments are audited by the Court of Auditors and local governments are audited by agencies of the state governments; (2) France is piloting several audit models; (3) in Ireland, Korea and Luxembourg, audits are carried out by audit departments operating under the auspices of the national government; (4) in Lithuania, Norway and Sweden, audits are carried out by local bodies; specifically, in Norway, audits cannot be conducted by a local body which is part of the legal entity of the municipality. Thus, audits are carried out mainly by audit companies owned by one or several municipalities or regions, but also by private audit companies; (5) in the United States, auditors vary by state: they can be conducted entirely by the state auditor, entirely by public accounting firms, or both; (6) in Germany, different types of audit are authorised at local level, including “self-auditing”.

Source: OECD Survey on Subnational accounting and monitoring of subnational finances (2019), based on answers to question 7. Are subnationals’ accounts audited?

MONITORING PRACTICES

The monitoring approach depends in part on the Constitution

National governments' authority to intervene in subnational finances

	Authority to monitor and take steps to remedy problems	No such authority
Unitary Countries	**17:** Estonia, France, Greece, Ireland, Israel, Japan, Korea, Lithuania, Luxembourg, Netherlands, New Zealand, Norway, Poland, Slovak Republic, United Kingdom; China, South Africa,	**4**: Czech Republic, Iceland, Portugal, Sweden
Federations	**1**: Spain	**8**: Australia, Austria, Belgium, Canada, Germany, Switzerland, United States; Brazil

Note: Answers provided by respondents sometime referred to legislation other than the constitution. Italy, Latvia and Turkey did not answer this question, as they answered a previous version of the questionnaire.
Source: OECD Survey on Subnational accounting and monitoring of subnational finances (2019), based on answers to question 1: What authority does the constitution give the national government in the area of subnational finances?

National governments' monitoring of subnational finances

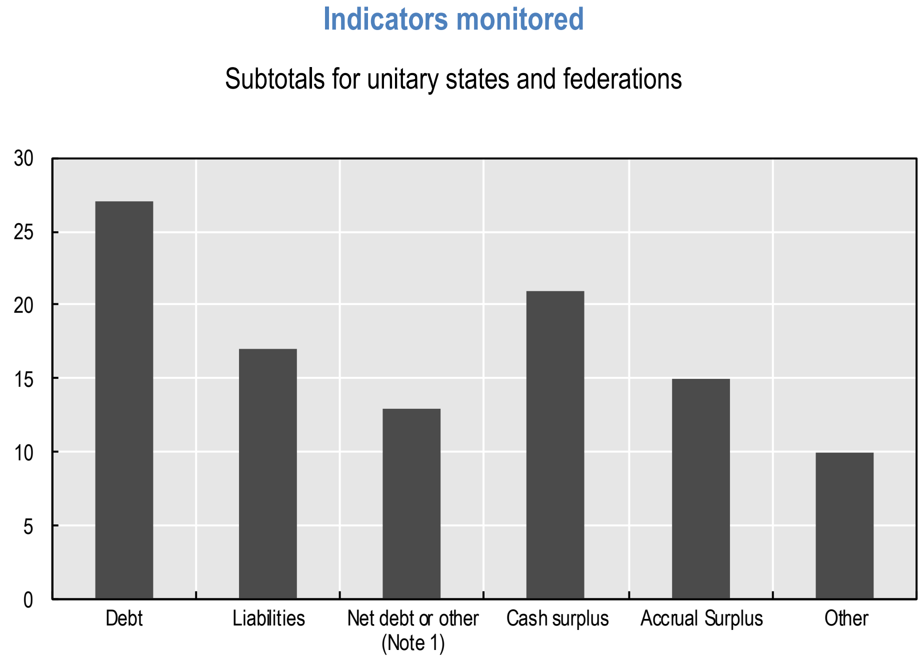
	Monitors	Does not monitor
Unitary Countries	**22:** Czech Republic, Estonia, France, Greece, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, Norway, Poland, Portugal, Slovak Republic, Sweden, Turkey, United Kingdom; China, South Africa,	**2:** Netherlands, New Zealand
Federations	**5:** Australia, Austria, Canada, Spain; Brazil	**4:** Belgium, Germany, Switzerland, United States

Source: OECD Survey on Subnational accounting and monitoring of subnational finances (2019), based on answers to question 11: Does the national government monitor the finances of subnational governments?

The nature of the monitoring varies widely

Responsible institution	Role
• Finance or Interior ministry (e.g. France) • Co-operative monitoring (e.g. Germany) • IFI (e.g. Spain)	• Control of compliance with fiscal rules • “Advisory”

Monitoring of debt and cash deficits is often supplemented by monitoring of accrual-based indicators



Note: Table excludes countries that indicated that national government did not monitor subnational finances. (1) Net debt or other includes net worth and net financial worth.
Source: OECD Survey on Subnational accounting and monitoring of subnational finances (2019), answers to question 14: Which indicators does the monitoring focus on?

CASE STUDY OF BRAZIL

Brazil’s situation exhibits many similarities with OECD countries

- Strict fiscal responsibility legislation following a series of crises
- Adoption of accrual accounting + strict reporting requirements…
- … but did not prevent yet bailouts and remaing challenges with implementation “in the field”

CONCLUSION

Conclusion and future directions

- Significant progress on use of accrual accounting but quality of standards and audit requirements are two remaining challenges for sub-nationals' accounting.

- Need to further weigh the value of specific indicators in detecting early signs of financial distress.

- Future directions:
  - importance of forecasts;
  - methods for benchmarking and comparative analysis;
  - use of both data and reports;
  - reports on risk.

http://www.oecd.org/gov/budgeting/