

Guide to Transparency in Public Finances

Looking Beyond the Core Budget

5. Future Liabilities



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Introduction

For more than a decade, civil society organizations around the world, as well as international financial institutions, have been pushing for governments to provide the public with more comprehensive budget information. The International Budget Partnership's (IBP) Open Budget Survey examines the accessibility in countries around the world of eight key budget reports that governments should publish in order to enable civil society, oversight institutions, and members of the public to participate effectively in budget processes and hold governments accountable for how they use public money. In two companion guides to the briefs listed below — the *Guide to Transparency in Government Budget Reports: Why Are Budget Reports Important, and What Should They Include?* and the *Guide to Transparency in Government Budget Reports: How Civil Society Can Use Budget Reports for Research and Advocacy* — the IBP describes the importance of each key budget report, the information that it should contain, and how civil society organizations can use them.

This is one of five briefs that goes beyond the eight key budget reports covered in the guides to examine other areas of public finance that are less well understood and especially vulnerable to efforts to shield them from public scrutiny. The other briefs are:

- Extra-budgetary Funds
- Tax Expenditures
- Quasi-fiscal Activities
- Contingent Liabilities

All of the briefs examine the following questions:

- What are these issues or activities, and why are they of interest?
- What information should the government include in budget documents and other reports on these issues in order to provide a comprehensive picture of the government's fiscal position and increase the public's understanding of how their money is being utilized?
- How can civil society groups use information contained in these documents to achieve their research and advocacy goals?
- Where can further information, country examples, and “model reports” be found?

The briefs are based on existing guidance and practices related to these areas of public finance gathered from various sources. In some cases, concrete examples are scarce, as these are new and complex areas of public budgeting.

The IBP will continue to build on this material and identify further public finance issues and activities that are typically shielded from public scrutiny but may have a major bearing on a country's public finances. Any additional briefs will be added to the IBP's website at: www.internationalbudget.org.

Future Liabilities

Future liabilities affect a government's medium- and long-term fiscal position, based on current government policies. They include expenditure projections with regard to pension and social security schemes, for example. Not many non-OECD countries include information on future liabilities in their budget documents, and practice shows that the necessary analysis may need to be updated only every few years. Nevertheless, civil society organizations should at least be aware of their possible utility in assessing the strategic policy choices that their government faces.

A. What are future liabilities, and why are they of interest?

Future liabilities are estimates of the future costs of current government programs that have a bearing on medium- and long-term fiscal policies and outcomes. These estimates need to be based primarily on projected changes in population. For example, estimates of changes in the number of young people are used to project the future cost of education, while estimates of the number of older people assist with projecting future health costs. Future liabilities may also include the future costs of pension schemes for government employees, based on projected attrition rates.

A calculation of future liabilities provides a long-term view of the financial sustainability of the government's current policies. It is important to note that while an assessment of long-term budgetary trends can provide a critical perspective, the corresponding estimates are very sensitive to the assumptions underlying them. Indeed, minor changes to the assumptions can have a major impact of the long-term view of the government's finances. In this sense, estimates of future liabilities should be interpreted as mere projections, rather than as actual indications of future government fiscal policy. The governments of the United States and the United Kingdom, for instance, issue estimates of future government income and expenditure for the next 25 and 50 years respectively, based on current government policies.

Below are two examples of future liabilities.

Government or state employee pension obligations – Many governments provide a pension scheme for all or some of their employees. An estimate of the costs of providing pensions to retired state employees is usually provided each year in the government's budget. The accounts then show the actual payments made compared with the budget. Additionally, there are a range of variables and assumptions used to determine the adequate level of resources needed to meet future pension payment obligations. Some of the most important estimates include:

- age at which employees will retire;
- number of years after retirement that employees will live and so be entitled to a pension;
- future salary increases of state employees;
- future rates of inflation;
- future levels of promotion of state employees; and
- the discount rate to be used to calculate the current value of future pension schemes.

In February 2008 the International Public Sector Accounting Standards Board issued *IPSAS 25: Employee Benefits*, which includes requirements for governments that report on the accrual basis (almost all governments still report on the modified cash basis) to account for their employee pension schemes.

Obligations for social security benefits – Most governments pay social security benefits to their citizens, the most common being state pension schemes (which cover all citizens of a country and not just its public employees) and the provision of education and health services. The uncertainties surrounding accounting for such schemes are similar to those related to accounting for employee pension schemes. However, it is much easier for a government to change its policies on the provision of social security benefits. For example, the U.K. government increased state pensions in line with average salaries between 1974 and 1980. Subsequently, state pension increases have been based on the inflation rate, which has increased less than salaries. As a result, the real value of a basic state pension has fallen dramatically, and around one fifth of U.K. pensioners now live below the poverty line. In addition, the age at which a pensioner can receive the state pension is being raised.

On the basis of current policies, state spending on education in the U.K. is expected to increase from 5 percent to 5.6 percent of GDP over the next 50 years. Over the same time period, spending on health is expected to increase from 7.4 percent of GDP to 9.9 percent (HM Treasury 2008). However, the policies themselves can change. For example, students in higher education in the 1970s and 1980s in the U.K. received a grant. This subsequently was changed to a loan, and most university students are now also required to provide tuition fees of at least £3,000 a year. Policy changes such as these should reduce or contain the government's future costs for higher education.

B. What information should governments include in budget documents and other reports on future liabilities?

Most governments do not report on future liabilities, and the level of information that might be reported may vary from country to country. Information on future liabilities is based on estimates, assumptions, and future projections, which may be subject to a large measure of variation. In addition, minor changes to one or two assumptions can radically change the nature of the projections (as in the case of oil price projections for countries that rely heavily on oil revenues to finance expenditure). For these reasons, ranges should be provided for future projections to indicate the level of the uncertainties involved.

The OECD's *Best Practices for Budget Transparency* (2002: p. 11) nevertheless provides some advice on reporting long-term fiscal sustainability, though very few governments have adopted this type of reporting. The OECD indicates that long-term reports should be released at least every five years, or whenever major policy changes take place; they should assess the budgetary implications of demographic change; and they should make explicit all key assumptions underlying the projections contained in the report, presenting a range of plausible scenarios.

In New Zealand the government is required to publish at least once every four years a statement on the long-term fiscal position looking out at least 40 years. In October 2009 the second of these reports was issued and provided three scenarios for the future (NZ Treasury 2009). In the U.K. similar reports have been issued with the budget for most years since 1999 and looking forward up to 50 years. The latest one was due to be issued in late 2009, sometime after the budget for that year. These reports “provide comprehensive analysis of long-term demographic developments, and their likely impact on the public finances” (HM Treasury 2008).

Some guidance also exists to indicate what kind of information countries should publish in relation to certain categories of future liabilities. For reporting on pension obligations for state employees, the OECD's *Best Practices* (2002: p. 13) makes the following recommendations:

- ➔ Employee pension obligations should be disclosed in the budget, the midyear report and the year-end report. Employee pension obligations are the difference between accrued benefits arising from past service and the contributions that the government has made towards those benefits.
- ➔ Key actuarial assumptions underlying the calculation of employee pension obligations should be disclosed. Any assets belonging to employee pension plans should be valued at market value.

Due to the complexities involved, pension liabilities are not usually calculated every year. South Africa makes these calculations every two or three years, and the 2007/08 financial statements provided the following information on its pension schemes in the notes to the government accounts:

36 Post-retirement benefits				
	Post Retirement medical assistance	36.1	56,000,000	56,000,000
	Pension funds	36.2	-	12,775,000
			<u>56,000,000</u>	<u>68,775,000</u>
36.1	Post-retirement medical assistance		56,000,000	56,000,000
	<p>This contingent liability is the estimated present value of the State's future commitment in respect of government employees' post employment medical assistance (including former members of the National Defence Force, the Police Service and Correctional Services). The valuation is at 29 February 2004. The previous valuation was dated 28 February 1999. This value does not include any contingent liabilities for the very large number of employees who are currently not members of medical aid schemes but who may become members at some future date.</p> <p>The State's commitment in respect of post retirement medical scheme assistance is provided for in the annual budget on the votes of the Defence Force, Police Service and Correctional Services in respect of former service members and on the Finance vote in respect of other government employees.</p>			
		Note	2007/08 R'000	2006/07 R'000
36.2	Pension funds		-	12,775,000
	Government Employees Pension Fund		-	12,775,000
	<p>This commitment represents the underfunding/surplus of the pension funds according to the most recent actuarial valuations. Actuarial valuations are conducted every three years. This liability continues to be based on incomplete assessment data.</p>			
	Funding levels		%	%
	Government Employees Pension Fund		101.6	96.5
	Temporary Employees Pension Fund		133.5	164.0
	Associated Institutions Pension Fund		112.0	155.6
	Valuation dates			
	Government Employees Pension Fund		March 2006	March 2004
	Temporary Employees Pension Fund		March 2007	March 2004
	Associated Institutions Pension Fund		March 2007	March 2005
	<p>Government Employees Pension Fund, Temporary Employees and the Associated Pension Fund are in surplus with R11 400 million, R80 million and R1 204 million respectively (2006/07: R9 040 million, R74 million and R1 742 million respectively).</p>			

This example indicates the uncertainties involved in estimating pension liabilities. The Associated Institutions Pension Fund was estimated to have a surplus of 55.6 percent of the future pension costs in 2006/07 based on a valuation conducted in March 2005, but the surplus falls to only 12 percent in 2007/08 based on a valuation conducted in March 2007. The South African financial statements do not disclose the assumptions made when calculating these estimates, or whether they have changed from one year to the next (RSA National Treasury: pp. 57-58).

Accounting standards in the area of obligations for social security benefits are less well developed than for reporting on government pension schemes. In February 2008 the International Public Sector Accounting Standards Board issued an Exposure Draft (ED) that covered obligations for social security benefits and long-term fiscal sustainability reporting. This ED suggested that governments should provide as a note to their accounts information on the present value of future payments for social security benefits for those citizens who have met the initial criteria for entitlement (for example, those

who have already retired for public pension benefits) and the key assumptions used when calculating this sum.

C. How can civil society use this information for research and advocacy?

Governments seldom report on future liabilities, including pension and social security obligations; it is technically complex and subject to a range of estimates or projections that can change the overall figures significantly from one year to the next. Such estimates are difficult to understand and may be subject to manipulation, which is not always easy or even possible to detect. All of these factors make it challenging for civil society groups to engage meaningfully in debates around reporting on future liabilities.

Nevertheless, where long-term fiscal sustainability reports are being introduced, civil society groups could advocate for specific reporting on the anticipated levels of future spending on clear poverty reduction measures, or on social security benefits for disadvantaged groups. This information would enable civil society to argue for changes in current policies in order to reach long-term goals on these issues.

D. Relevant materials, websites, and “model reports”

HM Treasury (United Kingdom). *Long-term public finance report: an analysis of fiscal sustainability*. London: HM Treasury. 2008. http://www.hm-treasury.gov.uk/d/bud08_longterm_586.pdf

International Monetary Fund. *Manual on Fiscal Transparency* (esp. pp. 47-48). Washington, D.C.: International Monetary Fund. 2007. <http://www.imf.org/external/np/pp/2007/eng/051507m.pdf>

International Public Sector Accounting Standards Board. *Consultation Paper: Reporting on the Long-Term Sustainability of Public Finances*. New York: International Accounting Standards Board. 2009. <http://www.ifac.org/sites/default/files/publications/exposure-drafts/00281.pdf>

International Public Sector Accounting Standards Board. *Exposure Draft 34, Proposed International Public Sector Accounting Standard: Social Benefits: Disclosure of Cash Transfers to Individuals or Households*. New York: International Accounting Standards Board. 2008. <http://www.ifac.org/sites/default/files/publications/exposure-drafts/00281.pdf>

International Public Sector Accounting Standards Board. *IPSAS 25: Employee Benefits*. New York: International Accounting Standards Board. 2008. http://www.ipsas.org/PDF_ipsas_standards_ifac/IPSAS25.pdf

New Zealand Treasury. *Challenges and Choices: New Zealand's Long-term Fiscal Statement*. 2009. <http://www.treasury.govt.nz/government/longterm/fiscalposition/2009>

Organization for Economic Cooperation and Development. *Best Practices for Budget Transparency*. Paris: OECD. 2002. <http://www.oecd.org/dataoecd/33/13/1905258.pdf>

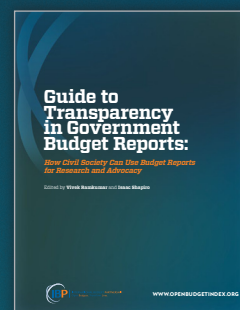
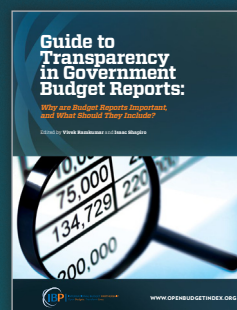
Republic of South Africa National Treasury. *Consolidated Financial Information for the year ended 31 March 2008*. Pretoria: National Treasury. 2008. <http://www.treasury.gov.za/publications/annual%20reports/annual%20financial%20statements/Consolidated%20fin%20info%20-%2031032008.pdf>

The Open Budget Initiative

This guide is part of a series that looks at public finance topics in terms of transparency and accountability. The Open Budget Initiative may produce additional guides around other important related topics in the future.

1. Extra-budgetary Funds
2. Tax Expenditures
3. Quasi-fiscal Activities
4. Contingent Liabilities
5. Future Liabilities

This series is a companion to two earlier **Open Budget Initiative** guides on public budget transparency — one for governments and one for civil society organizations.



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