

Announcement of discussion material Examination Results of
Conceptual Framework for Public Sector Accounting

This is to notify that the discussion material Examination Results of Conceptual Framework for Public Sector Accounting, reported by the Public Sector Accounting Framework Project Team, has been approved at a meeting of the board of directors held on March 25.

The discussion material includes comprehensive ideas and accounting methods for the state (the general account and special account), local municipal entities and incorporated administrative agencies, etc., (including incorporated administrative agencies, government-affiliated corporations, authorized corporations and municipal enterprises) and consists of three parts, namely, the Examination Results of Conceptual Framework for Public Sector Accounting (the preamble), the Table of Disputed Points concerning the Conceptual Framework for Public Sector Accounting which contains respective arguments, and the Conceptual Framework for Public Sector Accounting which is the subject of the arguments.

During the examination of the discussion material, opinions of the members were divided because this was the first time in Japan to examine a conceptual framework for public sector accounting and the members were unable to reach conclusions for some issues, as noted in the Examination Results of Conceptual Framework for Public Sector Accounting (the preamble) and the table of disputed points.

It is the hope of the Japanese Institute of Certified Public Accountants that many people involved in public sector accounting will use the discussion material as the base for discussion concerning a conceptual framework for public sector accounting and the association will announce tables containing disputed points of such discussion.

Executive Board Member: Shinobu Miyauchi

Conceptual Framework for Public Sector Accounting

**Conceptual base for preparations and reports of financial information and
budget compilations for the public sector**

March 25, 2003

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Conceptual Framework for Public Sector Accounting

1. Significance of the Conceptual Framework for Public Sector Accounting

The existence of the government, which is the major economic entity in the public sector, is ultimately based on the trust of the citizens, who are the constituents of the country, and is defined in the Constitution and political ideas.¹ Therefore, the government bears the obligations and responsibilities (fiduciary responsibility) to make decisions and establish policies which meet the interests of the citizens as much as possible, and at the same time, to report on and give explanations concerning the results of its performance to the citizens (public accountability).

1.1 Definitions

The Conceptual Framework of Public Sector Accounting has been created for the preparation and reporting of financial information in the public sector (public sector accounting information) and a series of conceptual basics, and is the theoretical ground for setting standards for the recognition, measurement, presentation and disclosure of public sector accounting (public sector accounting standards) and for the planning of fiscal and other systems.

1.2 Economic entities to be applied

The Conceptual Framework of Public Sector Accounting applies to general economic entities in the public sector (such as the central government, local municipal entities and government-affiliated corporations) which either do not aim to make profits or the profits made are not a criterion for the assessment of the achievements. Therefore, the premises and financial structures, etc., of Conceptual Framework of Public Sector Accounting are different from those of business accounting which applies to profit-making companies that aim to maximize profit or for which the amount of profit is a criterion for the assessment of the achievements.

¹ The Constitution of Japan states that “Government is a sacred trust of the people, the authority for which is derived from the people, the powers of which are exercised by the representatives of the people, and the benefits of which are enjoyed by the people.” (referred to in the first paragraph of the preamble of the Constitution).

Notwithstanding the above, the central government must be treated separately from other economic entities in the public sector because of its characteristics as the executive organ of the authority of the state, such as (1) the central government has the obligations and responsibilities to maintain independence internationally and (2) the central government has a special status based on the legal hierarchical structure in Japan including the authority to impose and collect taxes and the authority to issue money (through the central bank). Local municipal entities are treated separately from the central government because they depend on financial resources guaranteed by the central government through local fiscal schemes which consist of local fiscal plans, local allocation taxes and so on, although they have the authority to impose and collect taxes. With regard to government-affiliated corporations, including authorized corporations and incorporated administrative agencies (collectively referred to as “government-affiliated corporations” below), although some adopt self-supporting accounting such as the principle of break even, there are the risks of their bankruptcy as economic entities as a result of poor operation, which means that they ultimately depend on a guarantee of financial resources from the central government, in the same way as local municipal entities and therefore government-affiliated corporations are also treated separately from the central government.

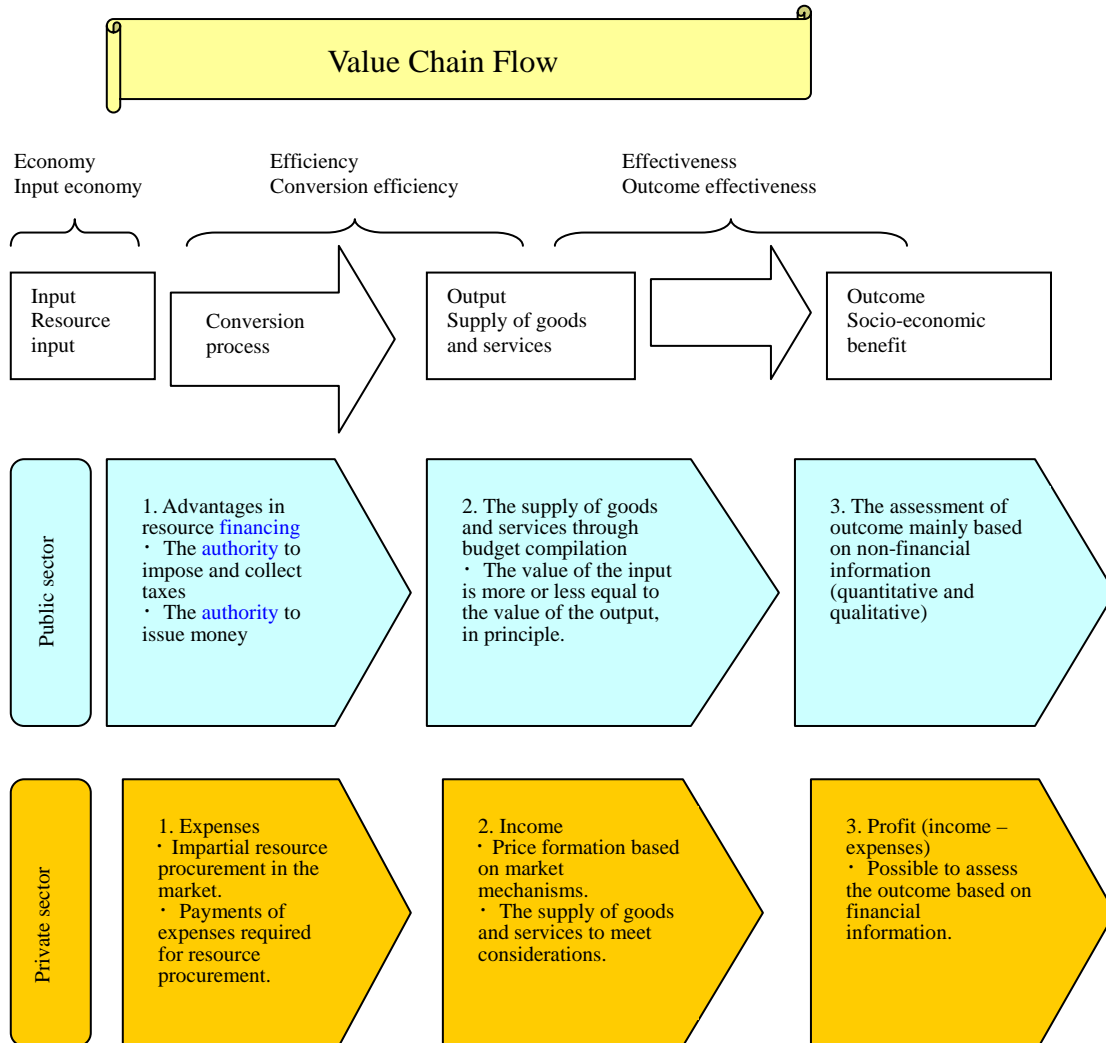
There is the opinion that economic entities in the public sector should be separated into types such as government or business based on earning power and profitability and that different accounting procedures should be applied to the types. However, such separation is not considered to be necessary because of the fact that earning power and profitability themselves are relative and the objectives (establishment of public governance, public accountability and the usefulness in decision making) which are common to all of the economic entities to which public sector accounting is applied.

1.3 Distinctive characteristics of public sector accounting

In order for the government to reach proper decisions, establish appropriate policies and accomplish public accountability, it has to understand the

distinctive characteristics of public sector accounting, which is different from business accounting. The following explanations are based on the value added generation process flow (value chain flow) concerning three points: (1) advantages in resource financing, (2) the supply of goods and services through budget compilation and (3) the assessment of outcome based on non-financial information (refer to Figure 1).

Figure 1. Distinctive characteristics of public sector accounting in the value chain



1.3.1 Advantages in resource financing

The most distinctive characteristic of public sector accounting is the relationship between the government, which has the authority to impose and collect taxes and to issue money (by means of the central bank), and other economic entities based on the hierarchical structure of resource allocation, in other words, the relationship generated by compulsory financing of resources by the government and the compulsory provision

of resources by economic entities other than the government, a situation which is different from that assumed by the neo-classical school of economics which is that all economic entities act rationally in the market (for maximization of profit and utility).

There is almost no external constraint in economic resource financing for the central government, which is one of the economic entities in the public sector, because it has the authority to impose and collect taxes and to issue money (by means of the central bank). Even if government debt balloons in size, the government will be able to repay the debt, which is nominally fixed, without problem because the fiscal management authorities are able to increase taxes (consumption tax and income tax) or implement measures to induce inflation which will reduce the value of money (monetization of government debt by the central bank = inflation tax). The characteristic described above also applies to economic entities in the public sector in addition to the central government (local municipal entities and government-affiliated corporations, etc.) because they have only soft budget constraints due to fiscal support by the central government.

The advantages enjoyed by the government in resource financing as described above mean that the citizens, who are the resource providers, bear a liability which is the same as unlimited joint and several liability for the government debt. In more detail, reflecting the effect of the authority to impose and collect taxes and to issue money (by means of the central bank) of the government, the citizens are compelled to provide an economic resource unlimitedly, which puts the citizens in a position bearing the same liability as unlimited joint and several liability for the government debt accumulated over generations as a result of the government's activities, regardless of whether or not they wish to do so.

1.3.2 Supply of goods and services through budgets

Economic entities in the public sector convert inputs of economic

resources into outputs of goods and services as do economic entities in the private sector. In addition to the distinctive characteristic of public sector accounting that resource input is backed by advantages in resource financing, as described above, there is also the characteristic that the prices of goods and services generated by the resource input are not based on the balance of demand and supply in the market mechanism.

In other words, the public sector is expected to supply public goods with characteristics such as non-excludable or non-rival in consumption, and quasi-public goods with characteristics of externalities of economy of an amount optimal for society through interventions in the market (subsidies and taxation) by the government and to supply after such interventions, because the optimal allocation of resources and the supply of goods and services are not realized automatically in the public sector through the market and price mechanisms. Under such circumstances, great importance is placed on the allocation of economic resources and the distribution of goods and services (transfer) through budget compilations interlinked with politics.

The establishment of a public sector accounting system enables assessments of budget compilations with estimates of public sector financial statements in general (described later in this document) for the following fiscal term, which will lead to more efficient allocation of resources and provision of goods and services that will generate the expected outcome.

1.3.3 Assessment of outcome based on non-financial information

In business accounting, the satisfaction of customers, who give a consideration for goods and services (output), guarantees the outcome, and therefore profit (revenues - expenses), which is financial information gained through the profit / loss calculation, can be an assessment criterion. On the other hand, in the public sector, economic entities, for which earning a profit is not a major objective, are operated using

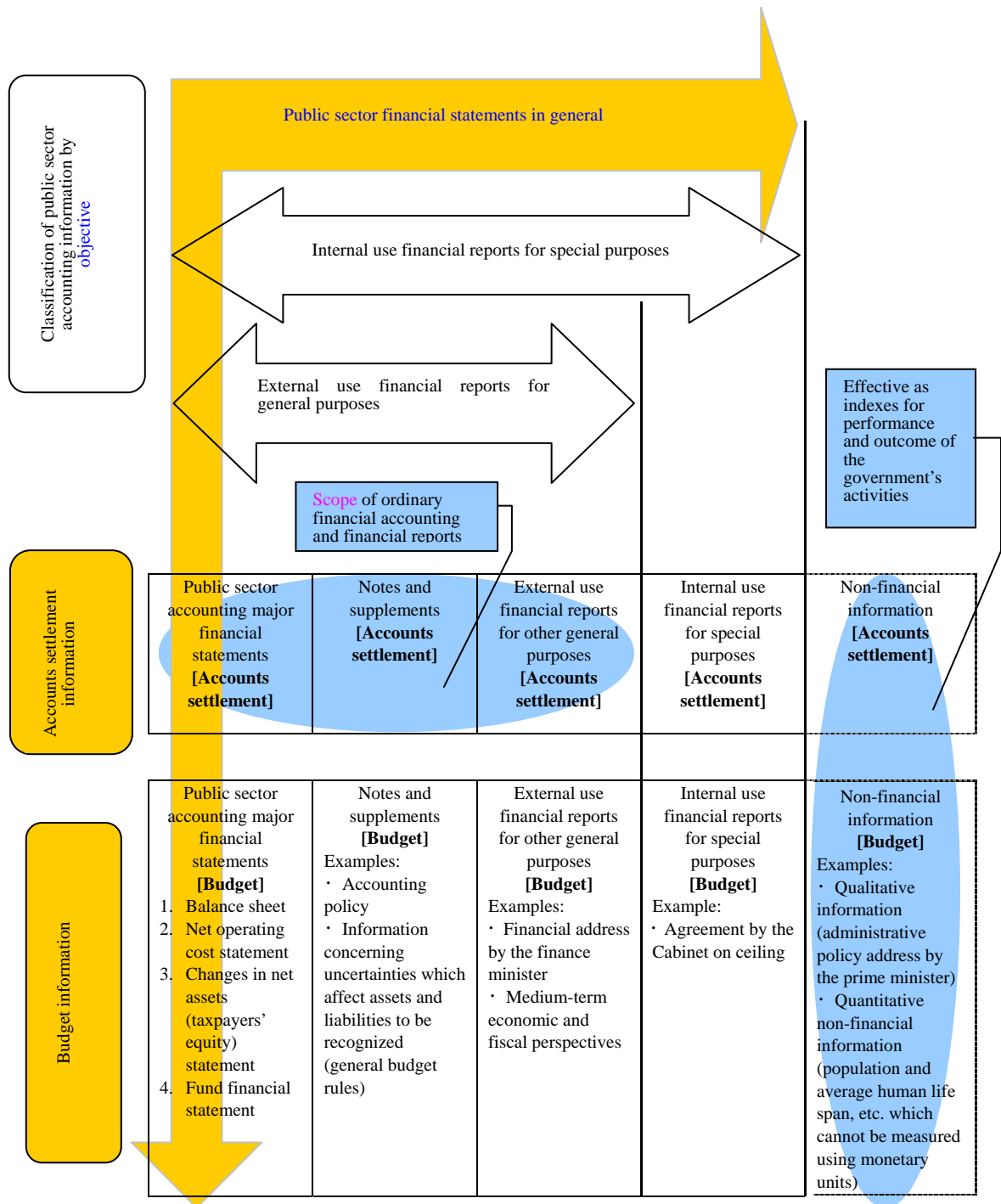
budgets as described above, rather than the consideration paid for goods and services (output), which is another characteristic of this sector. Even if accrual basis accounting as used in business accounting is implemented in public sector accounting in the same way as companies, this will only help to recognize expenses which is an element in the profit / loss calculation and to realize consequent increase in efficiency. The fundamental problem of the public sector is that economic entities are unable to raise sufficient outcome, that is, the benefit and satisfaction of the citizens.

In the public sector, the criteria of decision making must be expanded for performance measurement, which is assessment of performance or outcome, and the criteria should include financial information, which can be measured in monetary units, as well as non-financial information. Non-financial information includes not only qualitative information such as the government's administrative policy, but also quantitative information such as population, average human life span and traffic volume, which cannot be measured using monetary units.

1.4 Scope of public sector accounting information

The scope of financial information required by public sector accounting (public sector accounting information) is greater than that for ordinary financial accounting or for general purpose financial reports for external users because of the distinctive characteristics of public sector accounting, as described earlier. Public sector financial statements are the general financial reports of the government and they contain a large part of public sector accounting information (refer to Figure 2).

Figure 2. Scope and classification of financial information



1.4.1 Accounts settlement information of past events and budget information of future events

- (1) Accounts settlement information of past events: Financial information (accounts settlement information) reports in the public sector concerning past events must be prepared and announced in various forms. Public sector financial statements in general are a major part of the financial reports of the government, but other financial reports sometimes provide more effective financial information of government activities. Attention should be paid to the fact that there are effective indexes for the performance and outcome of government activities not only in financial information but also among non-financial information.

- (2) Budget information of future events: Budgets are plans to administer financial matters concerning economic activities including financing, management and use of resources required for the government to accomplish its duties. Financial information for budget compilation (budget information), which is not necessarily limited to information of items classified and aggregated in ledgers according to an induced method, is vital to control by budgets for government activities and post-inspection. Great importance is placed on the supply of goods and services through budget compilation in the public sector, as described earlier, and so budget information reports including relevant information must be prepared and announced.

Public sector accounting and public sector accounting information indicate accounts settlement information and budget information below unless otherwise noted.

1.4.2 General purpose financial reports for external users and special purpose financial reports for internal users

The government's financial reports are presented as general purpose financial reports for external users and special purpose financial reports for internal users, both of which are included in public sector accounting information, based on the objective of use, etc., of the reports.

- (1) General purpose financial reports for external users: External users of financial information cannot access this information directly, so financial information which fulfills the general and common purposes of many external users must be provided in these reports. Citizens may be regarded as internal parties because they are the constituents of the country, but at the same time they are external users of general purpose financial reports and cannot directly access the information. This status is the same as that of holders of company stock offered publicly. Such stockholders are the constituents (internal parties) of a company because they are the subscribers, but at the same time they are external users of general purpose financial reports. In addition to citizens, external users of financial information in the public sector include holders and potential investors of public bonds, certified public accountants, the Diet, which supervises government activities and has the right to investigate the activities, and the Board of Audit of Japan.

- (2) Special purpose financial reports for internal users: Internal users of financial information in the public sector bear the obligations and responsibilities (fiduciary responsibility) to ensure that government decisions and policies meet the interests of the citizens as much as possible. Therefore internal users have the right to access financial reports of sufficient detail to fulfill the special purposes described above. The government bears a responsibility to release internal use financial reports to the citizens to fulfill public accountability, in so far as such release does not impede its activities. Internal users of financial information in the public sector include Cabinet members who have the right to compile the budget (the Constitution, Article 73, Paragraph 5), the authorities responsible for budget compilation

that are assigned through tax payments, etc., to manage and use economic resources, and the Diet, which participates in decision making for resource allocation of the government with the legislative right and the voting right for the budget.

1.5 Measurement focus of public sector major financial statements

Among public sector financial statements in general which are general financial reports containing public sector accounting information, four statements (balance sheet, net operating cost statements, changes in net assets (taxpayers' equity) statements, and cash flow statements), which are particularly important in the financial operation in the public sector and which correlate with each other, are collectively called public sector major financial statements.

The measurement focus of public sector major financial statements indicates the scope of public sector major financial statements to be recognized and measured with regard to economic value changes for presentations and reports of fiscal positions, financial performance and changes in the fiscal positions of entities which are preparing reports. In more concrete terms, concerning elements of public sector major financial statements (assets, liabilities, taxpayer's equity, income, expenses and changes in resource budgets [taxpayer's equity]), the measurement focus indicates the scope of stock information (balances of the elements at the end of fiscal terms) and flow information (changes of the elements during fiscal terms) to be included.

On the other hand, the basis of accounting, which relates with the measurement focus, indicates the timing of public sector major financial statements to be recognized and measured with regard to economic value changes. Concerning public sector accounting in Japan, whether cash basis accounting or accrual basis accounting should be used is often discussed, which is a rather generalized topic. Such discussions must be more focused to determine whether cash basis accounting or accrual basis accounting should be performed for the measurement focus and, separately, whether cash basis

accounting or accrual basis accounting should be performed for the basis of accounting.

1.5.1 Measurement focus of business accounting

In business accounting accrual basis accounting, in which all economic resources (current financial resources and non-financial resources) that an entity, which is preparing reports, holds (the measurement focus) are recognized and measured at the time that the transactions accrue (basis of accounting), has been used.

The economic resources, described above as the measurement focus, are generally considered to consist of the stock information of the balance sheets, that is information of the balances of the elements at the end of fiscal terms (assets, liabilities and equities), and the flow information of the profit and loss statements, that is information of profit and loss transactions (income and expenses). Income and expenses are the increase and decrease of economic resources generated by external transactions between an entity, which prepares the reports, and third parties. Based on the fact mentioned above, flow information and stock information are connected by transferring the net profit of the fiscal term (income – expenses), obtained from the profit and loss statements, to the profit surplus in the balance sheets, and such transfer makes the information possible to be used as an assessment criterion for the performance and outcome of companies.

1.5.2 Measurement focus of public sector accounting

There are various procedures for public sector accounting and these include (1) pure cash basis accounting — cash inflow and outflow are the basis of accounting and the measurement focus, (2) modified cash basis accounting — cash inflow and outflow including the settlement period are the basis of accounting and the measurement focus, (3) modified accrual basis accounting — the accrual basis is the basis of accounting and financial resources, which are current assets and

liabilities mainly consisting of cash and cash equivalents, are the measurement focus in balance sheets, and (4) pure accrual basis accounting as used in business accounting — the accrual basis is the basis of accounting and economic resources, that are current financial resources and non-financial resources, are the measurement focus in balance sheets.

In public sector accounting in Japan, modified cash basis accounting, in which cash inflows and outflows including the settlement period (measurement focus) are recognized and measured at the time of the flows including the settlement period (basis of accounting), has been used. On the other hand, the Constitution and laws related to fiscal systems stipulate not only cash basis elements (expenditure, annual expenditure which is only cash outflow) but also accrual basis elements (long-term debts are economic resources) to be recognized and measured, by stating for example, “no money shall be expended, nor shall the State obligate itself, except as authorized by the Diet (the Constitution, Article 85, underlined by the author), “apart from amounts of annual expenditure budgets... (part omitted), in order for the government to take out debt, the government must obtain Diet approval through resolutions by proposing a budget in advance of actually taking out such debt” (Public Finance Law, Article 15, Paragraph 1, underlining by the author). It is understood that the government is entrusted to determine the accounting procedures to use by applying its discretion and judgment based on fiscal policy.

As a matter of fact, it has been considered that profit / loss calculations required by pure accrual basis accounting (accrual basis is the basis of accounting and economic resources are the measurement focus), as used in business accounting, are not necessary in the public sector because entities in the public sector are not targeting profit. Therefore, in Japan and some other countries, public sector entities have been using pure cash basis accounting, in which cash inflow and outflow are the basis of

accounting and the measurement focus (or modified cash basis accounting or modified accrual basis accounting). The advantage of cash basis accounting is that it is possible to recognize income expenditures as well as capital expenditures, which include spending for social capital formation, and expenditures made without receiving considerations (transfer and allocation) such as social security benefits and subsidies. It may be considered that cash basis accounting provides more useful information to make decisions concerning public measures because of the above advantage.

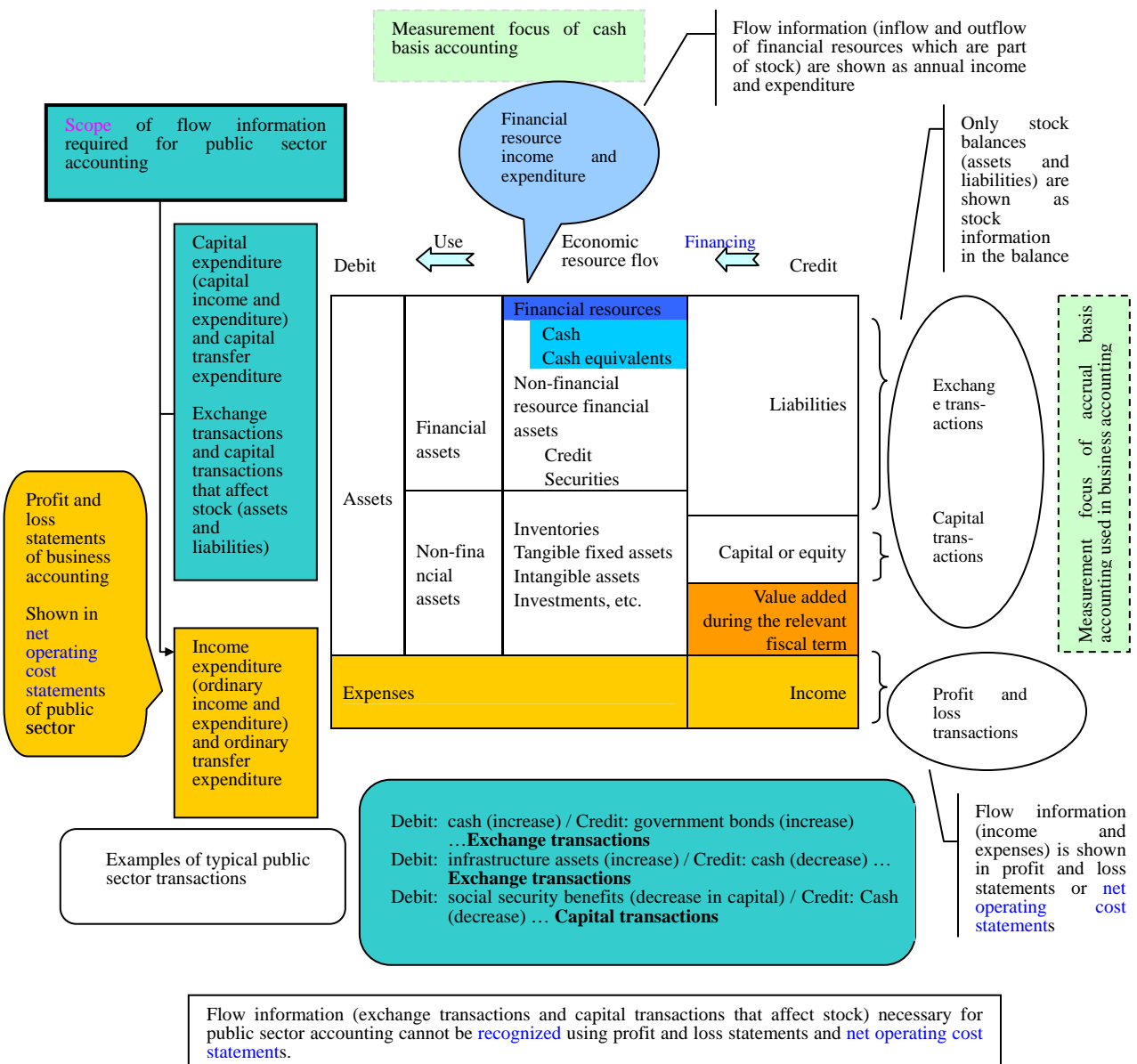
However, cash, which is the measurement focus of cash basis accounting, is only one of the items of stock (assets and liabilities) included in the balance sheet, and when cash basis accounting is used, information concerning other stock (fixed assets and long-term liabilities, etc.) becomes insufficient, giving rise to the problem of being unable to recognize future effects and burdens caused by fiscal management. In Japan, management of stock (assets and liabilities) and imposing appropriate burdens on generations of citizens through the management of stock are particularly important because of present fiscal circumstances such as the approximately forty percent of annual revenue that depends on the issue of bonds. This is the major reason that pure accrual basis accounting (accrual basis is the basis of accounting and economic resources are the measurement focus) has become necessary in the public sector and that stock information (balances of assets and liabilities) in the balance sheet is now disclosed through national government balance sheets (Ministry of Finance) and local government balance sheets (Ministry of Internal Affairs and Communications), etc.

There is a tricky problem in the implementation of accrual basis accounting (accrual basis is the basis of accounting and economic resources are the measurement focus) used in business accounting in the public sector. In the case of business accounting, profit (income – expenses) in the profit and loss statement is flow information used to

measure the outcome during the respective accounting period. The government and other public sector entities do not target profits. Through the actions of the government, goods and services are mainly provided based on budgets and without receiving considerations. Capital expenditures such as spending for social capital formation and expenditures without receiving considerations (transfer and allocation) such as social security benefits and subsidies are not profit and loss transactions and are treated as capital transactions which directly reduce the capital or non-exchange transactions and are the main types of government expenditures.

Because of the reasons described above, it is meaningless to simply apply accrual basis accounting as used in business accounting in the public sector or to try to recognize profit through profit / loss calculations as flow information in order to measure the performance and the outcome of government activities. The responsibilities of the government in fiscal management should be clarified by correlating the stock information on the balance sheet with flow information for which the scope has been expanded to include information of profit and loss transactions and of capital transactions, etc., that covers capital expenditures that affect stock (assets and liabilities), expenditures without receiving considerations (transfer and allocation) and some non-exchange transactions related to capital formation, of the relevant accounting period (refer to Figure 3).

Figure 3. Measurement focus of public sector accounting



Note 1

Profit and loss transactions: These transactions generate profit (loss) which is income (expenses). Profit and loss transactions do not affect capital directly, but indirectly by transferring the net profit of the relevant fiscal term (flow information) in the profit and loss statement to profit surplus (stock information) in the balance sheet. Income expenditures which should be deducted from the income correspond to expenses.

Note 2

Capital transactions: These transactions affect capital directly. Capital expenditures and expenditures without receiving considerations (transfer and allocation), that should be deducted from the capital, are factors that reduce the capital.

Capital increase (tax revenue in the equity theory concerning taxation positioning)

Direct capital reduction (depreciation of depreciable assets for which no corresponding income is expected)

Social security benefits, subsidies and grants (transfer and allocation)

Note 3

Exchange transaction: Exchange of the equivalents is conducted in assets or liabilities in these transactions and does not affect profit or loss or cause any change in capital directly.

Financial resource financing by issuing public bonds and repayments of principals of liabilities

Acquisition of fixed assets by expenditure of the capital

New standards announced by the Local Government Accounting Standards Board of the US (GASB 34 issued in June 1999) require the use of pure accrual basis accounting (accrual basis is the basis of accounting and economic resources are the measurement focus) for government-wide financial statements, which consist of statements of net assets (balance sheets), statements of activities (profit and loss statements), in the same way as for companies. At the same time, with regard to governmental fund accounting such as capital project fund accounting, the new standards allow modified accrual basis accounting (accrual basis is the basis of accounting and financial resources are the measurement focus) to be used as in the past. This is because in the case that the measurement focus covers all economic resources in balance sheets, the state of transactions which do not affect economic resources (net amounts) such as capital expenditures for capital projects (capital transactions) and issues of public bonds cannot be recognized through flow information, so fund financial statements prepared using the

modified accrual basis accounting are necessary in order to provide supplementary information.

2. Backgrounds of public sector accounting system reform

2.1 Fundamental issues

The fiscal state of the Japanese government has reached a crisis level which impairs the impartiality of the burdens between different generations of people. Despite the situation described above, the discipline of the government in fiscal management has not improved at all and the balance of outstanding public bonds continues to rise. Decisions made by such a government will eventually harm the benefits of the citizens significantly, particularly those of future generations who lack the means to insist upon their own interests.

This framework has been prepared focusing on issues such as how to ensure that the government efficiently uses the economic resources that the citizens (taxpayers, the electorate and so on) entrust to the government through their tax payments, etc., and that the government reaches appropriate decisions in state operations from the aspect of fiscal management, and the rules that should be implemented for the above. The following are the arguments concerning the direction that the public sector accounting system reform should take, based on the issues described above.

2.2 Functions of public finance

There are three functions of public finance: resource allocation adjustment, income distribution and stabilization of the economy (business cycle adjustment). Each of these functions has been recognized successively through the history of development of capitalism through the centuries, during which time the mercantilism, formation of nation states, attaching importance to social policies and Keynesian-style fiscal management have been realized. The function of resource allocation, which is the most fundamental function of public finance, means the allocation of available economic resources

between the public sector and the private sector, or among the various segments inside each sector. The resource allocation function should be regarded as the prime public finance function also in public sector accounting.

2.2.1 Resource allocation adjustment

Section 7 of the Constitution (Articles 83 - 91) and the Public Finance Law stipulate the basic principles of fiscal systems and management. In these stipulations, the greatest importance is placed on the establishment and control of fiscal democracy by the Diet. In more concrete terms, all of the decision-making concerning fiscal policies must have Diet approval in accordance with the principle of making resolutions in the Diet concerning statutory authority of fiscal management such as spending for national expenditures and the burdening of debts (the Constitution, Article 83, etc.) and in accordance with the principle of no taxation without law (the Constitution, Article 84). The upper limits of bond issues are determined in accordance with the general budget rules (Public Finance Law, Article 22, Paragraph 1), and of debt financing bonds (deficit-covering bonds) in accordance with the Public Bond Issue Special Provisions Law. Diet approvals are required to set the maximum values for both types of public bonds.

It is certain that the principle of making resolutions in the Diet concerning statutory authority of fiscal management aims to maintain democratic management of government activities in public finance. Under the system based on the above principle, although the government is expected to make decisions that benefit people of the current generation who have voting rights, the government may not be expected to do so for future generations including generations yet unborn. In fact, Diet approvals are impairing resource allocation and increasing unevenness in the burdens among people of different generations over the long term because of the increasing balance of outstanding public bonds.

Taking into consideration the circumstances described above, stress should be laid on the following two points when making decisions for fiscal policies:

- (1) Observance of the principle of making resolutions in the Diet concerning statutory authority of fiscal management in accordance with the principle of democracy.
- (2) Allocation of expenses between people of the current generation and future generations by regarding fiscal policies as the government's financial mediation to finance and allocate economic resources over the long term (from the present to the future). In other words, the views of future generations who are as yet unable to voice their opinions should be recognized as public sector accounting information and the interests of future generations must be secured to maintain democracy.

2.2.2 Income distribution

There is a trade-off between the function of income distribution in public finance, which is conducted through social policies (such as aid for the weak in society and establishment of safety nets) and a progressive income tax system, etc., and the function of resource allocation in public finance because it is possible that the income distribution affects efficiency in resource allocation. In other words, this is an issue as to whether the government stresses importance in social welfare or efficiency or as to how welfare and efficiency are balanced, so it may be considered that the issue should be left for discretionary decision-making in policy by politics. In the case that political decision-making concerning income distribution imposes a constraint on resource allocation through the market or price mechanisms, this would establish a boundary between the public sector and the private sector.

Taking into consideration the situation described above, the function of income distribution should be considered when determining the allocation of roles between the public sector and the private sector and

when setting the boundary between private sector accounting and business accounting in advance of determining an ideal form of the public sector accounting, establishing the Conceptual Framework for Public Sector Accounting concerning details of public sector accounting and setting public sector accounting standards. Public sector accounting information concerning the effect caused by income distribution on resource allocation through the execution of social policies such as the provision of social security benefits is effective to a certain extent in the assessment of establishment of general public policies, etc.

2.2.3 Stabilization of the economy

The function of stabilization of the economy (business cycle adjustment) in public finance is classified into two categories of built-in stabilization incorporated in the fiscal system and discretionary fiscal policy. In any case, during business downturns, fiscal volume is increased through the issuing of public bonds or business is stimulated through means such as tax reductions. On the other hand, when business is overheating and the possibility of inflation, etc., looms, then fiscal volume is cut, the execution of budgets is postponed, or the increase in effective demand is suppressed by means such as raising taxes. The characteristic of the function of stabilization of the economy is that the government tries to adjust business activity by implementing new measures, most of which will be effective for the short term, based on fiscal policies using its discretion to suit the economic conditions of the times.

The double budget system which was implemented in north European countries including Sweden and Norway in the latter half of the 1930s was a public sector accounting system which had as the major objective the stabilization of the economy (business cycle adjustment). The origin of the double budget system was the fixed assets accounting system (replacing the depreciation system) used by the railway companies in the United Kingdom in the latter half of the nineteenth century. The distinctive characteristic of the double budget is to separate outgoings

(expenditures) of cash into two categories: capital expenditures that should be deducted from the capital and income expenditures that should be deducted from the income. Under the double budget system, the increase in the income which is generated naturally during business booms is retained in the capital so that during business downturns the government is able to implement discretionary fiscal policies for business cycle adjustment by increasing capital expenditures. The principle of construction bonds (money borrowed by the government is used only for investment objectives; Public Finance Law, Article 4, Paragraph 1) in the fiscal system in Japan has the same effect as the double budget although expenditures are not separated into capital expenditures and income expenditures.

Since the end of World War II, the government of Japan has implemented many fiscal policies as the major means of business cycle adjustment. Public investments should be made to build the infrastructure to bring social and economic benefits not only to the current generation of people but also to future generations. However, in Japan, public investments have been made into inefficient or low productivity segments using business stimulation measures as an excuse, so the level of public investment is now near the limit considering the burdens of future tax payments. It is desirable to revise the roles allocated to fiscal policies and monetary measures in business cycle adjustments. Considering fiscal policies, stress should be laid on the function of resource allocation for the long-term, and measures to allocate resources over long periods of time should be implemented through means such as long-term government bonds and fiscal investment and loans. Considering monetary measures, stress should be laid on the function of business cycle adjustment for the short term, through means such as operations in the (short-term) money market, and the credit adjustment function of the monetary system.

2.3 Significance of public sector accounting system reform

2.3.1 Transitions of the public sector accounting system in Japan

The first step in the introduction of the modern accounting system in Japan is considered to be books such as “Accounting Method” (Yukichi Fukuzawa) and “Bank Bookkeeping Method” (Ministry of Finance) published in 1873, which interpreted Western bookkeeping methods. The new government formed at the beginning of the Meiji Era decided to implement double entry bookkeeping for the accounting at government offices, referring to the books, beginning with the Osaka Mint Bureau (established in 1871). In 1875, double entry bookkeeping began to be used for all accounting at the Ministry of Finance and by 1879 it was used at all government offices.

In 1873, Kaoru Inoue, the Vice-Minister of the Ministry of Finance, and Eiichi Shibusawa, the third secretary of the Ministry of Finance, who feared that the new government would cause a fiscal crisis, submitted recommendations concerning fiscal management and resigned their posts. Refuting the recommendations, Shigenobu Okuma, the Minister of Finance at that time, announced the estimates of annual revenue and expenditure for 1873 to show the soundness of the government’s public finance. Since then disclosure of government budgets has become a custom which has significantly affected the development of the public sector accounting system in Japan.

In 1881, the Public Accounts Act (notification no. 33, revised in 1882) was enacted. The act, which was prepared by referring to the accounts laws of France and Belgium and by revising previous relevant laws and regulations, contained stipulations concerning the public sector accounting system ranging from the preparation of budgets to accounts settlement. The act mandated the use of double entry bookkeeping for accounting at all government offices, as previously, and the preparation of inventories of assets (based on fair value) as required by French bookkeeping law. The Constitution of the Empire of Japan, which was

prepared based on the constitution of the German Union granted by the Emperor, was promulgated in 1889. A new Public Accounts Act (Law no. 4, became effective in 1890 and revised in 1921) was announced as a supplementary law of the Constitution. The style of the accounts laws of France and Belgium was maintained for the outline of the system under the new Public Accounts Act, although Kameral-style bookkeeping of cameralistics (single entry bookkeeping and cash basis accounting) was required.

After World War II, the present Constitution of Japan was enacted, and accounting for the budget accounts settlement was separated from accounting for other purposes such as revenue and expenditures, both of which were covered by the former Public Accounts Act. In 1947, the outline of a new public sector accounting system was established and the accounting for the budget accounts settlement began to be conducted in accordance with the Public Finance Law, while accounting for other purposes was performed in accordance with a new Public Accounts Act. Despite the changes implemented as described above, Kameral-style bookkeeping (single entry bookkeeping and cash basis accounting) is still used in public sector accounting in Japan.

In consideration of the transitions of public sector accounting system in Japan, as described above, it is understood that single entry bookkeeping and cash basis accounting, which are accepted as a natural choice for public sector accounting, are neither unalterable nor significant for the public sector accounting system.

2.3.2 Public sector accounting system under a democratic constitution

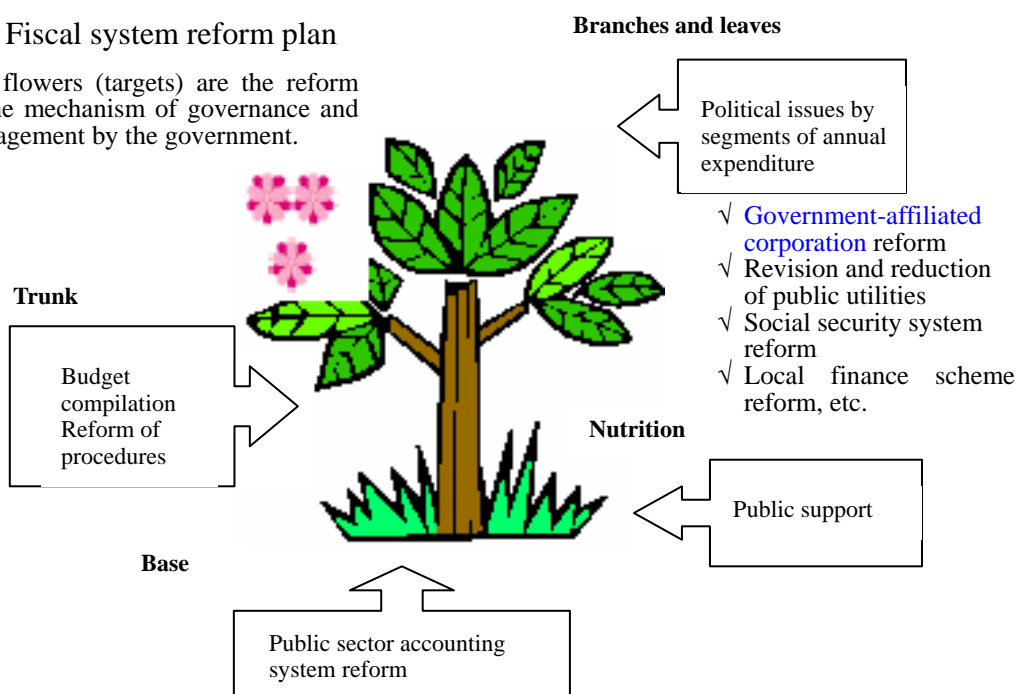
The parties with the greatest stake in the government's fiscal management are the citizens of the current and future generations. The government, which is entrusted with economic resources by citizens through tax payments, etc., bears the responsibility to explain the general fiscal conditions, etc., which are results of its management of the

resources, to the citizens.

Improvement of the public sector accounting system is vital to clarify the public accountability of the government through public sector accounting information and to materialize efficient and effective budget compilation. The public sector accounting system is ultimately positioned as an infrastructure system that will reform the mechanism of governance and management by the government through reform of the entire fiscal system (refer to Figure 4).

Figure 4. Fiscal system reform plan

The flowers (targets) are the reform of the mechanism of governance and management by the government.



2.4 Reform of budget compilation procedures

In the existing budget compilation procedures, new expenditure demands are assessed in detail regardless of the type of expenditure, such as general current expenditures and capital expenditures, under the principle of assessment for the increments. On the other hand, approvals are given to expenditures which have been demanded on a continuous basis from the previous fiscal year almost unconditionally. Assessments based on

medium-term or long-term viewpoints are not conducted for capital expenditures and transfer expenditures, which are based on laws and systems (government subsidies, social security benefits and local allocation taxes, etc.), despite the fact that such expenditures have a significant effect on future burdens. Therefore, it has been impossible to suppress ballooning of budgets with the existing budget compilation procedures.

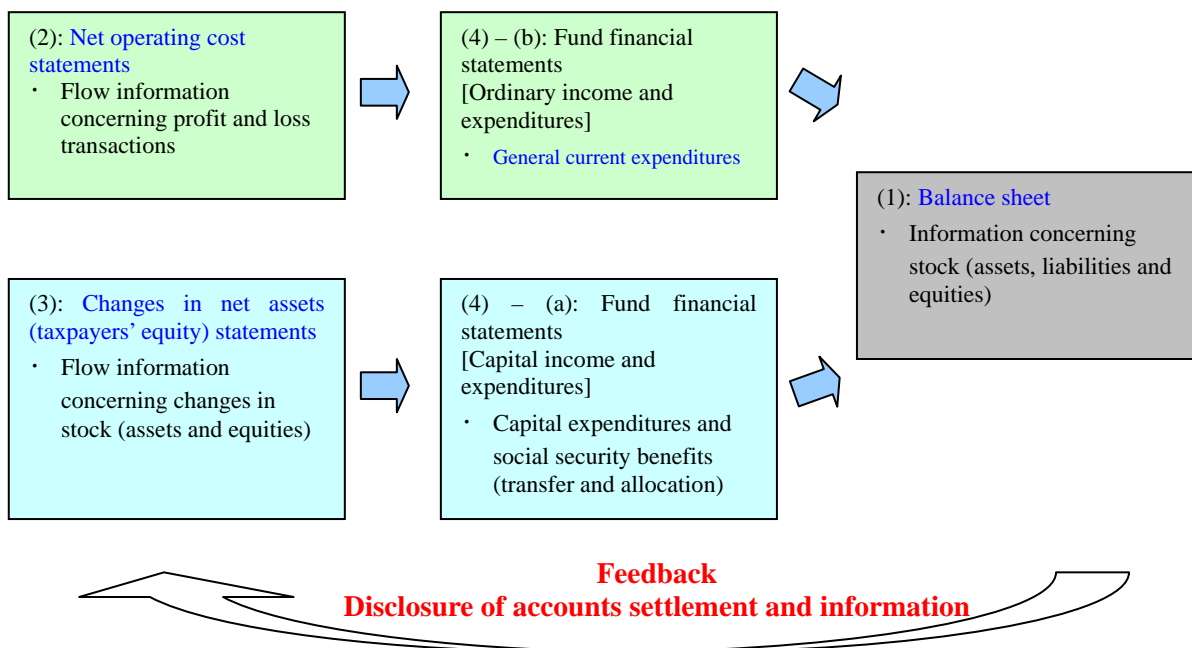
The achievements of public sector accounting system reform must be incorporated in the budget compilation procedures, and public sector major financial statements [(1) balance sheet, (2) net operating cost statements (net operating cost statements), (3) changes in net assets (taxpayers' equity) statements, (4) cash flow statements, all which are interlinked] must be prepared. As a result, the following will become possible:

- budget compilation will be performed estimating public sector major financial statements prepared using accrual basis accounting and double entry bookkeeping for the following fiscal term,
- medium-term and long-term financial plans will be prepared referring to financial analysis indexes obtained from public sector major financial statements, and
- accounts settlement information will be referred to when compiling the budget for the following fiscal term.

Budget items which should be assessed preponderantly must be separated from other budget items and the degree of importance of budget demands and the assessments should be clarified. In more detail, with regard to general current expenditures which mainly consist of salaries and allowances payable to employees, traveling expenses and the expenses of expendable supplies, existing accumulative-style procedures for demands and assessments must be abandoned and instead the fiscal management authorities should allocate budgets to each ministry in lump sums. Each ministry will be responsible for allocating its own budget and will apply its discretion for the allocation. Accounts settlement information of the fiscal year will be reflected in the budget compilation of the following fiscal term. Medium-term and long-term

financial analyses should be performed and assessments should be performed preponderantly for expenditures which will have a significant effect on future burdens, such as capital expenditures and expenditures set by the law and systems including social security benefits, local allocation taxes, subsidies and existing debts. It may be expected that the government will conduct appropriate fiscal management through the budget compilation procedure reform described above (refer to Figure 5).

Figure 5. Budget compilation procedure reform incorporating public sector accounting system reform



3. Objective of public sector accounting

The objective of the preparation and presentation of reports containing public sector accounting information is to provide information required by users. Therefore, it is beneficial to clarify the major users of public sector accounting information first and then to determine the types of information that they require.

3.1 Users of public sector accounting information

The major users of public sector accounting information may be categorized as citizens, Cabinet members (Cabinet), Diet members and other stakeholders based on the type and degree of the stake.

3.1.1 Citizens

The citizens use public sector accounting information from various standpoints such as taxpayers, the electorate, customers (as recipients of the goods and services provided by the government) and as investors of public bonds. The “citizens” category of users includes not only the citizens of the current generation who use the information now, but also the citizens of future generations who have a stake in the fiscal management of the government, as potential users.

3.1.1.1 Citizens of the current generation

Citizens of the current generation bear the expenses required for the government’s activities, as taxpayers, while at the same time they are customers of the government because they enjoy the benefits of goods and services provided by the government. This is the concept of traditional new public management (NPM), based on customer centrism. According to the concept, citizens have the right to receive the most valuable public services as considerations for the taxes they pay, and the government is required to pursue maximization of satisfaction of the citizens who are the customers of the government.²

3.1.1.2 Citizens of future generations

The citizens of future generations are potential users of public sector accounting information. Reflecting the effect of the

² New public management is a new concept of administration management which aims to provide higher quality goods and services more efficiently by implementing business techniques in the public sector. The theory of new public management is based on the implementation of elements in thorough competition, outcome assessments and separation of the planning of government policy from its execution.

advantages of the government in resource financing (the authority to impose and collect taxes and to issue money), the citizens of future generations will bear a liability which is the same as succeeding unlimited joint and several liability for the government debt which will be accumulated over generations as a result of the government's administration, regardless of whether or not they wish to do so. Under the condition described above, the citizens of future generations will participate in future governments as the electorate and taxpayers and will not be able to waive succeeding to such liability unless they renounce their nationality. It must be ensured that Cabinet members of the current generation perform appropriate governance in fiscal management in so far as is possible by preparing and presenting public sector accounting information reports that speak for the citizens of future generations, who will be in the position described above, for their aspirations and potential benefits.

In "traditional" new public management based on customer centricism, the citizens are regarded as customers of the government, in other words, as counterparties of external transactions (external parties) for the government which is an economic entity. In this theory, the citizens who are able to enjoy the benefits of the goods and services that the government presently provides are the citizens of the current generation who can pay the considerations. Under such a mechanism, Cabinet members of the current generation will ignore the benefits and aspirations of the citizens of future generations. The major function of fiscal management is to realize appropriate resource allocation over time (from the past, through the present and into the future) in order to maintain impartiality between generations. New public management that cannot secure benefits for future generations is not an appropriate solution for the problems of fiscal management.

The citizens of the current generation, as well as those of future generations who are future taxpayers, bear a liability which is the same as unlimited joint and several liability for the government debt which is accumulated over generations as a reflection of the effect of the advantages that the government enjoys in resource financing (the authority to impose and collect taxes and to issue money). These citizens should be regarded as users of public sector accounting information and in which case, the citizens, who assign the government to manage economic resources by paying taxes, will be regarded as the trustors, and therefore, the government, that manages and uses the trust assets, which are economic resources deposited by the citizens, will bear obligations and fiduciary responsibilities (stewardship) as the trustee. In this case, the citizens (trustors) will be regarded as internal parties (constituents) who contribute the asset base of the government (trustees), rather than being regarded as the government's customers; in other words, the counterparties (external parties) of external transactions for the government which is regarded as an economic entity.

This may be seen as equivalent to the concept of the agency theory.³ In the state governance mechanism of the theory, the principals (trustors), who are the citizens (the current and future taxpayers), entrust Cabinet members (of the current generation) as their agents (trustees) to manage the economic resources that they entrust through their tax payments. The major issue of the mechanism is imposing discipline on fiscal governance by the agent (trustee) to

³ The agency theory is used for the analysis of the interaction mechanism. In the theory, economic interaction between economic entities in an economic domain are analyzed by setting one unit as a principal and the other as an agent. For instance, in the corporate governance model of the agency theory, ownership and business operation are separated: stockholders transfer the right of business operation to managers who operate the business as their agents. The stockholders pursue profit through holding the shares, while the interest of the managers is in the profit generated from the overall business of the company, which gives rise to a possibility of moral hazard whereby managers pursue their own profit by sacrificing that of the stockholders. A mechanism to control managers to prevent such moral hazard through monitoring by stockholders and bonding, etc., is analyzed.

ensure that such governance does not conflict with the benefits of the principals (trustors).

The Trust Act, which stipulates the rights and obligations of the trustors and trustees including fiduciary responsibility, is not part of common law; it arose out of equity. If the Trust Act is applied to the transfer of economic resources through tax payments, the government will be regarded as a trustee and the citizens as trustors and beneficiaries who are entitled to the right which is similar to the possessive right for the government assets (trust assets) under equity. This right under equity may be called a residual claim (in a hierarchical structure) of the government assets, which is, in another word, equity, and, therefore, is referred to as “taxpayers’ equity” below.

3.1.2 Cabinet members (Cabinet)

The Cabinet, which is responsible for state governance, will be able to compile future budgets and determine the direction of public bond management by analyzing the government’s accounts settlement information, which is financial administration feedback information containing historical information, and also to prepare more appropriate fiscal management plans for the medium term and the long term through simulations of budget information.

In Japan, executive power rests with the Cabinet, based on the government structure (the Constitution, Article 65). It is understood that the Constitution requires that the Cabinet, to whom the citizens trust the executive power, be responsible for governance and for determining state strategies and the direction in which to lead the country (the Constitution, Article 65 and Article 66, Paragraph 3) and, furthermore, that administrative branches consisting of government officials and others whose duty is to assist the Cabinet, solely perform their original roles, such as execution of the laws (the Constitution, Article 72). Therefore, in

the classifications of users of public sector accounting information, Cabinet members, who are responsible for governance, must be clearly segregated from government officials who belong to a lower position.

Administrative branches consisting of government officials and others are established to carry out purposes such as executing laws objectively and neutrally. However, in reality, governance is often twisted because some administrative branches take over the executive power of the Cabinet or behave in pursuit of their own interests. Improvements in the public sector accounting system and the disclosure of public sector accounting information through the improved system are vital to monitor administrative branches and the actions of government officials from financial aspects. The public audit (value for money audit) system, which is conducted from the aspect of “value for money” (provision of the most valuable services as considerations of taxes), should be implemented as early as possible to audit all government activities following the suit of other countries such as the UK and New Zealand.

3.1.3 Diet members

Diet members use public sector accounting information for the dual purposes of monitoring the governance of the Cabinet and government activities through the exercise of their right to investigate the government (the Constitution, Article 62) and of promoting bonding of the government and participating in resolutions concerning resource allocation through the exercise of their legislative right (the Constitution, Article 41) and their voting rights for the budget (the Constitution, Article 86).

Under the current Constitution, the Diet is regarded as the highest organ of state power (the Constitution, Article 41) and the Constitution stipulates that the House of Representatives and the House of Councilors shall consist of elected members, representatives of all the people (the Constitution, Article 43). Embedded in the stipulations is the concept that

sovereignty resides in the Diet, which is modeled on the British parliamentary cabinet system. The above is understood by the fact that the draft of the Constitution prepared by the General Headquarters of the Allied Powers (the so-called MacArthur draft) included the stipulations that the assignments of Cabinet members shall require the consent of the Diet (the MacArthur draft, Article 62, Paragraph 1), and that the Diet has the right to review the judgments made by the Supreme Court on the condition that such judgments do not concern fundamental human rights (the MacArthur draft, Article 73, Paragraph 2). As a consequence, many people believe that the current Constitution grants authority to the Diet and to the members of the Diet (comparable with the power of stockholders' general meetings of joint-stock companies) in concrete terms, although the overall expressions used in the Constitution are rather abstract, including for example, "highest organ of state power" (the Constitution, Article 41) and "elected members, representatives of all the people" (the Constitution, Article 43).

The representatives of the people (underlined by the author), who exercise power in government (the legislature, the executive and the judicature) based on the sacred trust of the people, as stated in the preamble of the Constitution, are not only the Diet or the members of the Diet, in other words not only the "elected members, representative of all the people" (the Constitution, Article 43). In consideration of the agency theory, that assumes a mechanism of state governance in which the citizens (the principals) entrust the Cabinet (the agent) to manage the government, and also in consideration of the suppression and the equilibrium that the respective independence of the legislature and the executive and the judicature aims for, the Cabinet (more than half of the members of which shall be Diet members in accordance with the Constitution, Article 68, the provision in Paragraph 1) is legally entitled to exercise the executive power (the Constitution, Article 65 and Article 66, Paragraph 3). The authority of the Diet members, except for those who are also members of the Cabinet, must be limited to concrete

authority such as the right to investigate the government (the Constitution, Article 62), the legislative right (the Constitution, Article 41) and the voting right for the budget (the Constitution, Article 86).

3.1.4 Other stakeholders

3.1.4.1 Investors, creditors and rating agencies, etc.

Investors and creditors are those people who hold credit of the government as a result of their purchases of government bonds, their depositing of money in postal saving accounts and their participation in public pension schemes (regardless of nationality) and who have a stake in the capability to repay the debts and in the credit risks of the government, who is the debtor. Rating agencies determine ratings based on the debts of governments and announce the financial ratings that relate to the capability to repay the debts and the credit risks, etc., of the governments to current and potential investors. The investors and others use public sector accounting information to make decisions and judgments on financial matters.

3.1.4.2 Governments of other countries and international organizations, etc.

The preparation and presentation of reports of public sector accounting information are important for countries which need to attract funds from governments of other countries or international organizations, etc., although Japan does not require such funds to any great extent because Japan is the biggest creditor in the world from the aspect of net international investment (net foreign claims). For international organizations and governments of countries which donate aid to other countries, public sector accounting information of the countries to be assisted are very important to determine the details of such aid (the funding, periods and plans of the projects to be aided).

3.1.4.3 Economists and analysts, etc.

It is sometimes difficult even for governments to deal with the consequences of the activities of private financial institutions such as hedge funds, because international transfers of funds have risen enormously. The importance of preparation and publishing of reports of public sector accounting information by governments is increasing because such information forms the base of reports prepared by economists and analysts which are commonly used by market participants.

3.2 Users' information needs

3.2.1 Assessment of execution of fiduciary responsibility

All external users of public sector accounting information such as the citizens and Diet members require public sector accounting information (general purpose financial reports for external users) concerning the general fiscal conditions of the government in order to recognize and assess the fiduciary responsibility of the Cabinet. The Cabinet which is an internal user of public sector accounting information and which has the right to access the information directly, require public sector accounting information (special purpose financial reports for internal users) to fulfill its fiduciary responsibility which includes planning, decision-making and execution of government activities.

3.2.2 Assessment of performance and outcome of government activities

Citizens require public sector accounting information (general purpose financial reports for external users) in order to assess the performance and outcome of government activities which affect their lives and to make judgments of the competence, etc., of the Cabinet for themselves. Public sector accounting information (special purpose financial reports for internal users) is also required by budget authorities who manage and use the economic resources entrusted to the government through tax payments, etc., and by Diet members who participate in resolutions concerning resource allocation by the government through the exercise of legislative power and their voting rights for budgets, in order to assess

resource allocations by the government, resource budget conditions, the efforts made in the provision of public services and the accomplishments, etc., to take into consideration for future resolutions.

3.2.3 Examination of legal compliance with the budget

Taking into consideration the importance of budget compilations in public sector accounting, it is understood that all information users require public sector accounting information, particularly budget information. For instance, citizens and Diet members have to examine whether or not the Cabinet manages fiscal matters in compliance with the budget and the Cabinet needs public sector accounting information, particularly budget information, in order to govern fiscal management.

3.2.4 Assessment and improvement of the public sector accounting system

Public sector accounting information includes information of the public sector accounting system and information concerning general fiscal systems such as budget compilation. All users of information have a stake in the assessment and improvement of public sector accounting system because the design of this system may have a significant effect on fiscal management by the government.

3.3 Objectives of public sector accounting

3.3.1 Clarification of the fiduciary responsibility of the government

Concerning the functions of accounting, in Japan there has been a tendency since the Meiji Era to focus on calculations of assets and profits, partly because the Japanese accounting system was modeled after the modern Western accounting system with the purposes of establishing capitalism and raising wealth and military strength. In the UK, where modern accounting arose during the industrial revolution, reports of non-profit businesses called charge and discharge statements were prepared even before the establishment of business accounting. In the US, charge and discharge statements were also prepared for private trusts.

The name shows that they cover procedures beginning with the installation of stewardship (charge) of asset managers with regard to maintenance and management of the assets to the discharge of the stewardship.

Taking into consideration the above, the function to be stressed from among the primary accounting functions that are common between public sector accounting and business accounting, is the clarification of the stewardship, rather than the calculations for profits and other elements. In other words, the most important function of accounting is to provide explanations of the procedures beginning with the installation of stewardship (charge) to the discharge of the stewardship using the means of accounting in which accounting facts generated by the asset manager through the performance of his stewardship are recorded and calculated to confirm that the results of calculations match the actual assets. This is called the responsibility clarification function of accounting.

In public sector accounting, little importance is placed on calculations of profits and other elements. On the other hand, there is a requirement to clarify the responsibility of the government in fiscal management concerning the financing of economic resources through tax collections, etc., and the management of the resources. Therefore, it is understood that the objective of public sector accounting is to clarify the fiduciary responsibility of the government in fiscal management by presenting the state of its performance of stewardship, including general fiscal conditions, and the results of the stewardship.

Public sector accounting information required to clarify the fiduciary responsibility of the government in fiscal management include the following.

- (1) General fiscal conditions: Stock information that indicates the government's fiscal position, flow information that indicates financial performance, non-financial information concerning the

outcome of government activities, information concerning the overall effect of government activities, etc.

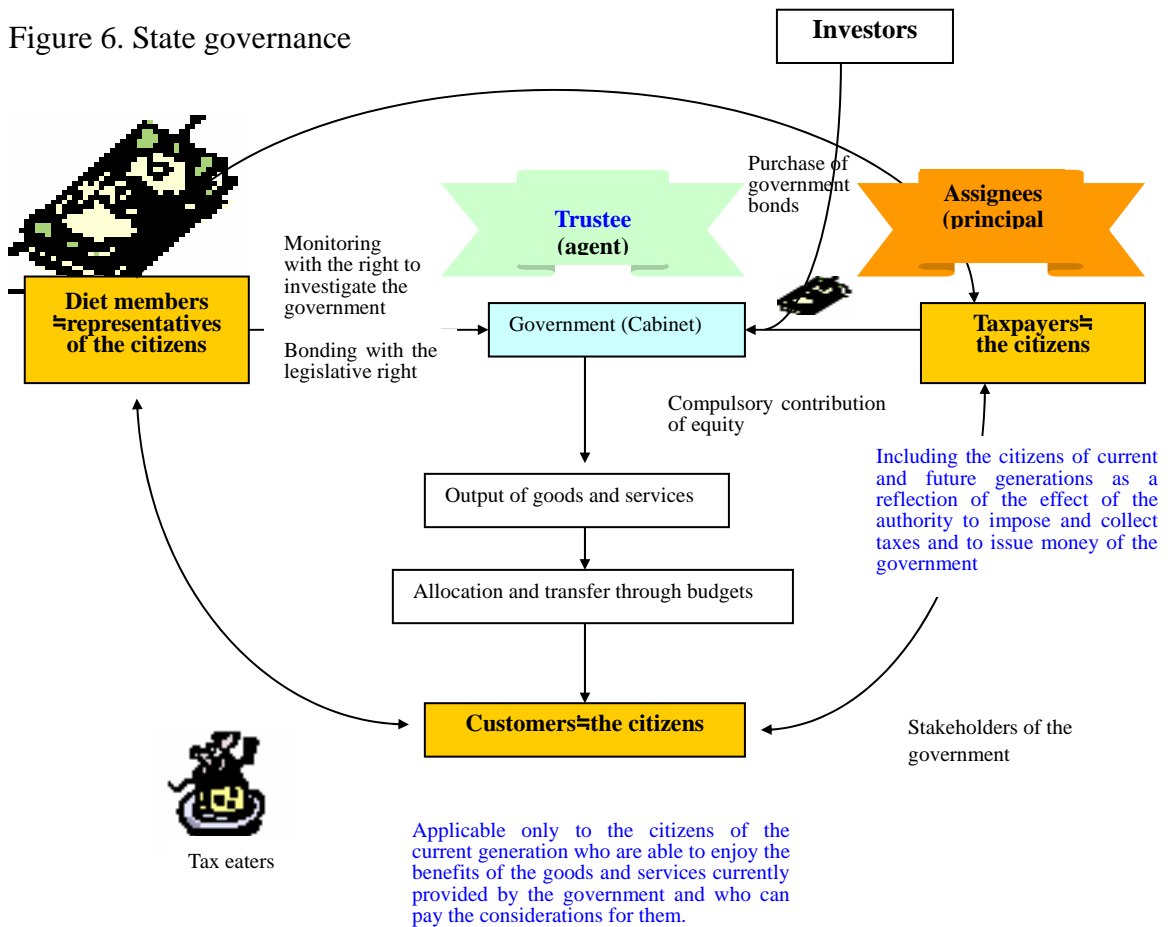
- (2) Stock information: Information concerning the government's fiscal position which is information of balances of the elements (assets, liabilities and taxpayers' equity) at the end of fiscal terms.
- (3) Flow information: Information concerning the government's performance during the relevant fiscal term which is information of financial performance and of changes in fiscal position during the period. The scope of flow information must be expanded to include information of profit and loss transactions as well as capital expenditures and expenditures without receiving considerations (transfer and allocation) that cause changes in stock (assets and liabilities), in order to cover the entire governance concerning resource allocation.

Public governance and public accountability are ideas incidental to the objective of public sector accounting which is to clarify the fiduciary responsibility of the government in fiscal management.

3.3.1.1 Public governance

Public governance is the mechanism of the state government system in which the principals (the trustors), who are the citizens (the current and future taxpayers), assign the Cabinet as their agent (the trustee) to manage the economic resources that they entrust through their tax payments, and in which the agent (the trustee, namely the Cabinet) holds obligations and responsibilities (fiduciary responsibility) to conduct governance which does not conflict with the benefits of the principals (the trustors, namely the citizens). [See Figure 6.]

Figure 6. State governance



Public governance is generally considered to impose discipline on the Cabinet. Public sector accounting aims to establish public governance by clarifying the responsibility of the Cabinet in fiscal management during which the management is monitored by external parties and the bonding of internal management is raised.

There are many stakeholders in the government; these include the citizens, governments of other countries, international organizations and rating agencies. The matters described above show that although there are various types of stakeholders in state governance, the greatest importance is placed on the benefits of the citizens. The citizens are in various standpoints, such as taxpayers, the electorate, customers (as recipients of the goods and services provided by the

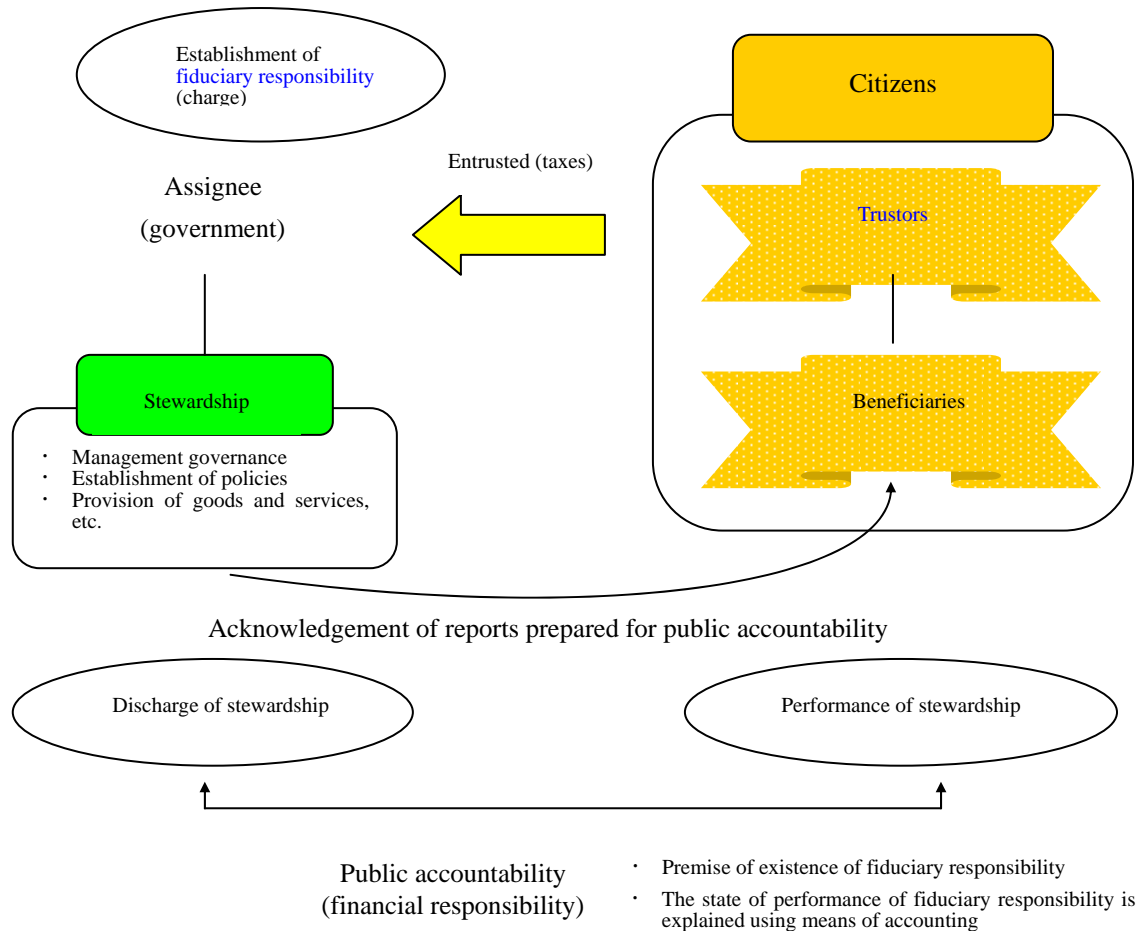
government) and investors of public bonds, all of whom are citizens of the current generation, but also include citizens of future generations who have a strong stake in the government's fiscal management. Therefore, the fact that the citizens have various standpoints must be taken into thorough consideration when placing the greatest importance on the benefits of the citizens in state governance.

3.3.1.2 Public accountability

Accountability is to provide explanations of procedures beginning with the establishment of stewardship (charge) to the discharge of the stewardship using the means of accounting based on the premise of the existence of stewardship by the asset manager. Public accountability and stewardship are united as a single entity which is called stewardship accountability or fiduciary accountability.

In this article, public accountability means the financial responsibility of the government under state governance to provide information and explanations to the citizens concerning the state of performance of its fiduciary responsibility and the results of its fiduciary responsibility, in other words, the governance of the management of tax financial resources, establishment of policies, the efforts made in the provision of public services and its accomplishments, based on the premise that the government bears the fiduciary responsibility in trust (see Figure 7).

Figure 7. Connection between fiduciary responsibility and public accountability



Public accountability is usually classified into the following five levels.

- (1) Policy-level accountability: adoption or rejection and values of policies.
- (2) Program-level accountability: achievements, outcome and effectiveness of program targets.
- (3) Performance-level accountability: efficient management, efficiency and economy.
- (4) Management process-level accountability: aptitude, procedures, plans, allocation, management, etc.
- (5) Law compliance-level accountability: budget compliance, etc.

Since the latter half of the 1990s, in Japan, the word “accountability” has been used as a general expression for the trend in administration transparency and information disclosure, examples of which are the guidelines for the preparation of net operating cost statements of government-affiliated corporations and the Japanese government balance sheet (trial work) by the Ministry of Finance. However, in the case that the function and the objective of public sector accounting, which is to clarify the responsibility of the government in fiscal management, is not sufficiently recognized, in many cases the information disclosed will merely be records and statistics which is far removed from the information needed to clarify financial responsibility. The value of information which does not clarify the responsibility or which is not useful for users to make decisions is extremely low as public sector accounting information, even though provision of the information will require much effort.

In the case that emphasis is placed on clarification of the fiduciary responsibility of the government, which is the function and the objective of public sector accounting, in the financing of economic resources through tax collections, etc., and in the management of the resources, two elements, namely, the source and the use of economic resources, must be recorded for each transaction. In the case described above, accounting (journals) using double entry bookkeeping must be performed for stock information and flow information, and relevant financial statements (the general ledger) must be prepared. Also, the difference between assets and liabilities on the balance sheet must be regarded as taxpayers’ equity to show the fiduciary responsibility of the government (the asset manager) in a constructive manner. Examples include the “Working Balance Sheet” by the Tokyo metropolitan government and the guidelines for preparation of financial statements of special accounts by the administration reform headquarters of the Liberal Democratic Party.

If, on the other hand, despite the requirement of accountability, information which does not clarify the responsibility is provided, then financial statements prepared using double entry bookkeeping are not necessary; rather, the requirement becomes the rearrangement of revenue and expenditures using single entry bookkeeping and the preparation of inventories (balance sheets) which are lists showing assets and liabilities. In this case, there is no special meaning for the difference between assets and liabilities, an example is the Japanese government balance sheet (trial work) by the Ministry of Finance.

3.3.2 Usefulness in decision making

The objectives of public sector accounting are to clarify the fiduciary responsibility of the government and to provide public sector accounting information which is useful for users of the information, such as the citizens, Cabinet members and Diet members, in making their decisions.

Information which is useful to make decisions means information which assists current and future users of the information to reach rational decisions. The users of the information (the citizens, Diet members and others) who assess the general fiscal conditions of the government, performance and outcome of the government activities, and the efforts made in the provision of public services and the accomplishments, will be able to make decisions based on public sector accounting information (general purpose financial reports for external users), such as whether or not to entrust or replace the Cabinet. The internal users of the public sector accounting information, such as the Cabinet and the fiscal management authorities, will be able to use the information (special purpose financial reports for internal users) to make their decisions concerning resource allocation by the government, the resource budgets and internal management, etc.

4. Qualitative characteristics of public sector accounting information

4.1 Significance

4.1.1 Relationship with objectives of public sector accounting

The qualitative characteristics of public sector accounting information must be included in such information to meet the objectives of public sector accounting (clarification of the fiduciary responsibility of the government and usefulness of the information users' decision making).

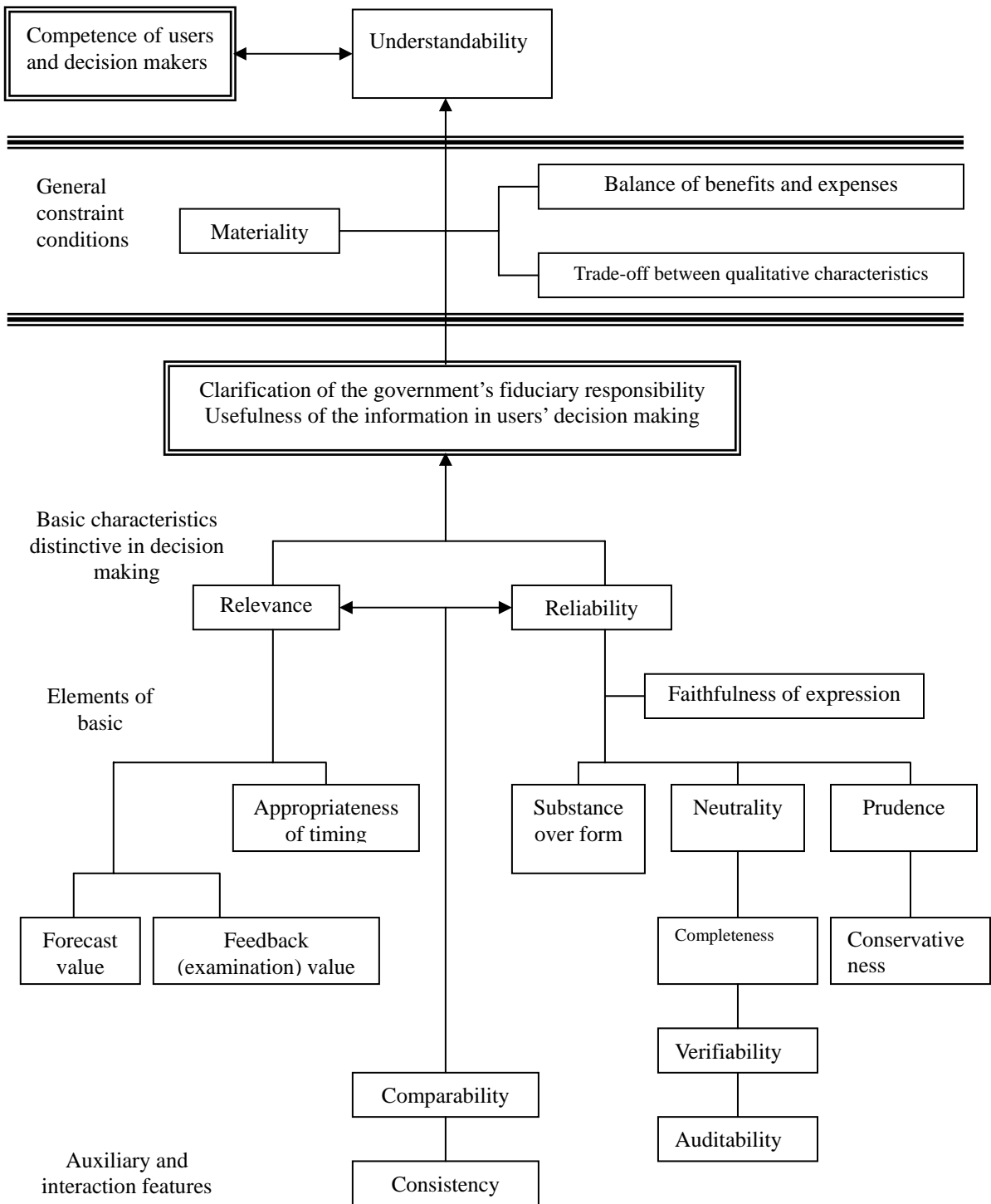
4.1.2 Hierarchical structure of qualitative characteristics (difference between economics and accounting)

The qualitative characteristics of public sector accounting information correlate with the objectives of public sector accounting (clarification of the fiduciary responsibility of the government and usefulness of the information users' decision making) and are prioritized to fulfill the objectives. The hierarchy of the qualitative characteristics plainly shows the difference between the approaches taken by economics and by accounting concerning uncertainties (or risks) caused by many different events.

How to deal with uncertainties (such as forecasts and prospects of rates of inflation expected and future discount rates) has always been an important issue in price formation and measurements in fixed asset accounting, and in estimates of the possibility of recovery of non-performing loans and estimates of the number of claims of guarantees, etc. Modern economics, which follows physics in mathematical processes, aims to express and control uncertainties precisely by using models based on analytics (differential and integral calculus) and probability theory. Economics is an approach that is applied in the pursuit of reliability and completeness, which are some of the qualitative characteristics of public sector accounting information, to the utmost. This is in contrast with accounting that emphasizes practical effectiveness and relevance, and therefore places importance on how to use accounting information which is a pool of measured values using

means such as incorporating a calculation factor for uncertainties in individual fixed asset appraisals. In other words, accounting is an approach that takes into consideration the balance of the overall priority of qualitative characteristics, including the degree of materiality of the general constraint conditions and the compromise between relevance and reliability. In the case that current value accounting (fair value basis) is adopted, preparation of reports of public sector accounting information and subsequent feedback must be conducted by linking relevant matters together and making modifications in accordance with changes in socio-economic conditions and by incorporating uncertainties of stakeholders' expectations that vary over time. The following are explanations of qualitative characteristics (see Figure 8).

Figure 8. Hierarchical structure of qualitative characteristics



4.2 Qualitative characteristics for clarification of fiduciary responsibility and usefulness in decision making

Relevance and reliability are qualitative characteristics that are vital to clarify the fiduciary responsibility of the government and to maintain the usefulness of information in users' decision making.⁴

4.2.1 Relevance

Public sector accounting information is considered to be relevant when it is useful for users in making decisions because it assists the users to examine and modify (feedback) their forecasts and expected values of events and outcomes of the past, present and the future, and if it is provided while still useful for users in making decisions.

4.2.1.1 Forecast value

Forecast value is a characteristic of information which is effective in raising the accuracy of users' forecasts concerning events and outcomes of the past, present and the future.

4.2.1.2 Feedback value

Feedback value is a characteristic of information which assists users to examine and modify their expected values concerning events and outcomes of the past, present and the future.

4.2.1.3 Appropriateness of timing

Appropriateness of timing is timing that is such that the information is available to decision makers while the information is still useful for making decisions.

⁴ Qualitative characteristics and their hierarchical structure described here are mainly based on the standard classifications of the business accounting framework (such as classifications by the International Accounting Standards Board and the US Federal Accounting Standards Board). The qualitative characteristics of public sector accounting information that must be included in such information and the hierarchical structure of the characteristics, described here, are tentative and therefore require further, comprehensive study.

4.2.2 Reliability and faithfulness of expression

Reliability is a characteristic of information which guarantees that the information faithfully presents events without error or bias.

Faithfulness of expression is a characteristic of information which guarantees that measured values and descriptions of events correspond to and accord with the actual events.

4.2.2.1 Substance over form

It is not enough just to follow legal procedures, accounting must be conducted based on substance and economic reality in order to provide public sector accounting information that faithfully presents events such as economic transactions.

4.2.2.2 Neutrality, completeness, verifiability and auditability

Neutrality means that there must be no bias in the information which is intended to reach predetermined results or lead to specific behavior.

Completeness means that the public sector accounting information is complete and free of error, although there may be constraints caused by the degree of materiality and expenses. Information which is not complete, because of omissions, etc., may give rise to falsehoods or cause misjudgment, and therefore impairs its reliability and relevance.

Verifiability means that more than one independent body is able to generate the same results when they measure the same items using the same method.

Possible to audit means that there are in existence predetermined standards allowing the examination and assessment of public sector

accounting information and procedures to report the results.

4.2.2.3 Prudence and conservativeness

Prudence means the exercise of reasonable care in making estimates with uncertain conditions so as not to appraise gains and assets excessively high and not to appraise losses and liabilities excessively low.

Conservativeness means treating uncertainties with caution by taking into thorough consideration the uncertainties and risks that the reporting entity faces.

4.2.3 Comparability and consistency

It must be possible to compare public sector accounting information between different fiscal terms and with information of other economic entities in the sector (governments of other countries and local municipal entities).

Consistency means that the same policy and procedures are observed throughout the respective period.

4.3 Understandability

Public sector accounting information must be easily understandable by the citizens — the most important users of the information.

Whether or not the information is understandable depends on the following three factors: the methods used to separate the results of events such as transactions into items and methods of settlement and classification; the methods used to present the information; and the competency, etc., of the users. The understandability of public sector accounting information is discussed based on the premise that the users of the information have considerable knowledge of the government's fiscal management, the public sector accounting system and other related matters, and that they make

constant efforts to learn from the information provided.

4.4 General constraint conditions

Any public sector accounting information to be included in public sector financial statements in general must fulfill the following general constraint conditions.

4.4.1 Materiality

If there is an omission or incorrect presentation in financial information and there is a possibility that this may affect the rational judgment of people who rely on the financial information, the materiality of the information means the degree of omission or incorrect presentation, taking into consideration the relevant circumstances, etc.

Materiality is the final determinant of which information to include in public sector financial statements in general. All of the characteristics described above, except for materiality, aim to maximize the usefulness of public sector accounting information. On the other hand, the materiality factor raises the question as to whether or not selected information is appropriate to be included in public sector financial statements in general.

4.4.2 Balance between benefits and expenses

The benefits of public sector accounting information must exceed the expenses required to provide the information.

4.4.3 Trade-off between qualitative characteristics

It is not possible for all of the qualitative characteristics described above to be included in public sector accounting information at the same time — compromise between the characteristics is required.

For instance, a report which is prepared with appropriate timing fulfills the requirement of relevance, but the reliability of events which have not

been settled is low. On the other hand, if the timing of release of a report is delayed, reliability increases but relevance weakens. Emphasizing comparability may impair both relevance and reliability.

5. Fundamental prerequisites for public sector accounting

The fundamental prerequisites of public sector accounting mean generally accepted assumptions or accounting postulates with the prerequisite of discussions concerning public sector accounting and the preparation and publishing of reports containing public sector accounting information.

5.1 Going concern (bankruptcy of public sector entities)

Reports containing public sector accounting information must be prepared and published on the premise that the government is a going concern; in other words, with the assumption that the administration management will continue for the foreseeable future. This means that the elements of public sector accounting information (assets, liabilities and changes in assets and liabilities) are measured assuming their continuation. On the other hand, if liquidation or significant scaling down of the administration management is vital or intended, different measurement bases that emphasize the break-up (or liquidation) value, etc., must be applied.

It is understood according to the law and economic reality that there is no risk of bankruptcy of the central government, which is one of the economic entities in the public sector, because the central government has advantages in resource financing based on the authority to impose and collect taxes and to issue money (by means of the central bank). Standards to acknowledge bankruptcy and procedures used for bankruptcy, which are different from the standards and procedures for private companies, are applied to economic entities in the public sector other than the central government (such as local municipal entities and government-affiliated corporations) because such entities only have soft budget constraint resulting from fiscal support from the central government.

This framework is based on the concept that under the law fundamental government bodies (public sector entities in a narrow sense), in other words, the fundamental governing functions of the central bank and local municipal entities, are not allowed to be discontinued and bankruptcy liquidation of the central government and local municipal entities is not approved, but that it is possible for the central government and local municipal entities to fall into a state of practical bankruptcy in economic reality as a result of significant increase and diffusion of excessive debts and to begin to follow restructuring procedures for bankruptcy in real terms based on political and discretionary decision making. The framework assumes that it is possible for public sector entities other than fundamental government bodies (such as public enterprises and government-affiliated corporations, etc.) to adopt not only restructuring-type bankruptcy procedures but also liquidation-type bankruptcy procedures. See “Bankruptcy of public sector entities”, which is supplementary discussion 1.

5.2 Accounting entities in the public sector (consolidated public sector financial statements)

In consideration of the objective of public sector accounting, which is to clarify the fiduciary responsibility of the government in fiscal management, all economic entities that participate in state governance and which have the objective of executing public policy must bear fiduciary accountability for public sector accounting information regardless of the names of such entities or account classifications. Therefore, the special account, government-affiliated corporations and entities with other legal status which are economic entities participating in state governance and which have the objective of executing public policy and practical connections with the government (the general account and special account) in economic reality should be consolidated, and consolidated public sector financial statements should be prepared and presented for the consolidated unit.

Consolidated public sector financial statements facilitate a comprehensive recognition of the overall expenses and resource budgets of the reporting

entities, even if funds are transferred between the general account, the special account and government-affiliated corporations, etc., (transfers among accounts, etc.) in any name or form, such as grants, subsidies, subscriptions or loans.

6. Public sector financial statements in general

Public sector financial statements in general are general financial reports concerning public sector accounting information and are prepared based on budgets or accounts settlements.

6.1 Public sector major financial statements

Among public sector financial statements in general, documents which have core functions and which correlate with each other are called public sector major financial statements. Public sector major financial statements consist of four documents, namely: balance sheet, net operating cost statements, financial changes in net assets (taxpayers' equity) statements and cash flow statements.

Balance sheet, net operating cost statements and cash flow statements are the equivalent of balance sheets, profit and loss statements and cash flow statements in business accounting, respectively. In addition to these three statements, changes in net assets (taxpayers' equity) statements that contain expanded flow information such as information of capital transactions (including some non-exchange transactions relating with capital formation and transfers to resource budgets) will be introduced.

6.1.1 Introduction of changes in net assets (taxpayers' equity) statements

In the case of accrual basis accounting which is used in business accounting (the accrual basis is the basis of accounting, and all of the economic resources are the measurement focus), increases and decreases of economic resources (income and expenses) caused by external transactions with third parties during the relevant fiscal terms are recognized and measured as profit and loss transactions (flow

information). Flow information and stock information are correlated by transferring the net profits of the relevant fiscal terms, which are the differences between the income and expenses described above, to the profit surpluses (stock information) in the balance sheets.

If pure accrual basis accounting (the accrual basis is the basis of accounting, and all of the economic resources are the measurement focus) which is used in business accounting is adopted in public sector accounting, the following problems will occur:

- The government and other entities in the public sector do not aim to make profits, therefore profit calculations for profit and loss transactions (flow information) are meaningless as a measure of the performance and outcome of government activities.
- Capital transactions and non-exchange transactions, including capital expenditures for social capital formation, and expenditures made without receiving considerations (transfers and allocations), including social security benefits and subsidies, which are not profit and loss transactions, are more important in government activities, but are not recognized or measured in accrual basis accounting.

Examination of cases of public sector accounting which used the same accrual basis accounting as used in business accounting (such as IFAC IPSAS 1 and GASB 34) shows that the outstanding balance between all transactions other than profit and loss transactions are only included in the changes in net assets, which is an account only for adjustments.

There are two accounting methods to solve the problems described above and to recognize and measure transactions other than profit and loss transactions (capital transactions and non-exchange transactions) which are more important in government activities, so that information of such transactions are included in financial statements.

- (a) A method which requires preparation of fund financial statements based on cash basis accounting (or modified cash basis accounting or modified accrual basis accounting) in addition to preparations of

balance sheets and profit and loss statements based on pure accrual basis accounting, which is the same as in business accounting. This is called fund accounting, and was adopted in the non-profit corporation accounting standards of Japan (published March 1977 by the Non-profit Corporation Supervisors' Liaison Committee) and the Local Government Accounting Standards Board of the US (GASB 34 published June 1999). This is a traditional accounting method for non-profit making entities, but it has problems such as the complication of the requirement of two recordings for one transaction (additional recording) and the independence and significance of fund financial statements, which are dropping due to the implementation of cash flow statements.

- (b) A method based on direct cash flow accounting, in which the balance sheets, profit and loss statements and additional statements of transactions other than profit and loss transactions (capital transactions and non-exchange transactions) are prepared at the same time as the cash flow statements, by recording all sources and uses of economic resources so that they are included in the series of financial statements.

This method does not require two recordings for one transaction (additional recording), and simultaneously produces balance sheets, profit and loss statements, statements of transactions other than profit and loss transactions (capital transactions and non-exchange transactions) and cash flow statements. However, this accounting method may appear to be rather complicated because direct cash flow accounting has not been disseminated yet.

Taking into consideration the fact that the two methods described above are similar in many respects and that the importance and recognition of cash flow accounting are increasing in both public sector accounting and business accounting, it may appear that the significance of fund accounting has decreased despite being a considerably rational and

traditional accounting method for non-profit making entities. This framework adopts the accounting method described in (b) with the preparation of statements of transactions other than profit and loss transactions (capital transactions and exchange transactions) based on direct cash flow accounting. These are changes in net assets (taxpayers' equity) statements that will be implemented.

6.1.2 Clarification of the responsibility of the government and management improvement

The public sector major financial statements adopted in this framework comprise four documents, namely: (1) balance sheets, (2) net operating cost statements, (3) changes in net assets (taxpayers' equity) statements and (4) cash flow statements, which correlate with each other. In the past, only (4) fund financial statements based on annual income and expenditures prepared by single entry bookkeeping have been prepared for the fiscal management of the government. It is only in recent years that national government balance sheets (Ministry of Finance) and local government balance sheets (Ministry of Internal Affairs and Communications), which are inventories containing lists of assets and liabilities, in other words the balance sheets (item 1 above), have been prepared.

If the responsibility of the government in fiscal management is clarified through public sector accounting system reform, keeping records of two factors, source and use of economic resources, for each transaction will be critical, and therefore introduces the need to adopt accounting procedures (journals) of stock information and flow information by double entry bookkeeping and financial statements that correlate with the above information (general ledgers). Furthermore, the differences between the assets and liabilities in balance sheets must not be regarded simply as differences but as taxpayers' equity to indicate the government's fiduciary responsibility in a constructive manner.

For resource allocation and internal management by internal users such as the Cabinet and the fiscal management authorities, more weighty assessments will become possible through medium-term and long-term financial analysis of expenditures which will significantly affect future finance [(a) capital expenditures and (b) expenditures which are based on laws and systems such as social security benefits, local allocation taxes, subsidies and existing debts] based on (3) changes in net assets (taxpayers' equity) statements. In the case that the equity theory is adopted for the positioning of taxes (described later), inflows and outflows of tax funds will be capital transactions which will increase or decrease taxpayers' equities directly, so the importance of (3) changes in net assets (taxpayers' equity) statements which include such information will rise.

6.2 Public sector financial statements in general

6.2.1 Balance sheets

(1) Balance sheets, the elements of which are assets, liabilities and taxpayers' equity (the differences between assets and liabilities), present the fiscal position of the government, in other words, the balances of the elements (assets, liabilities and taxpayers' equity) at the end of the relevant fiscal term (stock information). Balance sheets indicate the state of economic resources, financial structure, the impact caused by changes in the values of the assets and the liabilities, liquidity, solvency, risks, risk management and competency in response to changes in financial management, etc.

6.2.2 Net operating cost statements

(2) Net operating cost statements, the elements of which are expenses and income, present flow information of profit and loss transactions among the changes of fiscal position during the relevant fiscal term. They show the gross and net expenses required for the government's activities as administration expenses (net operating costs).

The outstanding balance between expenses and income in the net operating cost statements are presented as net operating costs which will be compensated by the resource budgets in changes in net assets (taxpayers' equity) statements (item 3 above).

6.2.3 Changes in net assets (taxpayers' equity) statements

(3) changes in net assets (taxpayers' equity) statements provide flow information concerning capital transactions, etc., (including some non-exchange transactions related to capital formation and transfers to resource budgets) which directly increase or decrease resource budgets and taxpayers' equity, among the changes of fiscal position during the relevant fiscal term. The element of changes in net assets (taxpayers' equity) statements is resource budget, which is separated into items that directly increase or decrease taxpayers' equity.

6.2.4 Cash flow statement

(4) Public sector accounting fund financial statements directly present inflows and outflows of cash and cash equivalents, in other words, income and expenditures of funds of entities in the public sector, such as the government.

6.2.5 Consolidated public sector financial statements

Consolidated public sector financial statements (consolidated balance sheet, consolidated net operating cost statements, changes in consolidated net assets (taxpayers' equity) statements and consolidated cash flow statements) are prepared based on the public sector major financial statements (items (1) – (4) described above).

6.2.6 Notes and supplements

Notes describe matters which are required for the preparation of public sector financial statements in general such as major accounting policies which are the prerequisites for the preparation of public sector financial statements in general, changes in the policies, segment information,

major events occurring later but by the date of preparation and details of distinctive presentation items.

Supplements provide additional information appropriate for users' information needs of public sector financial statements in general.

6.3 Accounting method particular to public sector accounting (accounting method by source and use of resources)

In the so-called public enterprise accounting, the accounting method by source and use of resources, which is different from business accounting methods, has been used in accordance with the accounting standards for government-affiliated corporations (published October 1987 by the Public Enterprise Subcommittee of the Fiscal Commission) and the accounting standards for incorporated administrative agencies (published February 2000 by the Research Group for Incorporated Administrative Agency Accounting Standards of the former Management and Coordination Agency), etc. In public enterprise accounting, income earned by government-affiliated corporations themselves is separated from resource budgets received through budgets such as grants for operations and subsidies in operation and capital formation, etc. On the one hand, the same accounting method as used in business accounting is applied to the income earned by government-affiliated corporations; on the other hand, a different accounting method is used in the case that corporations are operated or depreciable assets are acquired using resource budgets from budgets, in which the amount of the subsidies, etc., is included in the liabilities/net assets (collaterals to asset formation), so that at the time of generation of relevant expenses, these expenses are transferred from the liabilities/net assets to the income.

The purpose of the accounting method described above is to clarify the management responsibilities of government-affiliated corporations by avoiding the circulation of funds due to taxes imposed on resource budgets received through budgets, in the same way as for reduced value entries (Corporation Tax Law, Article 42 and the accounting principles for business

enterprise, Note 24) which postpone tax impositions and practically prevent the inclusion of resource budgets from budgets (such as subsidies and grants) in taxable profit (but the reduced value entries make things unclear), and by clarifying the objectives of spending resource budgets from budgets and the management state.

In government activities to execute public policies using funds raised by taxes, the ratio and importance of expenditures for social capital formation and expenditures without receiving considerations (transfers and allocations), such as social security benefits, subsidies and grants, are higher than those of entities adopting public enterprise accounting. Neither the expenses which are generated along with the government activities nor the income to compensate for the depreciations of depreciable assets are expected with regard to the expenditures described above, so these expenditures are not income expenditures (that is, costs) deductible from the income in the profit and loss statements (net operating cost statements), rather they must be recognized as capital expenditures directly deductible from the capital or the expenditures without receiving considerations (transfers and allocations). Therefore, with regard to capital transactions, etc., (including some non-exchange transactions related to capital formation and transfers to resource budgets), which are not included in profit and loss calculations, the responsibility of the government in fiscal management must be clarified by adopting the accounting method by source and use of resources in changes in net assets (taxpayers' equity) statements. See "Distinctive accounting method in public sector accounting", which is supplementary theory 2.

7. Elements of public sector major financial statements

In public sector major financial statements, the financial impact of events such as economic transactions are separated into major items based on economic characteristics. These major items are called the elements of public sector major financial statements.

7.1 Recognition and measurement of elements

Elements are recognized as such when they fulfill three recognition standards: meeting the definitions of elements of public sector major financial statements; having a high possibility that economic entities will enjoy the relevant future economic benefits (future cash flow) or the potential to offer services or otherwise losing such benefits or capacity (the probability of future economic benefits or potential to offer services); and having reliable cost or value that is measurable (measurement reliability); and they are incorporated in the balance sheets, net operating cost statements or changes in net assets (taxpayers' equity) statements.

The measurement of elements of public sector accounting financial statements is the equivalent of the valuations performed in business accounting and means the determination of the monetary values of the elements that have been recognized to be included in the balance sheets, net operating cost statements and changes in net assets (taxpayers' equity) statements. For instance, one of the following is used as a measurement standard for assets; historical costs, current costs, realizable (settlement) values and present values.

7.1.1 Adoption of current value accounting (fair value basis)

This framework adopts current value accounting (the so-called fair value basis) as the measurement standard, in principle, in order to reflect the fair values of elements to the greatest extent possible. In more concrete terms, elements are measured based on (discounted) present values, current costs and market (realizable) values, etc., according to their characteristics.

There is the opinion that historical cost basis should be used as the measurement standard because historical cost basis is grounded in objective values and aims to recognize the financing and use of funds. However, in this framework, current value accounting (so-called fair value basis) is adopted for the following reasons:

- Recognizing the state of fiscal management by the government is

difficult using the historical cost basis because impacts caused by unrealized gains and losses are significant in the historical cost basis as the maturity of the use of funds last a lot longer in public sector accounting than in business accounting.

- There is strong demand to maintain physical capital or at least for the presentation because the major duty of entities in the public sector is to provide appropriate levels of public services on a continual basis. With regard to assets (infrastructure assets, etc.) which must be kept at a capacity that is capable of providing services for an extremely long time, the impartiality of burdens between generations must be maintained by calculating fictitious fair values (\approx current values) and by cost attribution allocation over the relevant timeframes (from the past, present and the future).
- The financing and use of funds will be recognized not only by using the historical cost basis, but also by using accounting techniques (so that the re-evaluation differences of assets and liabilities are recognized and measured as a type of capital transaction and then included in the accumulated re-evaluation differences of assets and liabilities in the taxpayers' equity section).
- If the fair value basis is used, it is possible to compare expenses with those of the private sector which uses the same basis (market tests).

7.2 Balance sheets

The elements of balance sheets are assets, liabilities and taxpayers' equity.

7.2.1 Assets and liabilities approach

The definitions of the elements described below conform to the International Accounting Standards (the International Accounting Standards Committee) and the International Public Sector Accounting Standards (the International Federation of Accountants, Public Sector Committee), in principle (excluding resource budgets). In the standards,

all elements other than assets and liabilities (taxpayers' equity, income, expenses, resource budgets) are defined and calculated based on definitions and measurements of assets and liabilities. This means the adoption of the assets and liabilities approach, in which the performance (in more concrete terms, financial performance and changes in the fiscal position) of the reporting entities during the relevant fiscal term is measured, based on the changes in assets and liabilities during the term.

Because of the matters described above, if fair values (=current values or fair values) of assets and liabilities are reflected as much as possible in balance sheets, it will be possible to include the results in net operating cost statements and in changes in net assets (taxpayers' equity) statements. The impartiality of burdens between generations of different times (the present and the future) should be maintained through appropriate recognition of future expenses, etc., with reference to the above.

7.2.2 Grouping method

A classification based on liquidity and fixation or the liquidity grouping method used in business accounting is not needed in public sector accounting for the following reasons:

- Such classification and method are based on the historical cost basis and expense allocation theory in the theories of fixed asset accounting.
- In practice there is little need to secure liquidity for economic entities in the public sector (particularly the central government) because of the public sector's advantages in resource financing that arises from the authority to impose and collect taxes and to issue money (by means of the central bank).
- Maintaining coordination with the system of national accounts (money flow and international balance of payments, etc.) is important for public sector accounting as social accounting.

- A classification based on financial or non-financial should be adopted taking into consideration the trend of overall fair value appraisals of financial instruments in business accounting.

7.2.3 Assets

Assets are what an economic entity holds as a result of past events and are either (a) resources which are expected to generate future economic benefits (future cash flow) for the entity or (b) resources with potential to offer services that contribute to the objectives of the entity directly or indirectly.

(a) Resources expected to generate future economic benefits (future cash flow) are resources for which measurement of realizable (settlement) value through sales, etc., or of present value of discounted future cash flows is possible. On the other hand, assigning monetary value is impossible for resources with potential to offer services (b), because these are neither acquired for cash inflow by sales, etc., nor to gain income (future cash flow). Nevertheless, since these resources contribute significantly to public objectives, their calculated fictitious values (estimates) based on current (repurchasing) cost, etc., should be regarded as measured values in public sector accounting.

Entities in the public sector, which do not aim to earn profits, have many assets that contribute significantly to public objectives. Fictitious values based on current (repurchasing) cost, etc., must be regarded as measured values of assets with potential to offer services which do not generate cash flow in public sector accounting. Accumulated depreciation of these assets must be deducted after allocating depreciation expenses over their useful lifespan according to the types of assets from the aspect of materializing appropriate cost allocation between generations through resource allocation in the timeframe (the past, present and the future).

Recognition and measurement standards for the major assets which are

distinctive to public sector accounting (infrastructure assets, rights generated by contributions, heritage and natural resources, military assets and intangible assets) are described below.

7.2.3.1 Infrastructure assets

Infrastructure assets include road traffic (such as bridges and tunnels), water supply, sewerage, canals, embankments, ports and bays, electricity supply and communications. The characteristics of infrastructure assets are that a system or network is formed by coordinated linkage of many assets and that an extremely long useful lifespan is expected with regular maintenance and repairs.

With regard to the measurement of potential to offer services of infrastructure assets, accumulated depreciation should be deducted after calculating fictitious values based on current (repurchasing) cost, etc., and by allocating the depreciation expenses over the useful lifespan based on predetermined hypothetical calculations. Infrastructure assets that are constructed or acquired using funds financed through the issue of public bonds (construction bonds) in compliance with the Public Finance Law, Article 4, and the amount of depreciation for the relevant fiscal year is transferred to the national debt consolidation fund, it may be regarded as being both depreciation of infrastructure assets (expenses) and redemption of bond principals (income).

7.2.3.2 Claimable assets generated by capital subscription

The measured values of the claimable assets generated by capital subscription should be the net asset values based on current (repurchasing) cost or market (realizable) values, that are obtained by calculating fictitious values of relevant potential to offer services, rather than present values of discounted future cash flows generated by government-affiliated corporations, because the significance of such assets is a contribution to public objectives to be accomplished

through operation by government-affiliated corporations.

The state (the general account and the special account) should regard government-affiliated corporations as subjects of consolidation because they are identical economic entities in practice, due to the fact that the state (the general account and the special account) and government-affiliated corporations have a consolidated relationship in economic practice. From this viewpoint, the net asset value method described above will be positioned as the equity method (of one line consolidation). The costs, etc., of entire government-affiliated corporations will be recognized comprehensively by preparing consolidated public sector financial statements.

7.2.3.3 Heritage and natural resources

Heritage includes ancient ruins, artwork, historical buildings and natural heritage (such as Oku cedars and the Shirakami mountain district). Natural resources include fishery and forestry resources, which are regenerative, and underground mineral resources which include oil.

With regard to heritage and natural resources, either future economic benefits (future cash flow) are expected of them or they have potential to offer services, but the reliability of the measurements is low. This is because the state (government) originally acquired most of the heritage and natural resources free of charge (that is, historical costs of zero), which therefore makes it difficult even to calculate fictitious values based on historical costs or current (repurchasing) cost. In addition, assumptions of the useful lifespans are almost impossible. Consequently, there is no choice but to include heritage and natural resources in the assets with a value (for instance, a value of 1 yen), unless it is possible to gain realizable (settlement) values through sales, etc.

7.2.3.4 Defense assets

Recognition and measurement standards for defense assets have not been established yet because it is a premise that a lot of defense assets, which include weapons, ammunition and possibly defense facilities, are consumed (expenses) through military activity or destroyed (elimination) by opponents. Nevertheless, recognition and measurement of defense assets should be conducted in accordance with the system of national account (SNA) procedures in which military expenses are dealt as operating costs (expenses), except for capital expenditures (assets) for the same types of facilities as used for public welfare (such as airfields and hospitals).

7.2.3.5 Intangible assets

Intangible assets are generally classified into the following two categories in business accounting:

- Legal right (patent right, leases, superficies, trademark right, utility model right, design right, mining right, fishery right, etc.).
- Economically practical assets, i.e., business rights (or goodwill).

In the case that the future cash-flow earning power of a company exceeds the average future cash-flow earning power of general companies or of companies in the same business (such as the case in which the company is in a monopolistic position in the market) because of differences in legal right, business relationships established through the continuance of business, financial connections, qualities of employees and corporate governance, both categories of intangible assets commonly indicate such excessive future cash-flow earning power.

In public sector accounting, which consists of the government (governing entity) and the objects of government activities

(governed entities), there is a legal hierarchical structure. Therefore, in the case that the government has excessive future cash-flow earning power arising from the hierarchical structure supported by the legal system, etc., and such earning power can be recognized, this should be included in balance sheet as an intangible asset.

Opinion exists that not only intangible assets with measurable (discounted) present values (such as radio wave frequencies and airport departure and landing rights), but also intangible assets such as the authority to impose and collect taxes and to issue money, should be recognized and measured ultimately as excessive future cash-flow earning power of the government based on the legal system, etc. However, including such authority extends the range of assets enormously, impairing the qualitative characteristics, particularly reliability of measurement, that public sector accounting information should embody. Therefore, only excessive future cash-flow earning power that fulfills two requirements — the possibility of separation from other assets, and the possibility of reliable measurement with the (discounted) present value, etc. — is included in assets using the measured value. Earning power other than this is not included in the assets (or is recognized and included in the assets with a remainder value of, for instance, 1 yen). In the case of the government's excessive future cash-flow earning power lasting for a limited time, depreciation expenses must be allocated over the effective period and the accumulated depreciation deducted.

7.2.4 Liabilities

Liabilities are present obligations generated by the past events of an economic entity, the discharge of which is expected either (a) to cause outflows of resources which produce economic benefits (future cash flow) from the economic entity or (b) to lower the potential to offer services that contributes to the objectives of the economic entity directly

or indirectly.

Reserves are liabilities which are measurable only by using adequate estimates and include reserves for payments based on guarantees, reserves for value changes, liability reserves for insurance program special accounts and reserves for public pension liabilities.

Described below are recognition and measurement standards for liability reserves for various insurance program special accounts and for the government's public pension liabilities, both of which are liabilities in public sector accounting requiring theoretical consolidation, particularly for system designing.

7.2.4.1 Liability reserves for insurance program in special accounts

Liability reserves for insurance program special accounts (national pensions, welfare insurance, seamen's insurance, labor insurance, earthquake reinsurance, agricultural mutual insurance, forest insurance, fishing vessel reinsurance and fishery mutual insurance, trade insurance, automobile third party liability reinsurance and post office life insurance) are statutory reserves made for provision against future insurance payments, etc., and are included in liabilities in the balance sheet. Payment reserves are reserves for outstanding payments (such as insurance payments for which the payment obligation has already been generated) which are not included in expenditures by the end of the relevant fiscal year. Therefore, payment reserves are separated from liability reserves for provision against future insurance payments, etc.

The Insurance Business Act prior to revision in 1995 stipulated that liability reserves shall be calculated using the same calculation basis as for insurance premiums, and that liability reserves for existing contracts would not be revised in principle, and so relevant insurance premiums were saved in the reserves as they were. Since

the revision of the Insurance Business Act in 1995 (Article 116, Paragraph 2, etc.), the law requires that liability reserves be calculated on a separate basis from insurance premiums and are maintained to secure future insurance money solvency, meaning that the balance of liability reserves must be sufficient to cope with rationally predictable market risks based on occasional changes of interest rates, etc., (standard liability reserve system). Standard liability reserves are a type of minimum liability reserve. Liabilities generated by insufficient reserves grow, so insurance companies that are unable to maintain standard liability reserves will be supervised more strictly. Therefore, an accounting method in compliance with the revised Insurance Business Act must be applied to liability reserves for insurance special accounts and the balances of the liability reserves must be sufficient to cope with rationally predictable market risks based on occasional changes of interest rates, etc., (standard liability reserve system).

7.2.4.2 Public pension liabilities of the government

Pension insurance is a long-term insurance which provides the insured and bereaved families of the insured with various pensions arising from the old age, handicap, death, etc., of the insured. Public pension plans in Japan consist of national pension plans which form the basic pensions of all citizens, and various pension plans for employees (welfare pension insurance, mutual aid associations for national public service employees, mutual aid associations for local public service employees, mutual aid associations for private school teachers and mutual aid associations for employees of agricultural and fishery organizations). The public pension plans are managed by insurance program special accounts (welfare insurance special accounts and national pension special accounts) or by mutual aid associations which are authorized corporations. The public pension liabilities of the government, which is the pension fund manager, are included in the liability as a liability reserve of pension

insurance. The recognition and measurement standards of public pension liabilities must be examined based on the premise of general recognition and measurement standards for liability reserves for insurance program special accounts, and take into consideration the standards and ideal system design (defined contribution pension plan or defined benefit pension plan) for the reserves.

Public pension plans in Japan maintain a funded system with insurance premium contributions linked to pension payments, and, at the same time, a modified funded system whereby the premiums paid by the current generation are used to provide pensions for the present pension recipients. Only settled surpluses are reserved in the current pension plans (National Pension Special Account Act, Article 12 and Welfare Insurance Special Account Act, Article 8). Minimum reserves (minimum liability reserves) must be sufficient to cover the present value of pensions payable for the elapsed period (the present value of pensions payable for work performed by the insured in the current and previous fiscal terms) that the government has promised to pay, in case the relevant pension plan is terminated (non-continuity basis).

There are two types of public pension plans (defined contribution pension plans and defined benefit pension plans) which are equivalent to the retirement benefit plans of corporate pensions.

- (1) Defined contribution pension plans: These are public pension plans in which the contributions paid by the insured are reserved inside the government. Under the plans, even if the reserve funds (and the investment profit and loss) are insufficient to meet the present value of pensions payable for the elapsed period (the present value of pensions payable for work performed by the insured in the present and previous fiscal terms) according to fiscal recalculation, the insured will not bear any legal obligation to make additional contributions.

The liability collateral to assets (public pension reserves payable), which is the same amount as the pension assets (reserves), is included in the liability in defined contribution pension plans.

- (2) Defined benefit pension plans: These are retirement benefit plans excluding defined contribution pension plans, in other words, public pension plans which generate a legal obligation on the government to provide pensions payable for work performed by the insured in the present and previous fiscal terms of amounts that the government has promised to pay. In defined benefit pension plans, the total amount of the present value of pensions payable for the elapsed period (the present value of pensions payable for work performed by the insured in the present and previous fiscal terms), including any insufficient amount of funding, is included in the liability as a public pension liability.

Public pension plans in Japan use the so-called gradation premium method (National Pension Act, Article 87, and Welfare Pension Insurance Act, Article 81) in which immediate premiums are determined based on perspectives for the future assuming gradually rising premiums (premium rates). Public pension plans in Japan use the modified funded system and so have the distinctive characteristics of a pay-as-you-go system. However, taking into consideration that the premiums (premium rates) of the plans gradually rise (undefined contributions) and that defined benefit pension plans provide statutory determined amounts of pensions, the total amount of present value of pensions payable for the elapsed period (the present value of pensions payable for work performed by the insured in the current and previous fiscal terms) should be included in the liability as a public pension liability. If the amount to be included in the liability has become so enormous that

sustaining the plans becomes impossible, public pension plans should be revised and the feasibility of transferring public pension plans to defined contribution pension plans, etc., should be examined.

7.2.5 Taxpayers' equity

Under the state governance mechanism, citizens entrust economic resource management to the government through their tax payments, which means that the citizens are the trustors. At the same time, the citizens are put into a position of bearing the same liability as unlimited joint and several liability for the government debt accumulated over generations as a result of the government's financial activities, as a reflection of the effect of the advantages that the government enjoys in resource financing (the authority to impose and collect taxes and to issue money). On the other hand, the government bears obligations and responsibilities (fiduciary responsibility) as a trustee and manages and uses economic resources entrusted by the citizens as trust assets.

Citizens should be regarded as internal parties (constituents) of the government who contribute the asset base of the government, rather than being regarded as customers of the government, in other words, as counterparties of external transactions (external parties) for the government which is an economic unit. Using the analogy of the concepts of the Trust Act (and equity, which is the base of the act), under the state governance mechanism, the government is regarded as a trustee and the citizens as trustors and as beneficiaries who are entitled to the right which is similar to the possessive right for the government assets (trust assets) under equity. This right under equity may be called a residual claim (in hierarchical structure) of the government assets, that is, "equity." This right is referred to as "taxpayers' equity" below, taking into consideration the above.

In this paper, taxpayers' equity means the interest of the taxpayers in the

assets of the government, which is an economic entity in the public sector, after the deduction of all liabilities. Therefore, the value of the equity is the difference between the assets and the liabilities, in other words, net assets or net worth. Taxpayers' equity is categorized according to the sources and uses, which in this framework are capital formation by tax funds, accumulated increase or decrease of resource budgets (financial resources surpluses), accumulated direct capital consumption, accumulated assets and liabilities re-evaluation differences and identified balances at the commencement.

7.2.5.1 Positioning of taxes (equity theory and income theory)

In public sector accounting, different accounting methods are used depending upon the positioning of taxes, that is (a) equity or (b) income for the government, which are the financial resources of the government. The (a) equity theory positions the citizens as the ultimate equitable interest holders of the state and regards taxes as contributions (contributed capital) from the citizens who are the equitable interest holders. The (b) income theory, on the other hand, positions the citizens as customers of the goods and services that the government provides and regards taxes as considerations (earned capital) for the goods and services.

This framework adopts the (a) equity theory for the following reasons:

- taxes are the asset base entrusted to the government by the citizens, (≡ taxpayers and the electorate) who are the constituents (internal parties) of the state, for management by the government; it is not appropriate to recognize collected taxes as income generated by external transactions with third parties (external parties), and
- the linkage between the citizens' benefits and burdens in taxes is unclear, thereby making it difficult to recognize taxes as

income that corresponds to the costs of government activities (under the principle of correspondence of expenses and income).

The (b) income theory positions the citizens as customers who pay considerations for the provision of the goods and services by the government in accordance with their degree of satisfaction.

Therefore, this theory treats the citizens (who are customers) only as the citizens of the current generation who can enjoy the benefits of goods and services provided by the government and who pay considerations for such goods and services at the present time. In recent years, the ill effects of tax-eater democracy, in which only the parties who consume taxes have influence on state governance (such as special-interest group politics whereby some diet members act for specific groups of people), have been pointed out. This problem occurs because the citizens (who are customers) pressurize diet members for preferred allocation and transfer of the goods and services provided by the government while seeking to bear as little burden as possible. Attention should be paid to the consequence of this, which is impairment of the impartiality of resource allocation over the relevant timeframes, in other words the impartiality of burdens between different generations of people including the future generation. On the other hand, the equity theory regards citizens as including the citizens of future generations. The citizens of the current generation and those of future generations bear a liability which is the same as unlimited joint and several liability for the government debt, which is accumulated over generations because of the government's financial activities, as a reflection of the effect of the advantages that the government enjoys in resource financing (the authority to impose and collect taxes and to issue money). Therefore, under the equity theory, citizens include not only the taxpayers of the current generation but also those of future generations. Importance should be attached to taxpayers' democracy,

in which the interests of parties who bear taxes are respected, in consideration of the objectives of public sector accounting to clarify the fiduciary responsibility of the government.

7.2.5.2 Tax funds

Tax funds are funds or accounts of tax revenues which are separated from others for accounting in order for the expenditures to be transferred to the resource budgets of changes in net assets (taxpayers' equity) statements.

As described above, contributed taxes should be recognized and measured as a kind of capital transaction similarly to the increase of equity contributed by taxpayers who are the equitable interest holders. Therefore the contributed taxes are treated as an increase of resource budgets in the changes in net assets (taxpayers' equity) statements through tax funds.

7.3 Net operating cost statements

The elements of the net operating cost statements are expenses and income.

7.3.1 Expense

Expenses are reductions in economic benefits and ability to offer services caused by outflow or decrease of assets or by generation of liabilities resulting from efforts to produce outcome through activities during the relevant fiscal term. Expenses reduce equity except for equity related to allocation to equitable interest holders (such as dividends).

Expenses include not only the expenses generated during the ordinary activities of economic entities, but also losses. The former include salaries and allowances of employees, traveling expenses, research and development expenses, interest payments and depreciation expenses and are usually outflows or reductions of assets such as cash and cash equivalents, inventories, tangible fixed assets, etc. Losses are items that

fulfill the definitions of expenses excluding the expenses described above, and include losses caused by natural calamities and by disposal of non-current assets.

Expenditures for social capital formation and expenditures without receiving considerations (transfer and allocation) such as social security benefits, subsidies and grants are not income expenditures, in other words, expenses that should be deducted from the income in the profit and loss statements (net operating cost statements), because income that corresponds to expenses generated during the activities of the government or depreciations of depreciable assets is not expected. Rather, these expenditures should be recognized as capital expenditures which are directly deducted from the capital and as expenditures which do not receive considerations (transfer and allocation). For this reason they are not included in expenses in net operating cost statements, but are treated as expenditures which directly reduce resource budgets or taxpayers' equity.

7.3.2 Income

Income is increase in economic benefits and ability to offer services resulting from inflow or increase of assets or by reduction of liabilities, as the outcome of activities during the relevant fiscal term. Income raises equity except for equity related to contributions by equitable interest holders (such as capital increases).

Income consists of non-tax revenues and gains. Non-tax revenues are income other than tax revenues and are mainly generated during the ordinary activities of economic entities. Non-tax revenues include sales, remuneration, interests, dividends, royalties and income from leases. Gains include profits on sales of state assets and gains generated by disposal of non-current assets.

If taxes are positioned according to the equity theory, tax revenues

(transfers from tax funds) directly increase resource budgets and taxpayers' equity, and are not included in the income of net operating cost statements. Transfers (income) from other accounts such as subsidies and grants that citizens are expected to eventually bear through tax payments also directly increase resource budgets and taxpayers' equity and are not included in the income of the net operating cost statements, as in the case above.

7.4 Changes in net assets (taxpayers' equity) statements

The element of the changes in net assets (taxpayers' equity) statements is resource budget which is separated into items that directly increase or decrease taxpayers' equity.

7.4.1 Resource budgets

Resource budgets are capital transactions in public sector accounting that directly increase or decrease taxpayers' equity through the inflow and outflow of tax funds relating to contributions of equity holders (taxpayers), etc., as changes in fiscal positions during the relevant fiscal term.

Factors decreasing resource budgets include resource budgets for net operating costs (which are the balances of net operating cost statements), resource budgets for capital formation by tax funds and resource budgets for subsidies and grants. Factors increasing resource budgets include transfers of tax funds, transfers of capital formation (liabilities/net assets collateral to asset formation) to resource budgets and reversals of liabilities collateral to general account retained specific resource (transfers to resource budgets). In changes in net assets (taxpayers' equity) statements, increases and decreases of resource budgets are presented in total amounts, separated by the causes of the respective increase or decrease.

Factors that directly increase or decrease taxpayers' equity include direct

capital consumption (direct decrease in the value of the capital in the case that income corresponding to the decrease in the values of depreciable assets is not expected) and re-evaluation differences between assets and liabilities.

7.5 Cash flow statements

7.5.1 Differences from cash flow statements in business accounting

Public sector accounting fund financial statements are the equivalent of cash flow statements in business accounting, but their objectives and functions are different. Cash flow statements in business accounting are expected to be used to monitor the funding (liquidity) of companies to maintain appropriateness. On the other hand, for economic entities in the public sector (particularly the central government), there is little need to pay attention to funding (liquidity), because of their advantages in resource financing based on the authority to impose and collect taxes and to issue money (by means of the central bank). Rather, importance is laid on resource allocations through budget compilation, which is a characteristic of public sector accounting. Therefore, cash flow statements are expected to be used during budget compilation to feedback accounts settlement information, etc. in order to maintain budget compliance and budget control in the government's activities.

7.5.2 Expansion of the concept of funds

Taking into consideration the above, the concept of funds in cash flow statements is expanded in order to materialize an accounting method based on accrual basis accounting and to maintain budget compliance and control based on cash basis accounting. In other words, not only cash, but also cash equivalents consisting of short-term accounts receivables (receipts during the settlement period) and short-term accounts payables (payments during the settlement period), which are generated by transactions performed during the settlement period, are regarded as funds which are included in the fund in the balance sheet.

7.5.3 Compartmentation of capital account and current account

Account categories according to the national account system (such as money flow and international balance of payments) will be implemented in cash flow statements. In other words, funds are separated into current revenues and expenditures or capital revenues and expenditures based on the economic characteristics of the funds. However, if categorization based on the economic characteristics of funds is difficult, such funds may be categorized on a one-year basis as exceptions. On the one-year basis, use of funds and asset holding (or source of funds financing) that will survive for one year or more from the day following the preparation day are included in capital income and expenditures, and use of funds and asset holding (or source of funds financing) that will survive for less than one year from the day following the preparation day are included in ordinary current revenues and expenditures.

In fiscal management in the public sector, categorization of ordinary income and expenditures and capital income and expenditures will secure the so-called golden rule system (the principle of construction bonds which limits the objective of borrowing by the government to investments). Also in practice in budget compilation, the aim is to promote assessments taking into consideration the types of financial resources (for instance performance of asset assessment for capital income).

7.6 Notes and supplements

Notes are needed in order to include information concerning the accounting policy selected and applied for standards, major transactions and events in public sector major financial statements, and other information such as additional information required for appropriate presentation which is not included in the main text of public sector major financial statements.

Supplements must include supplemental information for all public sector major financial statements.

8. Concept of capital maintenance concept in public sector accounting

Capital maintenance concept in public sector accounting, which is very different from that of business accounting in aspects such as the premises, must be clarified based on the requirements of the users of public sector accounting information and the objectives of public sector accounting.

8.1 Maintenance and presentation of capital

The capital maintenance concept determines the specific volume of capital that reporting entities must maintain and separate recovery of invested capital to be included in the capital or income. In other words, capital expenditures which should be deducted from the capital, and income expenditures which should be deducted from the income, are separated, and part of the comprehensive income generated by invested capital (changes in the net assets generated by transactions with parties other than equity holders and other events during the relevant fiscal term) which is required to restore capital to maintain the predetermined volume is included in the capital, and the surplus is included in the income.

The capital maintenance concept in business accounting has the same characteristics as the concept of profit calculations based on profit and loss calculations for the income. However, in the case of public sector accounting, the concept of profit calculations is not necessary in principle because entities in the public sector do not aim to make profits. Therefore, the capital maintenance concept in public sector accounting genuinely questions the specific amount of capital that the government is obliged to maintain.

Therefore, who should determine the specific amount of capital that the government must maintain, and by what means? For instance, whether or not a super-highway that goes through thick forests, or huge monuments such as the pyramids (this may be an extreme example), are infrastructure assets that really will be needed by future generations, and therefore should be maintained, will have to be determined by future generations through

democratic means. Such things cannot be allowed to generate unlimited burdens on future generations with the excuse that it is impossible to determine the specific amount of capital that the government must maintain at the present time.

After all, it must be concluded that in public sector accounting it is impossible to effectuate the capital maintenance concept which is needed to determine the specific amount of capital that the government must maintain. On the other hand, stakeholders such as citizens must monitor government activities by analyzing the factors that change taxpayers' equity, which fluctuates daily as a result of the government's fiscal management. Therefore, at the very least, the capital presentation concept is required to occasionally indicate taxpayers' equity, in other words the amount of capital that the government holds, which fluctuates on a daily basis.

8.2 Presentation of physical capital in the public sector accounting

In business accounting, calculations for the capital and profits are performed based on the understanding that the financial capital is sustained by profits, and profits which are able to be appropriated are calculated. On the other hand, in the public sector, the principle duty of the entities is to provide suitable levels of public services on a constant basis and so presentation of the physical capital that corresponds to the potential to offer services is the base of the financial structure. For these reasons, this framework adopts the physical capital presentation concept.

As a result of adopting the physical capital presentation concept, re-evaluations of assets and liabilities or changes in equity by modified presentation are included in accumulated assets and liabilities re-evaluation differences in the taxpayers' equity section in balance sheet as re-evaluation differences of assets and liabilities (or capital maintenance modified values), through asset and liability re-evaluation profit and loss section in the changes in net assets (taxpayers' equity) statements.

Conceptual Framework for Public Sector Accounting (ver. 5.3)

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Supplementary discussion 1 Bankruptcy of public sector entities

1. Question raised

Is the bankruptcy of the state (central government), local municipal entities and their government-affiliated corporations, etc., all of which are public corporations, possible? Shutting down public sector entities for bankruptcy would be difficult, taking into consideration public utility and public order based on the law, but it may be possible for public sector entities to become bankrupt in economic reality. Therefore, what conditions and standards should be used to recognize the bankruptcy of public sector entities?

1.1 Differences between statutory understanding and economic reality

In theory, the Bankruptcy Law, etc., regard capacity for bankruptcy as the general eligibility of entities to accept an adjudication of bankruptcy and to bear statutory status as a bankrupt. On the other hand, the causes of bankruptcy are individual and concrete reasons stipulated by the law as grounds to recognize the financial deterioration of debtors to the extent that they require bankruptcy adjudication, such as deficiency in assets and suspension of payments.

In finance theory which aims to understand economic reality, credit risks are either the risk of becoming unable to settle all liabilities because of financial deterioration or decrease in the value of the assets, etc., held by the debtors (that is, bankruptcy) or uncertainties based on probability.

1.2 Arguments concerning the Bankruptcy Law and practices

The traditional, commonly-held view of the Bankruptcy Law regards public sector entities in a narrow sense (the state and local municipal entities) as fundamental government entities and therefore the capacity for bankruptcy of these public sector entities cannot be recognized because to do so would constrain governance due to the adjudication of bankruptcy, and public enterprises do not have capacity for bankruptcy either because they are regarded as special entities that exercise the administrative authority of the

state. Under this view, it may be said that there is no problem in public sector entities increasing their liabilities unlimitedly and accumulating huge deficiencies in assets because it is impossible for public sector entities to go bankrupt according to the law.

On the other hand, a recent influential view asserts that it is rational to commence bankruptcy procedures against public sector entities, except in the case of fundamental government bodies (the state and local municipal entities) such as public enterprises and government-affiliated corporations, which require liquidation because of insolvency or deficiency in assets. In other words, the general capacity for bankruptcy of all public sector entities other than the state and local municipal entities should be recognized in the absence of any special regulations to the contrary. It is considered to be sufficient to examine the feasibility of fiscal support from the national treasury through loans and guarantees, etc., based on individual causes of bankruptcy.

Both the traditional, commonly-held view and the recent influential view of the Bankruptcy Law disallow the existence of the capacity for bankruptcy of fundamental government bodies (the state and local municipal entities). However, with regard to local municipal entities, the financial restructuring plan under the Special Measures Law for the Promotion of Local Government Financial Restructuring contains, in practice, restructuring-type bankruptcy procedures, which means that there are standards to recognize the bankruptcy of local municipal entities in reality based on the Special Measures Law.

Regarding administrative work based on the Bankruptcy Law, there are no relevant precedents concerning the capacity for bankruptcy of public sector entities, so this largely depends on future views concerning the legislation. The following are examinations of financial theories and theories of macroeconomics which should form the base of future legislation theory, with particular focus on the link between the bankruptcy of public sector entities and the authority to impose and collect taxes and to issue money, from the

aspect of economic reality.

2. Theory concerning the bankruptcy of the state

2.1 The authority to impose and collect taxes and to issue money

The authority to impose and collect taxes means the authority of the state to collect fiscal resources compulsorily through taxes. Seigniorage, then, is the profit generated through the issue of money by an entity with such authority (the central government or, in many cases, the central bank). In other words, the difference between the face value of money and the cost of issuing the money belongs to the entity entitled to issue money as its profit, because although money is included in the liability of the entity, money does not generate any interest and the entity is not obliged to make good the liability. However, under today's state finance, tax revenues greatly exceed the profit (measured as payment earmarked for the government by the central bank). Therefore, issues concerning the bankruptcy of the state resolve themselves into the link between the concept of bankruptcy and cash inflow generated through the execution of the authority to impose and collect taxes.

2.2 Link between bankruptcy and advantages of the government in resource financing

There is almost no external constraint in economic resource financing on the state (central government) because the state has the authority to impose and collect taxes and to issue money (by means of the central bank). Even if government debt balloons in size, the government will be able to repay the debt by implementing measures (1) to increase taxes (absorption of private funds using the authority to impose and collect taxes) or (2) to induce inflation (fund financing using the authority to issue money). Item (1) includes increases of general taxes such as consumption tax and income tax, introduction of tax on security holding (imposing a tax on holders of government bonds) and the introduction of a property tax (implemented after determining the values of the assets held through a deposit blockade) which was applied in Japan for some time after World War II. Item (2) means the

monetization of government debt by the central bank which is part of the government. In economics, reduction in the value of money (inflation) is equivalent to imposing a tax (inflation tax) on money (the liability of the entity entitled to issue money).

2.2.1 Possibility of bankruptcy through actualization of liquidity risks

There is the possibility of default through the actualization of international liquidity risks (stringency of foreign currency funding) in the case of liabilities in foreign currencies. More than a few countries have experienced defaults and have rescheduled debts at the Paris Club or have practically started restructuring-type bankruptcy procedures in accordance with IMF programs, etc.

On the other hand, in the case that most of a government's debt is in the domestic currency, bankruptcy arising through the actualization of liquidity risks (stringency of funding) is almost impossible, because if the fiscal condition of a state has reached a truly stringent state, the government would probably compel the central bank to monetize the government's debt despite the existence of fiscal regulations such as the principle of no taxation without law (legislative procedures would have to be completed to raise taxes) and the independence of the central bank (the right to refuse to underwrite government bonds).

2.2.2 Possibility of bankruptcy by deficiency in assets

Even a government that is deficient in assets will not go bankrupt immediately. However, there is a limit in the absorption of private funds by the government although the government has the authority to impose and collect taxes. To procure funds unlimitedly through the exercise of the authority to impose and collect taxes means to unlimitedly increase the liabilities of the entity entitled to issue money (the state, that is, the government or the central bank). Rise in government debt definitely impairs resource allocation and the impartiality of burdens between different generations of people (resource allocation over the timeframes

of the past, present and the future). The issuing of government bonds is the same as consuming resources (which would otherwise be available for future generations), because government bonds are issued using future tax revenues as security.

Inflation (reduction in the value of money) induced through monetization by the central bank will eventually be the only means to adjust the impartiality of resource allocation caused by the rise in the liabilities of the state as described above. The adjustment of resource allocation by means of inflation (reduction in the value of money) will cause the transfer of economic resources from the creditor to the obligor (including the state), thereby shifting benefits from financial asset holders to real asset holders and to current workers.

2.3 Recognition of bankruptcy of state finances

2.3.1 Necessity of political and discretionary decision-making

Taking into consideration the link between bankruptcy and the advantages enjoyed by the government in resource financing (the authority to issue money and the authority to impose and collect taxes), political and discretionary judgment on how the following three types of costs generated by impaired resource allocation should be borne impartially by the citizens of the present and future generations is required in order to recognize the bankruptcy of state finances.

- Costs generated by impairment of resource allocations caused by increase in the liability of the state (inflation or reduction in the value of money).
- Costs generated as a result of tightening of the issue of money with proper fiscal regulations by the state (that is entitled to issue money and to impose and collect taxes) or costs generated by increase of taxes (the costs of deflation measures).
- Costs generated by market risks (reduction in the international value of the currency) of yen-based assets from the aspect of foreign

capital investments.

The matters described above suggest that it is possible for public sector entities in a narrow sense (the state and local municipal entities) to commence restructuring-type bankruptcy procedures based on political and discretionary judgment in the case that the state or a local municipal entity goes bankrupt practically in economic reality because of significant increase and diffusion of deficiency in assets, despite the fact that the law does not allow for discontinuance of fundamental governing functions or bankruptcy of the state or local municipal entities.

2.3.2 Precondition to recognize bankruptcy of state finances

Concerning bankruptcy of the state, changes in the tax system (to implement and exercise the authority to impose and collect taxes) or in monetary policy (monetization of the government's debt) affect the costs generated by impairment of resource allocation (inflation costs, deflation costs and costs caused by international reduction in the value of the currency), and at the same time are regarded politically as either evading actual bankruptcy or the commencement of restructuring-type bankruptcy procedures. Therefore, the precondition for recognition of the bankruptcy of a state is a political and discretionary judgment as to whether or not recognition of bankruptcy is possible based on the assumption that the tax system and monetary policy remain unchanged.

3. Bankruptcy recognition standards for public sector entities

What standards should be used to recognize the practical bankruptcy of fundamental government bodies (the state and local municipal entities) and other public sector entities (such as public enterprises and government-affiliated corporations)?

3.1 Overview: State finances

Bankruptcy recognition standards of the state (the central government with fundamental governance competence) are examined in overview.

As described above, concerning the liabilities of the Japanese government in yen, bankruptcy of the state caused directly by actualization of liquidity risks (stringency of funding) is not possible for as long as the government (including the Bank of Japan) has the authority to impose and collect taxes and to issue money. Significant increase and unlimited diffusion of deficiency in assets in state finances would lead to the actualization of credit risks through inflation (reductions in the value of the currency domestically and internationally), in other words, bankruptcy in economic reality, which would make it possible to commence restructuring-type bankruptcy procedures in practice (although the law does not allow for such bankruptcy).

3.1.1 Bankruptcy recognition standards by flow variables

The conditions for sustainability of financial deficits in public finances are that the balance of debt to GDP does not increase during the period of a business cycle (between five and ten years), in other words, the primary balance, which is the balance between expenditures other than public bond expenses and revenue other than that from public bonds (borrowing), remains in equilibrium, and that, at the same time, the nominal growth rate exceeds the interest rate on borrowing. If these conditions of sustainability of financial deficit are not fulfilled, bankruptcy of the state will be actualized by rapid deterioration of the fundamentals such as crowd out in the private sector, further deterioration of financial conditions arising from the rise in long-term interest rates, a drop in the value of the currency stemming from outflows of capital investments overseas, and hyperinflation (refer to Figure 9).

Figure 9 Bankruptcy recognition standards by flow variables

| Debit | Fund revenue and expenditures | Credit |
|---|-------------------------------|--------|
| Principal redemption expenditures | Public bond revenue | |
| Interest payment expenditures (revenue expenditures) | | |
| Current expenditures (revenue expenditures) | Primary balance deficit | |
| | Tax revenue | |
| Capital expenditures | Non-tax revenue | |

The timing of judgments for conditions of sustainability of the financial deficits described above is subsequent to one business cycle (5-10 years) — a relatively long period — because the major elements used in making judgments are flow variables of fiscal management (primary balance and the nominal growth rate, etc., of respective fiscal years). Therefore, not only the conditions of sustainability of financial deficits, but also stock variables of fiscal management (the amount of deficiency in assets of the government and measured value of the authority to impose and collect taxes as intangible fixed assets, etc.) should be considered for the bankruptcy recognition standards of state finances.

3.1.2 Bankruptcy recognition standards by stock variables

In public sector accounting, assets are defined as resources that economic entities hold as a result of past events and are expected to generate future inflow of economic benefits (future cash flow) to the entities or have the potential to offer services that contributes directly or indirectly to the purposes of the entities. The authority to impose and collect taxes in the

future may be regarded as being generated by past events which are legislations of tax laws in the abstract, but in practice the measured value of the authority to impose and collect taxes in the future depends upon future events (economic conditions of the private sector and tax system revisions, etc.) which cannot be determined now, which means that the right is not usually included in the assets. Although the measured value of the authority to impose and collect taxes in the future depends upon future events, if such authority is regarded as a resource with potential to offer services as described above, it is possible to include the right in the assets as a kind of intangible asset, using calculated fictitious values.

In the case of the above, the deficiency in assets, for example, ¥806,430 billion in the national government balance sheet for 1999 (trial work) by the Ministry of Finance, is included in the assets in the balance sheet of the government as the measured value of the authority to impose and collect taxes in the future. Then the number of years required to complete the depreciation (redemption) is calculated assuming that a constant percentage of tax revenue (such as the ratio of principal redemption expenditure) is expended on the depreciation (redemption) every year, in the same way as for other intangible assets. At this point, it may be possible to recognize the state of bankruptcy on the assumption that depreciation (redemption) takes, for instance, three generations (one century) or more (refer to Figure 10).

Figure 10 Bankruptcy recognition standards by stock variables

| Debit | Balance sheet | Credit |
|--|---------------|-------------|
| Financial assets | | |
| Non-financial assets | | |
| Deficiency in assets | | |
| : | | Liabilities |
| Depreciation (redemption) for the 3rd year | | |
| Depreciation (redemption) for the 2nd year | | |
| Depreciation (redemption) for the 1st year | | |

3.1.3 Right to recognize bankruptcy of state finances

Now the question is who should make the political and discretionary judgment of the state bankruptcy described above and based on what procedures? The government has advantages in resource financing because of its authority to impose and collect taxes and to issue money, which means that there exists a hierarchical structure for resource allocation between the central government and other economic entities. Therefore, under such a hierarchical structure, examinations must be performed from aspects such as determining the incentives that affect the governance of resource allocation by the government.

Under the current fiscal system, all judgments related to fiscal policies are made by resolutions of the Diet, so it may be said that financial democracy is maintained (the Constitution, Article 83, etc.). Under the current fiscal system, the government is expected to perform governance for the benefit of the citizens of the current generation who have the right to vote. Therefore, how should governance be secured that benefits the

citizens of future generations?

According to existing concepts, resource allocation in the private sector is optimized through the market mechanism, but the market mechanism does not operate to allocate resources between the public and private sectors or within the public sector itself, so optimization through budget compilation, which is closely linked with politics, is assumed for the public sector. However, it is obvious that assumptions of the optimization of resource allocation through budget compilation and optimal provision of public goods and quasi-public goods by the government are mere fictions by looking at the current fiscal crisis and malfunctioning in Japan.

Taking into consideration the above, expert and independent organization and governance which maintain the transparency of the procedures to determine policies and which are free from politics or political pressure, in the same way as determining monetary policies by the central bank, are required to devise fiscal policies. Therefore, at the same time as observing the principle of resolutions at the Diet concerning the statutory authority of fiscal management (the Constitution, Article 83) from the viewpoint of democracy, budget compilation based on financial analysis using public sector major financial statements and asset and liability management by the government (ALM), etc., which will be materialized through reform of the public sector accounting system, etc., must be performed in order to realize impartiality of the burdens placed on citizens of different generations.

3.2 Prior to detailed discussions: changes in the financial institution bankruptcy system

Prior to detailed examinations of bankruptcy recognition standards and bankruptcy procedures for local municipal entities and government-affiliated corporations, etc., the failure of financial administration and changes in the financial institution bankruptcy system in the 1990s are reviewed. Financial

institutions, particularly banks, have been issuing and providing deposit money (means of settlement), which is the systematic infrastructure of socio-economics. After the bursting of the bubble economy, the business of financial institutions deteriorated because of the outbreak of huge amounts of non-performing loans and the burdens caused by the debts, and consequently financial institutions went bankrupt one after the other. In the latter half of the nineties, the so-called convoy style of financial administration collapsed, giving need to a new type of bankruptcy scheme to dispel anxiety about the fiscal system. There are many lessons to learn from these times when considering issues related to the dependence of financial institutions on the state (central government), the impact on state finances, the most appropriate bankruptcy recognition standards and bankruptcy procedures, and problems concerning local municipal entities and government-affiliated corporations.

3.2.1 Convoy-style financial supervision and its collapse

Financial institutions are able to avoid bankruptcy because the institutions themselves are able to create and provide liquidity through financial mediation in the money market (the short-term money market), and in any case, if they ever do experience stringency of funding (in other words, actualization of liquidity risks), the central bank, which is the lender of last resort, provides the institutions with funds. The authorities conducted a so-called convoy style of financial administration, in which all financial institutions were protected and none were allowed to go bankrupt, with the aims of maintaining credit stability and protecting depositors, taking into consideration the financial crisis at the beginning of the Showa era. Under the convoy style of financial administration, the authorities provided financial institutions with funds regardless of the extent of the deterioration in their business in order to avoid bankruptcy caused by stringency of liquidity.

In the latter half of the nineties, after the bursting of the bubble economy, the business of financial institutions had deteriorated significantly for reasons such as the huge deficiency in assets generated by the increase of

non-performing loans and the subsequent losses from depreciation of the debts, etc. Many financial institutions in dire straits went bankrupt due to actualization of credit risks (withdrawal of deposited money because of rumors of business problems which made it difficult to procure funds even from the call market) and consequent stringency of liquidity (suspension of payments and default).

In November 1997, Sanyo Securities Co., The Hokkaido Takushoku Bank, and Yamaichi Securities Co. went bankrupt, making obvious the fact that the authorities were no longer able to maintain the convoy style of financial administration. Bankruptcy recognition standards and bankruptcy procedures for financial institutions were finally legislated through the establishment of the Financial Supervisory Agency in July 1998 and enactment of the Financial Institution Restructuring Law and Emergency Measures Law for Early Recovery of the Soundness of Financial Functions in October 1998. The Long-Term Credit Bank of Japan and The Nippon Credit Bank were placed under special official management in October and December 1998 respectively.

3.2.2 Bankruptcy recognition standards: the costs of allowing or avoiding bankruptcy

It is acknowledged that during a financial crisis, the authorities made a political and discretionary judgment as to whether or not to allow the financial institution concerned to commence bankruptcy procedures, by comparing the costs required to save the enterprise, which would otherwise go bankrupt, (costs such as the amount of public funds required) with the political benefits (such as maintaining credit stability and the protection of depositors), in short, a comparison between the costs required to allow the bankruptcy and the costs required to avoid the bankruptcy. The costs of bankruptcy of financial institutions include the costs arising from the disturbance of credit stability due to a hard landing and from deposit insurance payments subsequent to the bankruptcy. On the other hand, the costs required to avoid bankruptcy are not brought to

public notice because financial institutions are allowed to continue business by receiving funding for some time. It should be borne in mind that when financial institutions eventually go bankrupt after all efforts, the public funds expended in efforts to stave off the bankruptcy are also shouldered by the citizens. Another cost is the loss of the trust in the authorities due to the lack of information disclosed about the debts, etc., as a result of the delay in the commencement of bankruptcy procedures.

3.3 Detailed discussion 1: bankruptcy recognition standards and bankruptcy procedures of local municipal entities

3.3.1 Guarantee of financial resources by the state (central government)

Currently, the shortage of financial resources at local municipal entities is guaranteed to be made up through local finance plans and local allocation tax systems. Local government bonds are equivalent to a tacit government guarantee, because the issue of local government bonds only requires permission (consultation is required from fiscal year 2006) and the cost of public bonds (the principal and interest redemption expense) is included in the annual expenditure in the local finance plan and measures implemented in later years (part of the principal and interest redemption expense is included in the basic financial demand), etc. Furthermore, the majority of local government bonds are underwritten by government funds (funds from fiscal loans and postal insurance) and funds of finance corporations (the Japan Finance Corporation for Municipal Enterprises), which means that the issuing of local government bonds depends almost totally on funds provided by the state (central government).

3.3.2 Bankruptcy recognition standards

Is bankruptcy of local municipal entities possible when the state (central government) guarantees provision of substantial financial resources? The answer depends upon the degree of impact of the bankruptcy of local municipal entities on state finances. In other words, if there is a

possibility that the cost to be borne by the state (central government) arising from the bankruptcy of local municipal entities affects state finances, the state will make a political and discretionary judgment as to whether or not to allow the entities to commence bankruptcy procedures, by comparing the costs of bankruptcy with the costs of avoiding bankruptcy, as was the case at the time of the collapse of the convoy style of financial administration.

Under the current system, only the state (comprising the central government and the Diet) is able to radically reform the local tax system (the implementation and exercise of the authority to impose and collect taxes) and the actions that local municipal entities facing a financial crisis may take are very limited, for example, reducing annual expenditures. This means that if the current local tax system continues unchanged, it is possible to recognize bankruptcy as economic reality based on bankruptcy recognition standards using flow variables and stock variables, as is the case for state finances.

3.3.3 Fiscal Restructuring Organization Program

The Fiscal Restructuring Organization Program was implemented through the enactment of the Special Measures Law for the Promotion of Local Government Financial Restructuring because after World War 2 local municipal entities needed increasing levels of funding for the renewal of the public school system and establishment of police forces operated by local governments, etc., and consequently many local municipal entities had significant deficits in the accounts settlement for fiscal year 1954. It is possible to apply the Fiscal Restructuring Organization Program based on the Special Measures Law to local municipal entities which went into deficit in 1955 and thereafter (Article 22, Paragraph 2).

3.3.3.1 Standards to recognize fiscal restructuring organizations

It is possible to regard entities which have become fiscal

restructuring organizations as having started proceedings to avoid bankruptcy or as having commenced restructuring-type bankruptcy procedures, in practice. The Special Measures Law for the Promotion of Local Government Financial Restructuring (Article 2) stipulates that local municipal entities wishing to become financial restructuring organizations shall make an application to the state after receiving approval from the respective assembly, with the prerequisite that their real balance (balance – financial resource carried forward to the following fiscal year) has fallen into deficit. The Financial Restructuring Organization Program is designed so that local municipal entities decide for themselves to accept state control, based on the principal objective of local self-government (the Constitution, Article 92), and not for the government to recognize and compulsorily take control of organizations with deficits. Therefore, in reality, almost no local municipal entities with a real balance in the red apply to become financial restructuring organizations immediately, and in many cases do so only when their deficit has reached the level at which issue of general industrial bonds is restricted by the Special Measures Law for the Promotion of Local Government Financial Restructuring (Article 23 of the law and Article 11-2 of the Enforcement Ordinance), in other words, the level of deficit at which the real balance ratio against the size of standard finance exceeds a predetermined percentage (20% for municipal governments, 5% for prefectural governments).

3.3.3.2 Restructuring-type bankruptcy procedures

In the Financial Restructuring Organization Program, the financial restructuring plan practically has the features of restructuring-type bankruptcy procedures. Financial restructuring organizations are able to defer their deficits because they are allowed to issue financial restructuring bonds on condition that they submit a financial restructuring plan to the state. However, local municipal entities that became financial restructuring organizations in fiscal

year 1955 and onwards are not allowed to issue financial restructuring bonds; instead, restrictions on issuing general industrial bonds are eased (Article 23 of the law and Article 11-2 of the Enforcement Ordinance) based on the financial restructuring plan. Financial restructuring organizations are eligible to receive financial support from the state, including government loans for temporary borrowings, permission for the issue of employees' retirement allowance bonds in order to reduce their number of employees, etc., and inclusion of the interest payable on temporary borrowing and part of the retirement allowances in a special local allocation tax.

3.3.3.3 Problems of the Fiscal Restructuring Organization Program

The major problem of the Fiscal Restructuring Organization Program is that bankruptcy recognition standards are based on a deficit in the real balance (balance – financial resource carried forward to the following fiscal year) because the real balance is a flow variable which is relatively easy to manipulate in fiscal management, so that in an extreme case, no matter how huge a financial deficit has accumulated, as long as local government bonds are issued, local municipal entities can avoid becoming financial restructuring organizations without causing stagnation in administration. Therefore, bankruptcy recognition standards must incorporate more objective criteria such as a combination of flow variables and stock variables. Although the current program allows local municipal entities to decide whether or not to become financial restructuring organizations, the right to recognize bankruptcy should be held by an independent entity (the state or a third party organization, etc.) in order to clarify responsibility in fiscal management.

In the financial restructuring plan of the restructuring-type bankruptcy procedures, priority is given to cuts in annual

expenditures rather than to tax increases aimed at eliminating the deficit, and only in the case that cuts in annual expenditures are insufficient is the introduction of taxation at a rate higher than the standard rate and general tax not stipulated in the Local Tax Law allowed. These are restructuring measures focusing on cutting annual expenditures. However, financial restructuring organizations should be obliged to increase taxes in order to at least clarify the responsibility for fiscal management failure. The program should incorporate more effective measures such as establishment of local government financial restructuring trustees, mergers of neighboring local governments as a remedy, and the takeover of debts by the state.

3.4 Detailed discussion 2: bankruptcy recognition standards and bankruptcy procedures of government-affiliated corporations

3.4.1 Fiscal support by the state (central government)

Government-affiliated corporations (including authorized corporations and incorporated administrative agencies) depend upon the state (central government) for financial support, in the same way as local municipal entities, and receive subscriptions, subsidies and grants, etc., from the government every year. As part of the fiscal investment and loan reform of 2001, Fiscal Investment and Loan Program Agency Bonds have been issued without attaching the government's guarantee in order to procure funds for government-affiliated corporations, but this gives rise to the possibility that the bonds are not appraised appropriately (the rating, etc.) in the market. There is doubt whether a tacit government guarantee is attached to Fiscal Investment and Loan Program Agency bonds, in part because there is no law stipulating the bankruptcy of government-affiliated corporations.

3.4.2 Bankruptcy recognition standards

The state should make a political and discretionary judgment as to whether or not to allow government-affiliated corporations which are facing a

financial crisis to commence bankruptcy procedures, by comparing the costs of bankruptcy with the costs of avoiding bankruptcy, as with the bankruptcy of financial institutions. In the case of government-affiliated corporations, either liquidation-type bankruptcy procedures or restructuring-type bankruptcy procedures are used, depending upon the public good features and financial base, etc., of the respective corporation.

The costs of bankruptcy of government-affiliated corporations include the costs generated by the decline of public services caused by the hard landing and of financial support for liquidation-type or restructuring-type bankruptcy procedures. The costs of avoiding bankruptcy are not brought to public notice because government-affiliated corporations are allowed to continue to operate by receiving funding for some time. However, when government-affiliated corporations eventually go bankrupt despite all efforts, the public funds expended in the attempts to stave off the bankruptcies are also borne by the citizens.

For recognition of bankruptcy of government-affiliated corporations, financial analysis identical to that performed in business accounting to a certain extent is possible, although elements such as public good features and the financial base of government-affiliated corporations are different from those of entities in the private sector. Balance sheet assuming as a private sector entity and profit and loss statement assuming as a private sector entity described in the Guidelines for Preparation of Net Operating Cost Statement for Government-affiliated Corporations (published 2001 by the Fiscal Commission) may be assessed highly because they are based on the same concept as the above. It is possible to estimate the costs required for bankruptcy procedures for government-affiliated corporations (the costs of bankruptcy) and to estimate the amount of public funds required to avoid the bankruptcy of government-affiliated corporations (the costs of avoiding bankruptcy) using the same methods as used in bankruptcy analysis for private sector entities based on the

levels of profits of the previous few years and the ratio of profit of the relevant fiscal year to total liabilities and by applying impairment accounting based on the difference between planned asset management results and actual results.

3.4.3 Bankruptcy procedures

The following are required with regard to bankruptcy procedures: revisions and improvements of the current accounting standards for government-affiliated corporations (published October 1987 by the Public Enterprise Subcommittee of the Fiscal Commission) and the accounting standards for incorporated administrative agencies (published February 2000 by the Research Group for Incorporated Administrative Agency Accounting Standards of the Management and Coordination Agency), revisions of financial supports to government-affiliated corporations including contributions, subsidies and grants, etc., provided by the government, and statutory improvements concerning bankruptcy procedures.

Supplementary discussion 2 Particular accounting procedures in public sector accounting (prototype)

The Guidelines for Preparation of Financial Statements of Special Accounts, etc., were prepared on a trial basis using this framework as the theoretical foundations for the government body that is responsible for compiling budgets to be used as a manual for the preparation of public sector financial statements in general. The guidelines explain in a concrete manner the accounting procedures particular to public sector accounting, using examples of typical accounting procedures for the special account, and include much explanation not only for the special account, but also for the general account and government-affiliated corporations, etc. The following are some relevant citations from the guidelines.

1. Particular accounting procedures for changes in net assets (taxpayers' equity) statements

Accounting procedures for net operating cost statements are used when expenses arising from operations and income corresponding to depreciation of depreciable assets are expected, that is, when it is possible to perform profit and loss calculations and fixed asset accounting (depreciation calculations) identical to those used in business accounting. On the other hand, accounting procedures which are distinctive to public sector accounting are used mainly for changes in net assets (taxpayers' equity) statements when expenses arising from operations by the government and income corresponding to depreciation of depreciable assets are not expected, for example, social capital formation for public policies (capital expenditures) and social security benefits (expenditures without receiving considerations), in other words, for capital transactions (including some exchange transactions relating with capital formation and transfers to resource budgets), etc., which are core transactions for public policies and which are not included in the profit and loss calculations.

The following are explanations concerning changing liabilities collateral to asset formation to resource budgets through a timeframe of special accounting for changes in net assets (taxpayers' equity) statements and apply to various cases

focusing on three elements: accounting by financial resources for social capital formation, reversal of general account retained specific resources and accounting for elimination and sales of social capital.

1.1 Use of worksheets

In this framework and the Guidelines for Preparation of Financial Statements of Special Accounts, etc., worksheets (see the attached worksheets) are used to prepare public sector major financial statements. This method using worksheets is effective to clarify the links between items recorded for respective accounting and between accounts, to recognize the positioning of the public sector major financial statements in the entire system, and to avoid two recordings for one transaction (additional recording) as required for fund accounting of the non-profit corporation accounting standards (published March 1977 by the Non-profit Corporation Supervisors' Liaison Committee), etc.

The worksheet method requires the same recordings as for the preparation of cash flow statements using the direct method. Therefore, accounts of cash flow statements are summarized in the fund of balance sheets, and accounts of changes in net assets (taxpayers' equity) statements are summarized in the taxpayers' equity section of balance sheets. It should be noted that with regard to accounts of cash flow statements, fund revenue is recorded in the debit side and fund expenditures are recorded in the credit side to correspond to the debits and credits of the fund (debit side) of the balance sheets.

1.2 Accounting procedures by source and use of resources for social capital formation

Three types of accounting procedures are used for social capital formation according to the types of financial resources, these are (a) tax funds (specific resources), (b) funds transferred from the general account and (c) public bonds (special account bonds).

In the case of social capital formation using (a) tax funds (specific resources)

or (b) funds transferred from the general account, at the time of capital expenditures, social capital formation is recorded as the decrease of resource budgets in resource budgets for capital formation in the changes in net assets (taxpayers' equity) statements in either case, but in public accounting sector balance sheets, in the case of (a) tax funds (specific resources), liabilities collateral to asset formation are included in the taxpayers' equity section and in the case of (b) funds transferred from the general account, liabilities collateral to asset formation are included in the general account adjustment. Later, liabilities collateral to asset formation are changed to resource budgets and recorded in accordance with the increase in direct capital consumption of the social capital formation so that the decrease (direct capital consumption) and the increase (resource budget changed from capital formation liability) of resource budgets and taxpayers' equity are offset (shaded area).

Example of recording: social capital formation by tax fund (specific resource)

| | | | | | | | | | |
|---|---|---------|---|----|-----|----------|--|----|-----|
| 1 | At the time of receipt of tax funds (specific resource) | (debit) | Tax fund (specific resource) income | CF | 100 | (credit) | Tax fund (specific resource) | NW | 100 |
| 2 | At the time of asset acquisition | (debit) | Public asset (infrastructure asset) | BS | 70 | (credit) | Capital expenditure by tax fund | CF | 70 |
| 3 | | (debit) | Resource budget for capital formation by tax fund | NW | 70 | (credit) | Capital formation liability by tax fund | BS | 70 |
| 4 | At the time of capital decrease | (debit) | Direct capital consumption | NW | 7 | (debit) | Accumulated direct capital consumption | BS | 7 |
| 5 | At the time of changing to resource budget | (debit) | Capital formation liability by tax fund | BS | 7 | (debit) | Resource budget changed from capital formation liability by tax fund | NW | 7 |

Note: The following abbreviations are used for financial statements. BS: balance sheet / PL: net operating cost statement / NW: changes in net assets (taxpayers' equity) statement / CF: public sector accounting cash flow statement

In the case of social capital formation using (c) public bonds (special account bonds) as financial resources, at the time of capital expenditures, social capital formation is recorded in the assets in balance sheets and also in the liabilities as the balance of public bonds (special account bonds) issued. Then, public

bond (special account bond) principal redemption expenditures are included in public sector accounting cash flow statements, regardless of increase in direct capital consumption of the social capital formation, which means that only the decrease (shaded area) in resource budgets and taxpayers' equity (direct capital consumption) will be effective in changes in net assets (taxpayers' equity) statements.

Example of recording: social capital formation by public bonds (special account bonds)

| | | | | | | | | | |
|---|--|---------|--|----|----|----------|---|----|----|
| 6 | At the time of issue of public bonds (special account bonds) | (debit) | Revenue from issue of public bonds (special account bonds) | CF | 50 | (credit) | Public bonds (special account bonds) | BS | 50 |
| 7 | At the time of asset acquisition | (debit) | Public asset (infrastructure asset) | BS | 50 | (credit) | Capital expenditure | CF | 50 |
| 8 | At the time of capital decrease | (debit) | Direct capital consumption | NW | 5 | (debit) | Accumulated direct capital consumption | BS | 5 |
| 9 | At the time of public bond (special account bond) principal redemption | (debit) | Public bonds (special account bonds) | BS | 1 | (debit) | Public bond (special account bond) principal redemption expenditure | CF | 1 |

1.3 Reversal of general account retained specific resources

There are cases in which specific resources, which should be put in the special account, are retained in the general account for reasons such as stringency in the public finance of the general account, so withdrawing and then transferring them to the special account later may be regarded as being identical to changing tax funds (specific resources) to resource budgets in the timeframe.

The actual accounting procedure for the above is to transfer liabilities/net assets collateral to asset formation to resource budgets and to record the fund revenue realized by the dispositions at the time of the dispositions, as in the case of direct capital consumption for social capital formation. In other words, at the time of retaining specific resources in the general account, they are included in the assets as general account retained specific resources in balance

sheets, and the same amount is included in liabilities collateral to general account retained specific resources in the general account adjustments. In the case of withdrawal of the specific resource in a later year, the liability collateral to general account retained specific resources in the general account adjustment is transferred to the resource budget changed from liability collateral to general account retained specific resources, which is part of the increase of the resource budget in the changes in net assets (taxpayers' equity) statement. When general account retained specific resources of the balance sheet are withdrawn because the funds have been actually transferred, they are included in the current revenue of the public sector accounting cash flow statement, as in the case of ordinary tax fund (specific resource) revenue.

Example of recording: receipt of reversal of liabilities collateral to general account retained specific resources (transfer to resource budget) from the general account

| | | | | | | | | | |
|----|---|---------|--|----|----|----------|---|----|----|
| 10 | At the time of retaining in the general account | (debit) | General account retained specific resource | BS | 70 | (credit) | Liability collateral to general account retained specific resource | BS | 70 |
| 11 | At the time of disposition (receipt) | (debit) | Liability collateral to general account retained specific resource | BS | 70 | (credit) | Resource budget changed from liability collateral to general account retained specific resource | NW | 70 |
| 12 | | (debit) | Income from reversal of general account retained specific resource | CF | 70 | (credit) | General account retained specific resource | BS | 70 |

1.4 Accounting procedures for sales and retirement of social capital

In the case that an asset, for which capital formation liability by tax fund (specific resource) or by funds transferred from the general account is recorded, such as social capital formation for public policy, is eliminated or sold, all of the capital formation liability for the asset is changed to the resource budget in a lump sum, and (a) any loss generated by the elimination or sale is included in the social capital elimination and sales loss, and (b) any profit generated by the elimination or sale is included in the social capital

elimination and sales profit.

Example of recording: (a) if loss of ¥30 million is generated by elimination or sale

| | | | | | | | | | |
|-----|---|---------|---|----|----|----------|---|----|-----|
| 13 | At the time of elimination or sale | (debit) | Accumulated direct capital consumption | BS | 20 | (credit) | Public asset (infrastructure asset) | BS | 100 |
| 13b | | (debit) | Current revenue | CF | 50 | | | | |
| 13c | | (debit) | Social capital elimination and sales loss | NW | 30 | | | | |
| 14 | At the time of changing to resource budget in a lump sum | (debit) | Capital formation liability by tax fund | BS | 80 | (debit) | Resource budget changed from capital formation liability by tax fund | NW | 80 |

Example of recording: (b) if profit of ¥15 million is generated by elimination or sale

| | | | | | | | | | |
|-----|---|---------|--|----|----|----------|---|----|-----|
| 13 | At the time of elimination or sale | (debit) | Accumulated direct capital consumption | BS | 20 | (credit) | Public asset (infrastructure asset) | BS | 100 |
| 13d | | (debit) | Current revenue | CF | 95 | (credit) | Social capital elimination and sales profit | NW | 15 |
| 14 | At the time of changing to resource budget in a lump sum | (debit) | Capital formation liability by tax fund | BS | 80 | (debit) | Resource budget changed from capital formation liability by tax fund | NW | 80 |

2. Other accounting procedures for changes in net assets (taxpayers' equity) statements

The following are outlines of accounting methods by item with examples of recordings. The same numbers used in the previous section are used for duplicated recording examples.

2.1 Decrease of resource budgets

(a) Resource budget for net operating cost: ¥6 million

Shortages of resource budgets for government activities, in other words net operating costs, arise through profit and loss calculations for net operating cost statements. Net operating costs which are generated during activities by the government will be replenished by resource budgets for net operating costs in changes in net assets (taxpayers' equity) statements.

| | | | | | | | | | |
|----|-------------------------------------|---------|--|----|-----|----------|--------------------|----|---------|
| 15 | At the time of replenishing expense | (debit) | Resource budget for net operating cost | NW | 600 | (credit) | Net operating cost | PL | 60 0 |
|----|-------------------------------------|---------|--|----|-----|----------|--------------------|----|---------|

(b) Resource budget for capital formation by tax fund (specific resource):

Capital expenditure of ¥80 million for construction of public asset (infrastructure asset)

In the case of capital formation using tax funds (specific resources) as financial resources at the time of capital expenditure, it is included in resource budgets for capital formation by tax fund (specific resources) as a decrease in the resource budgets in changes in net assets (taxpayers' equity) statements and the same amount is included in liabilities collateral to asset formation by tax fund (specific resources) in the taxpayers' equity section of balance sheets because fixed assets are considered to comprise part of the government's asset basis.

| | | | | | | | | | |
|---|----------------------------------|---------|---|----|----|----------|---|----|----|
| 2 | At the time of asset acquisition | (debit) | Public asset (infrastructure asset) | BS | 70 | (credit) | Capital expenditure by tax fund | CF | 70 |
| 3 | | (debit) | Resource budget for capital formation by tax fund | NW | 70 | (credit) | Capital formation liability by tax fund | BS | 70 |

(c) Resource budget for capital formation by funds transferred from the general account: Capital expenditure of ¥210 million for construction of public asset (infrastructure asset)

In the case of capital formation using funds transferred from the general account as financial resources, it is included in resource budgets for capital formation by funds transferred from the general account as a decrease in the resource budgets in changes in net assets (taxpayers' equity) statements, and the same amount is included in liabilities collateral to asset formation by funds transferred from the general account in the general account adjustments in balance sheets.

| | | | | | | | | | |
|----|----------------------------------|---------|-------------------------------------|----|-----|----------|---|----|-----|
| 16 | At the time of asset acquisition | (debit) | Public asset (infrastructure asset) | BS | 210 | (credit) | Capital expenditure by funds transferred from the general account | CF | 210 |
|----|----------------------------------|---------|-------------------------------------|----|-----|----------|---|----|-----|

| | | | | | | | | | |
|----|--|---------|---|----|-----|----------|---|----|-----|
| 17 | | (debit) | Resource budget for capital formation by funds transferred from the general account | NW | 210 | (credit) | Capital formation liability by funds transferred from the general account | BS | 210 |
|----|--|---------|---|----|-----|----------|---|----|-----|

(d) Direct capital consumption: ¥50 million

Basically, in activities for public policies, income that corresponds to depreciation of depreciable assets is not expected, rather the amount of depreciation is considered as a direct decrease in the value of the capital (not included in profit and loss calculations). Therefore, such depreciation is included in accumulated direct capital consumption in the taxpayers' equity section of balance sheets and at the same time in direct capital consumption in decrease of resource budgets and taxpayers' equity of changes in net assets (taxpayers' equity) statements.

In the case that capital is formed by expending tax funds (specific resources) or by resource budgets of funds transferred from the general account, the breakdown of direct capital consumption will be direct capital consumption for capital formation by tax fund or direct capital consumption for capital formation by funds transferred from the general account because the relevant liabilities collateral to asset formation are offset by changing them to resource budgets according to the increase of direct capital consumption.

| | | | | | | | | | |
|----|--|---------|--|----|----|----------|--|----|----|
| 18 | At the time of capital decrease | (debit) | Direct capital consumption | NW | 50 | (credit) | Accumulated direct capital consumption | BS | 50 |
| 4 | (for tax funds) | (debit) | Direct capital consumption by tax fund | NW | 7 | (credit) | Accumulated direct capital consumption by tax fund | BS | 7 |
| 19 | (for funds transferred from the general account) | (debit) | Direct capital consumption by funds transferred from the general account | NW | 20 | (credit) | Accumulated direct capital consumption by funds transferred from the general account | BS | 20 |

(e) Asset and liability re-evaluation loss: impairment of public asset (infrastructure asset) of ¥15 million

Guidelines for the Preparation of Financial Documents for the Special

Account, etc., adopt an accounting method based on fair value basis in principle, so asset and liability re-evaluation differences are generated in each fiscal term. Asset and liability re-evaluation differences are included in accumulated asset and liability re-evaluation differences in the taxpayers' section of balance sheets as capital transactions that increase or decrease taxpayers' equity directly. In changes in net assets (taxpayers' equity) statements, asset and liability re-evaluation losses are included in the section of decrease of resource budgets and taxpayers' equity, and asset and liability re-evaluation profits are included in the section of increase of resource budgets and taxpayers' equity.

Asset and liability re-evaluation losses are recorded when measured values of assets and liabilities are reviewed such as revisions of values of assets in the state owned asset ledger, and when declines in the ability to offer services capacity of assets are recognized and impairment accounting is applied for such losses.

| | | | | | | | | | |
|----|------------------------------|---------|--|----|----|----------|-------------------------------------|----|----|
| 20 | At the time of re-evaluation | (debit) | Asset and liability re-evaluation loss | NW | 15 | (credit) | Public asset (infrastructure asset) | BS | 15 |
|----|------------------------------|---------|--|----|----|----------|-------------------------------------|----|----|

2.2 Increase of resource budgets

- (f) Tax funds (specific resource): receipt of ¥200 million from national tax funds

In the case that the equity theory is used with regard to the positioning of taxes, tax fund revenue (specific resources) is included in tax funds (specific resources) in the increase of resource budgets of changes in net assets (taxpayers' equity) statements as capital transactions that directly increase taxpayers' equity.

| | | | | | | | | | |
|---|---|---------|--------------------------------------|----|-----|----------|-------------------------------|----|-----|
| 1 | At the time of receipt of tax funds (specific resource) | (debit) | Tax fund (specific resource) revenue | CF | 100 | (credit) | Tax funds (specific resource) | NW | 100 |
|---|---|---------|--------------------------------------|----|-----|----------|-------------------------------|----|-----|

- (g) Funds transferred from the general account: ¥120 million of ¥300 million of the funds received from the general account is for expenses for issuing

construction bonds

In public sector accounting cash flow statements, funds transferred from the general account are included in current revenue except for funds transferred from the general account for issuing construction bonds, which are included in capital revenue. On the other hand, in changes in net assets (taxpayers' equity) statements, funds transferred from the general account are included in funds transferred from the general account in the increase of resource budgets in lump sums regardless of how such funds are used (regardless of current expenditures or capital expenditures and in case of capital expenditures, acquisition of non-depreciable assets or depreciable assets).

| | | | | | | | | | |
|-----|--|---------|--|----|-----|----------|--|----|-----|
| 21 | At the time of receipt of funds transferred from the general account | (debit) | Revenue of funds transferred from the general account (for issuing construction bonds) | CF | 180 | (credit) | Funds transferred from the general account | NW | 300 |
| 21b | | | Revenue of funds transferred from the general account (for others) | CF | 120 | | | | |

(h) Transfer to resource budget of capital formation (liabilities/net assets collateral to asset formation) by tax fund (or funds transferred from the general account): changing ¥25 million which is equivalent to the amount of direct capital consumption to the resource budget

In changes in net assets (taxpayers' equity) statements, direct capital consumption (refer to 14b and 14c in Section (d) above) for capital formation by tax fund (specific resources) or funds transferred from the general account is offset by recording the resource budgets changed from liabilities collateral to asset formation by tax fund (or funds transferred to the general account).

| | | | | | | | | | |
|----|---------------------------------|---------|--|----|----|----------|--|----|----|
| 19 | At the time of capital decrease | (debit) | Direct capital consumption by funds transferred from the general account | NW | 20 | (credit) | Accumulated direct capital consumption by funds transferred from the general account | BS | 20 |
|----|---------------------------------|---------|--|----|----|----------|--|----|----|

| | | | | | | | | | |
|----|--|---------|--|----|----|---------|---|----|----|
| 22 | At the time of changing to resource budget | (debit) | Liabilities collateral to asset formation by the general account | BS | 20 | (debit) | Resource budget changed from liabilities collateral to asset formation by the general account | NW | 20 |
|----|--|---------|--|----|----|---------|---|----|----|

- (i) Reversal of liabilities collateral to general account retained specific resource (liabilities/net assets collateral to asset formation): receipt of ¥70 million from the general account

In the case of a reversal of specific resource which has been retained in the general account, the liability collateral to general account retained specific resource in the general account adjustments is transferred to the resource budget changed from liability collateral to general account retained specific resource in the increase of resource budgets of a changes in net assets (taxpayers' equity) statement. At the same time, the general account retained specific resource in a balance sheet is removed for inclusion in the current revenue of the public sector accounting cash flow statement.

| | | | | | | | | | |
|----|--------------------------------------|---------|---|----|----|----------|---|----|----|
| 11 | At the time of disposition (receipt) | (debit) | Liability collateral to general account retained specific resource | BS | 70 | (credit) | Resource budget changed from liability collateral to general account retained specific resource | NW | 70 |
| 12 | | (debit) | Revenue from reversal of general account retained specific resource | CF | 70 | (credit) | General account retained specific resource | BS | 70 |

- (j) Asset and liability re-evaluation profit: increase of fair value of public asset (infrastructure asset) by ¥10 million as a result of a revision of the values of the assets in the state owned asset ledger

Asset and liability re-evaluation profits are recorded when measured values of assets and liabilities are revised, such as revisions of values of assets in the state owned asset ledger.

| | | | | | | | | | |
|----|------------------------------|---------|-------------------------------------|----|----|----------|--|----|----|
| 23 | At the time of re-evaluation | (debit) | Public asset (infrastructure asset) | BS | 10 | (credit) | Asset and liability re-evaluation profit | NW | 10 |
|----|------------------------------|---------|-------------------------------------|----|----|----------|--|----|----|

3. Accounting procedures for all public sector major financial statements in general
 All revenues and expenditures in statements for accounts settlements and for budgets and revenues and expenditures of special funds which are not included in annual accounts (Public Finance Law, Article 44, underlining by the author) are included in current revenues and expenditures or capital revenues and expenditures of public sector accounting cash flow statements based on economical features of revenues and expenditures. The revenues and expenditures described above, together with profit and loss transactions which do not generate any inflow or outflow of actual funds, and capital transactions (including exchange transactions), etc., are treated so that all of the elements above interlink throughout the entire system of public sector major financial statements.

3.1 Current expenditures and expenses

Current expenditures (including current transfer expenditures) are included in items for expenses of net operating cost statements according to classifications (code numbers) by expenditure purposes.

Example of recording: the case of expenditure of ¥550 million as an operating expense and expenditure of ¥170 million as a non-operating expense.

| | | | | | | | | | |
|-----|----------------------------|---------|-----------------------|----|-----|----------|---------------------|----|-----|
| 24 | At the time of expenditure | (debit) | Operating expense | PL | 550 | (credit) | Current expenditure | CF | 720 |
| 24b | | (debit) | Non-operating expense | PL | 170 | | | | |

3.2 Capital expenditures and non-financial assets

In the Guidelines for the Preparation of Financial Documents for the Special Account, etc., only state-owned assets are included in the assets of balance sheets (refer to p7). Therefore, only capital expenditures other than capital transfer expenditures (transfer to local entities and other accounts, etc.) are recorded in non-financial assets (receivables, tangible fixed assets, intangible assets and investments, etc.).

Example of recording: the case of expenditure of ¥30 million as a loan, expenditure of

¥330 million for a public asset (infrastructure asset) and expenditure of ¥90 million as a contribution

| | | | | | | | | | |
|-----|---|---------|-------------------------------------|----|-----|----------|--|----|-----|
| 25 | At the time of asset acquisition | (debit) | Non-financial asset | BS | 450 | (credit) | Capital expenditure (narrow sense: non-capital transfer expenditure) | CF | 450 |
| 25a | (for loan) | (debit) | loan | BS | 30 | (credit) | long-term loan expenditure | CF | 30 |
| 25b | (for public asset) | (debit) | Public asset (infrastructure asset) | BS | 330 | (credit) | Capital formation expenditure | CF | 330 |
| 25c | (for the government's contribution, etc.) | (debit) | Government's contribution, etc. | BS | 90 | (credit) | Contribution expenditure | CF | 90 |

At the same time as the above, in the case of capital expenditure using tax funds or funds transferred from the general account, accounting by financial resources described earlier is performed and the resource budget for capital formation is recorded in the changes in net assets (taxpayers' equity) statement and capital formation liability is recorded in the balance sheet.

Example of recording: the case of expenditure of ¥70 million for public asset (infrastructure asset) by tax fund

| | | | | | | | | | |
|---|----------------------------------|---------|---|----|----|----------|---|----|----|
| 2 | At the time of asset acquisition | (debit) | Public asset (infrastructure asset) | BS | 70 | (credit) | Capital expenditure by tax fund | CF | 70 |
| 3 | | (debit) | Resource budget for capital formation by tax fund | NW | 70 | (credit) | Capital formation liability by tax fund | BS | 70 |

Example of recording: the case of capital expenditure of ¥210 million by funds transferred from the general account

| | | | | | | | | | |
|----|----------------------------------|---------|---|----|-----|----------|---|----|-----|
| 16 | At the time of asset acquisition | (debit) | Public asset (infrastructure asset) | BS | 210 | (credit) | Capital expenditure by funds transferred from the general account | CF | 210 |
| 17 | | (debit) | Resource budget for capital formation by funds transferred from the general account | NW | 210 | (credit) | Capital formation liability by funds transferred from the general account | BS | 210 |

3.3 Issues of public bonds and principal redemptions

Flow information of issues of public bonds and principal redemptions is able to be understood only through public sector accounting cash flow statements because these are neither profit and loss transactions nor capital transactions. Some people insist that cash basis accounting is preferable for public sector accounting for the reason described above, but this is not a correct view. Securing financial resources for redemptions is a major problem in public bond management policy. Principal redemption expenditures of public bonds are covered by the increase of funds generated by financial resource surplus that is summed up in resource budget increase and decrease (financial resource surplus) of changes in net assets (taxpayers' equity) statements and, therefore, the surplus determines the debt redemption capacity of the government.

Example of recording: the case that public bonds (special account bonds) were issued for ¥50 million and principal redemption of ¥1 million has been performed after resource budget increase and decrease (financial resource surplus) of ¥5 million was generated

| | | | | | | | | | |
|-----|--|---------|--|----|-----|----------|---|----|-----|
| 6 | At the time of issue of public bonds (special account bonds) | (debit) | Revenue from issue of public bonds (special account bonds) | CF | 50 | (credit) | Public bonds (special account bonds) | BS | 50 |
| 26 | Acquisition of redemption financial resource | (debit) | Decrease of resource budget | NW | 800 | (credit) | Increase of resource budget | NW | 805 |
| 26b | | (debit) | Resource budget increase and decrease (financial resource surplus) | NW | 5 | | | | |
| 27 | Changing redemption financial resource to fund | (debit) | Fund | BS | 5 | (credit) | Resource budget increase and decrease (financial resource surplus) | NW | 5 |
| 9 | At the time of public bond (special account bond) principal redemption | (debit) | Public bonds (special account bonds) | BS | 1 | (debit) | Public bond (special account bond) principal redemption expenditure | CF | 1 |

3.4 Transferring debts to the general account, etc.

In the past, there were cases in which debts were transferred to the general account for reasons such as significant deterioration in the financial conditions of the special accounts, etc., (such as the special account for the state-owned forest program and the Japan Railway Liquidation Organization). Transfers of debts are non-fund transactions that do not generate inflow or outflow of actual funds and are not included in revenues or expenditures in statements for accounts settlements or budgets.

The Guidelines for the Preparation of Financial Documents for the Special Account, etc., were prepared based on the concept of increasing the scope of the guidelines in the future to include the general account in order to consolidate accounting with the special account, etc. As preparation for this, transfers of debts to the general account are included in the general account adjustment of the balance sheet.

Example of recording: the case of transferring a debt of ¥50 million in the special account to the general account

| | | | | | | | | | |
|----|------------------------------------|---------|---|----|----|----------|---|----|----|
| 28 | At the time of transferring a debt | (debit) | Debt to be transferred to the general account | BS | 50 | (credit) | Transfer of debt to the general account, etc. | BS | 50 |
|----|------------------------------------|---------|---|----|----|----------|---|----|----|

4. Templates of financial statements

Figure 11 Balance sheet for ___ special account

| Assets | FY | FY | Liabilities | FY | FY |
|---|------|------|--|------|------|
| | 2000 | 2001 | | 2000 | 2001 |
| Funds | xxx | xxx | Accounts payable and accrued expenses | xxx | xxx |
| Cash | xxx | xxx | Money in custody, etc. | xxx | xxx |
| Cash equivalents (short-term receivables and short-term payables) | xxx | xxx | Advance received and unearned revenue | xxx | xxx |
| Non-financial assets | | | Postal savings | | |
| Receivables | xxx | xxx | Financial loan fund deposits | xxx | xxx |
| Receivables and accrued revenue | xxx | xxx | Liability reserves | xxx | xxx |
| General account retained specific resources | xxx | xxx | Payment reserves (insurance money payable) | xxx | xxx |
| Prepayments and prepaid expenses | xxx | xxx | Short-term government bonds | xxx | xxx |
| Financial loan fund deposits | xxx | xxx | Public bonds | xxx | xxx |
| Lending | xxx | xxx | Borrowing | xxx | xxx |
| Other receivables | xxx | xxx | Reserves | xxx | xxx |
| (exemption) Allowance for doubtful accounts | Δxxx | Δxxx | Reserves for potential losses of guarantee arrangements | xxx | xxx |
| Securities | xxx | xxx | Reserves for bonuses | xxx | xxx |
| Inventory | xxx | xxx | Reserves for repairs | xxx | xxx |
| Real estate for sale, etc. | xxx | xxx | Reserves for retirement benefits, etc. | xxx | xxx |
| Tangible fixed assets | xxx | xxx | Liabilities | xxx | xxx |
| Land (including parks, etc.) | xxx | xxx | General account adjustments | | |
| Trees | xxx | xxx | Capital formation by funds transferred from the general account | xxx | xxx |
| Buildings | xxx | xxx | Liabilities collateral to asset formation by funds transferred from the general account | xxx | xxx |
| Structures | xxx | xxx | (exemption) Accumulated direct capital consumption | Δxxx | Δxxx |
| Machines and tools | xxx | xxx | Accumulated transfers of debts to the general account, etc. | xxx | xxx |
| Vessels | xxx | xxx | Liability collateral to general account retained specific resources | xxx | xxx |
| Aircraft | xxx | xxx | Liability collateral to general account retained specific resources (exemption) Accumulated direct capital consumption | xxx | xxx |
| Public assets (infrastructure assets) | xxx | xxx | 1. Capital formation by tax fund (specific resources) | Δxxx | Δxxx |
| (exemption) Accumulated direct capital consumption | Δxxx | Δxxx | dispositions of general account retained financial resources | | |

| | | | | | |
|--|------------|------------|--|------------|------------|
| (exemption) Accumulated amount equivalent of depreciations | Δxxx | Δxxx | General account adjustments | xxx | xxx |
| 2. Capital formation by funds transferred from the general account (general account bonds) | xxx | xxx | Taxpayers' equity | | |
| Assets belonging to the general account | xxx | xxx | Capital formation by tax fund (specific resources) | xxx | xxx |
| (exemption) Accumulated amount equivalent of depreciations | Δxxx | Δxxx | Capital formation liability by tax fund (specific resources) | xxx | xxx |
| 3. Capital formation by public bonds (special account bonds) | xxx | xxx | (exemption) Accumulated direct capital consumptions | Δxxx | Δxxx |
| (exemption) Accumulated amount equivalent of depreciations | Δxxx | Δxxx | Accumulated resource budget increase and decrease (financial resource surplus) | xxx | xxx |
| (Public asset land) | (xxx) | (xxx) | Accumulated direct capital consumption | xxx | xxx |
| (Public asset facilities) | (xxx) | (xxx) | Accumulated asset and liability re-evaluation differences | xxx | xxx |
| Suspense accounts for constructions and unfinished facilities, etc. | xxx | xxx | Unidentified balance at the commencement | xxx | xxx |
| Intangible assets | xxx | xxx | | | |
| Assets recorded in the state owned asset ledger such as superficies | xxx | xxx | Taxpayers' equity | xxx | xxx |
| Assets not recorded in the state owned asset ledger | xxx | xxx | | | |
| Software for own use | xxx | xxx | | | |
| Investments, etc. | xxx | xxx | | | |
| Government's contributions, etc. | xxx | xxx | | | |
| Beneficiary right on real estate investment trust funds | xxx | xxx | | | |
| Other | xxx | xxx | | | |
| Assets | <u>xxx</u> | <u>xxx</u> | Liabilities and taxpayers' equity | <u>xxx</u> | <u>xxx</u> |

Δxxx are items to be exempted.
Values inside the parentheses are for reference.

Figure 12 Net operating cost statement for ___ special account

| | FY2000 | FY2001 |
|---|--------|--------|
| (___ program) | Δxxx | Δxxx |
| Expenses | | |
| Operating expenses | Δxxx | Δxxx |
| Costs corresponding to ___operating revenue | Δxxx | Δxxx |
| Personnel expenses (including defrayments of mutual aid association) | Δxxx | Δxxx |
| Traveling expenses | Δxxx | Δxxx |
| Non-personnel expenses | Δxxx | Δxxx |
| Subsidies and commissions | Δxxx | Δxxx |
| Subsidies to the state, etc. (excluding defrayments of mutual aid association) | Δxxx | Δxxx |
| Subsidies other than subsidies to the state, etc. (excluding defrayments of mutual aid association) | Δxxx | Δxxx |
| Other current expenditures (including current transfer expenditures) | Δxxx | Δxxx |
| Non-fund transaction expenses | Δxxx | Δxxx |
| Transfer to ___ reserve | Δxxx | Δxxx |
| Transfer to ___ reserve | Δxxx | Δxxx |
| Depreciation expenses | Δxxx | Δxxx |
| Non-operating expenses | Δxxx | Δxxx |
| Public bond (special account bond) interest payment expenses | Δxxx | Δxxx |
| Interests paid on borrowing | Δxxx | Δxxx |
| Fixed asset elimination and sales losses | Δxxx | Δxxx |
| Miscellaneous expenditures | Δxxx | Δxxx |
| Income | xxx | xxx |
| Operating revenues | xxx | xxx |
| Operating revenue from ___ (transfers from the general account) | xxx | xxx |
| Revenue from use of ___ | xxx | xxx |
| Operating revenue from ___ (transfers from other special accounts) | xxx | xxx |
| Revenue from commissions of ___ | xxx | xxx |
| Operating revenue from ___ (collected directly by relevant special account) | xxx | xxx |
| Revenue from insurance premiums of ___ | xxx | xxx |
| Revenue from ___ | xxx | xxx |
| Non-operating revenue | xxx | xxx |
| Interests received on deposits to the fiscal investment and loan program | xxx | xxx |
| Revenue from leases of real estate | xxx | xxx |
| Fixed assets sales profits | xxx | xxx |
| Miscellaneous revenue | xxx | xxx |
| Operating income and expense | xxx | xxx |
| Non-operating income and expense | xxx | xxx |
| Net operating cost | Δxxx | Δxxx |

Figure 13 Changes in net assets (taxpayers' equity) statement for ____ special account

| | FY2000 | FY2001 |
|---|-------------|-------------|
| Decrease of resource budgets and taxpayers' equity | <u>Δxxx</u> | <u>Δxxx</u> |
| Decrease of resource budgets | Δxxx | Δxxx |
| Resource budgets for net operating costs | Δxxx | Δxxx |
| Resource budgets for capital formation by tax fund (specific resources) | Δxxx | Δxxx |
| Resource budgets for Project A | Δxxx | Δxxx |
| Resource budgets for Project B | Δxxx | Δxxx |
| Resource budgets for capital formation by funds transferred from the general account | Δxxx | Δxxx |
| Resource budgets for Project C | Δxxx | Δxxx |
| Resource budgets for Project D | Δxxx | Δxxx |
| Social capital elimination and sales losses | Δxxx | Δxxx |
| Direct capital consumption (amount equivalent of depreciations) | <u>Δxxx</u> | <u>Δxxx</u> |
| Capital formation by tax fund (specific resources) | Δxxx | Δxxx |
| Capital formation by funds transferred from the general account | Δxxx | Δxxx |
| Capital formation by public bonds (special account bonds) | Δxxx | Δxxx |
| Asset and liability re-evaluation losses | <u>Δxxx</u> | <u>Δxxx</u> |
| Increase of resource budgets and taxpayers' equity | <u>xxx</u> | <u>xxx</u> |
| Increase of resource budgets | <u>xxx</u> | <u>xxx</u> |
| Tax funds (specific resources) | xxx | xxx |
| Funds transferred from the general account | xxx | xxx |
| Dispositions of general account retained financial resources (transfer to resource budgets) | xxx | xxx |
| Transfers of capital formation (liabilities/net assets collateral to asset formation) to resource budgets | xxx | xxx |
| Tax funds (amount equivalent of direct capital consumption) | xxx | xxx |
| Funds transferred from the general account (amount equivalent of direct capital consumption) | xxx | xxx |
| Social capital sales profits | xxx | xxx |
| Asset and liability re-evaluation profits | <u>xxx</u> | <u>xxx</u> |
| Increase and decrease of resource budgets and taxpayers' equity | <u>xxx</u> | <u>xxx</u> |

Figure 14 Public sector accounting cash flow statement for ___ special account

| | FY2000 | FY2001 |
|---|-------------|-------------|
| | <u>Δxxx</u> | <u>Δxxx</u> |
| Current revenues and expenditures | | |
| Current expenditures | Δxxx | Δxxx |
| Current expenditures (narrow sense: non- current transfer expenditures) | Δxxx | Δxxx |
| Personnel expenses | Δxxx | Δxxx |
| Non-personnel expenses | Δxxx | Δxxx |
| Traveling expenses | Δxxx | Δxxx |
| Subsidies and commissions | Δxxx | Δxxx |
| Public bonds (special account bonds) interest payment expenses | Δxxx | Δxxx |
| Interests paid on borrowing | Δxxx | Δxxx |
| Non-operating expenditures | Δxxx | Δxxx |
| Miscellaneous expenditures | Δxxx | Δxxx |
| Current transfer expenditures (expenditures for other accounts, government-affiliated corporations and local municipal entities) | Δxxx | Δxxx |
| Current transfer expenditures for the general account | Δxxx | Δxxx |
| Current transfer expenditures for ___ special account | Δxxx | Δxxx |
| Current transfer expenditures for ___ government-affiliated corporations, etc. | Δxxx | Δxxx |
| Current transfer expenditures for local municipal entities | Δxxx | Δxxx |
| Current revenues | | |
| Operating revenue | <u>xxx</u> | <u>xxx</u> |
| Non-operating revenue | xxx | xxx |
| Interests received on deposits to the fiscal investment and loan program | xxx | xxx |
| Revenue from leases of real estate | xxx | xxx |
| Miscellaneous revenue | xxx | xxx |
| Tax fund (specific resource) revenue | xxx | xxx |
| Current transfer revenue from other special accounts, etc. | xxx | xxx |
| Revenue from funds transferred from the general account (excluding issues of public (construction) bonds stipulated in Public Finance Law, Article 4) | xxx | xxx |
| Current transfer revenue from ___ special account | xxx | xxx |
| Current transfer revenue from ___ special account | xxx | xxx |
| Current transfer revenue from local municipal entities | xxx | xxx |
| Current revenues and expenditures | <u>xxx</u> | <u>xxx</u> |

| Capital revenues and expenditures | FY2000 | FY2001 |
|--|--------|--------|
| Capital expenditures | Δxxx | Δxxx |
| Capital expenditures (narrow sense: non-capital transfer expenditures) | Δxxx | Δxxx |
| Capital formation expenditures for public assets (infrastructure assets) | Δxxx | Δxxx |
| Capital formation expenditures using tax funds (specific resources) as financial resources | Δxxx | Δxxx |
| Capital formation expenditures for Project A | Δxxx | Δxxx |
| Capital formation expenditures for Project B | Δxxx | Δxxx |
| Capital formation expenditures using funds transferred from the general account as financial resources | Δxxx | Δxxx |
| Capital formation expenditures for Project C | Δxxx | Δxxx |
| Capital formation expenditures using public bonds (special account bonds) as financial resources | Δxxx | Δxxx |
| Capital formation expenditures for Project D | Δxxx | Δxxx |
| Public bond (special account bond) redemption expenditures (principals) | Δxxx | Δxxx |
| Capital transfer expenditures (expenditures for other accounts, government-affiliated corporations and local municipal entities and including long-term lending and borrowing, etc.) | Δxxx | Δxxx |
| Capital transfer expenditures for the general account | Δxxx | Δxxx |
| Capital transfer expenditures for ___ special account | Δxxx | Δxxx |
| Capital transfer expenditures for ___ government-affiliated corporations, etc. | Δxxx | Δxxx |
| Capital transfer expenditures for local municipal entities | Δxxx | Δxxx |
| Capital revenues | xxx | xxx |
| Revenue from issues of public bonds (special account bonds) | xxx | xxx |
| Revenue from borrowing by special account | xxx | xxx |
| Revenue from capital transfers from other special accounts, etc. | xxx | xxx |
| Revenue from funds transferred from the general account (issues of public (construction) bonds stipulated in Public Finance Law, Article 4) | xxx | xxx |
| Capital transfer revenue from ___ special account | xxx | xxx |
| Capital transfer revenue from ___ special account | xxx | xxx |
| Capital transfer revenue from local municipal entities | xxx | xxx |
| Capital revenues and expenditures | xxx | xxx |
| Fund revenue and expenditures (total of current revenues and expenditures and capital revenues and expenditures) | xxx | xxx |
| Beginning fund balance | xxx | xxx |
| Ending fund balance | xxx | xxx |

Figure 15 Attached supplementary tables in various formats

Form 1

| Asset type | | Beginning balance | Term increase | Term decrease | Ending balance | Accumulated depreciations | | Ending post-deduction balance | Notes |
|-----------------------|----------------------------|-------------------|---------------|---------------|----------------|---------------------------|--------------------|-------------------------------|-------|
| | | | | | | | Term depreciations | | |
| Tangible fixed assets | Land | xxx | xx | xx | xxx | xxx | xxx | xx | xx |
| | Depreciable assets | xxx | xx | xx | xxx | xxx | xxx | xx | xx |
| | Machines and tools | xxx | xx | xx | xxx | xxx | xxx | xx | xx |
| | Public assets | xxx | xx | xx | xxx | xxx | xxx | xx | xx |
| | | | | | | | | | |
| | Total | xxx | xx | xx | xxx | xxx | xxx | xx | xx |
| Intangible assets | Superficies | xxx | xx | xx | xxx | xxx | xxx | xx | xx |
| | Patent right | xxx | xx | xx | xxx | xxx | xxxx | xx | xx |
| | | | | | | | | | |
| | Total | xxx | xx | xx | xxx | xxx | xxx | xx | xx |
| Investments, etc. | Government's contributions | xxx | xx | xx | xxx | xxx | xxx | xx | xx |
| | Beneficial ownership right | xxx | xx | xx | xxx | xxx | xxx | xx | xx |
| | Other | xxx | xx | xx | xxx | xxx | xxx | xx | xx |
| | | | | | xxx | xxx | xxx | xx | xx |
| | Total | xxx | xx | xx | xxx | xxx | xxx | xx | xx |

Note 1: The breakdown of “tangible fixed assets”, “intangible assets” and “investments, etc.” is in accordance with the items in the balance sheets.

Note 2: The values for the “previous term ending balance”, “term increase”, “term decrease” and “ending balance” should be the values of the assets of the relevant balance sheet (fair values), in principle. Concerning the columns “term increase” and “term decrease”, the values of the assets which were acquired or disposed of during the term must be separated from the re-evaluation differences generated by the re-evaluation of assets and written in parentheses.

Note 3: In the case of increases or decreases because of special reasons such as dispositions or loss due to natural calamities, the reasons for the increase or decrease and the values of the relevant facilities, etc., must be written in the footnotes.

Note 4: The fixed assets for which the depreciations are included in the net operating cost statements (depreciable assets for which income for their depreciations is expected) and the fixed assets for which the amounts equivalent to their depreciations are not included in the profits or loss (depreciable assets for which income for their depreciations is not expected) must be included.

Form 2

| Type | Beginning balance | Term increase | | Term decrease | | Ending balance | Notes |
|------|-------------------|--|-------|--------------------------|-------|----------------|-------|
| | xxx | Purchased, produced or transferred during the term | Other | Disbursed or transferred | Other | xxx | xx |
| | xxx | | xx | | xx | xxx | xx |
| | xxx | | xx | | xx | xxx | xx |
| | xxx | | xx | | xx | xxx | xx |
| | xxx | | xx | | xx | xxx | xx |

Note 1: Written by inventory type.

Note 2: In 'other' in the column "term increase", the increase of inventories realized for reasons other than purchases, production or transfers from another account during the fiscal term (reasons such as re-evaluation differences generated by re-evaluation of assets) should be written, as well as the reasons for the increase.

Note 3: In "other" in the column "term decrease", the decrease in inventories realized for reasons other than disbursements for sales and use of inventories or transfer to another account (reasons such as re-evaluation differences generated by re-evaluation of assets) should be written, as well as the reasons for the decrease.

Form 3

| Type | Name of corporation, etc. | Assets | Liabilities | Net assets | Capital | Proportion of the government's contributions in the capital | Proportion of contributions from the special account in the capital | Calculated equity of the special account | Contributions from the special account | Difference |
|----------------------------------|---------------------------|--------|-------------|------------|---------|---|---|--|--|------------|
| Right generated by contributions | OO Corporation | xx | xx | xxx | xxx | xx | xx | xxx | xxx | xxx |
| Equity securities | OA Corporation | xx | xx | xxx | xxx | xx | xx | xxx | xxx | xxx |
| Stocks | ΔΔ Corporation | xx | xx | xxx | xxx | xx | xx | xxx | xxx | xxx |

Form 4

| Borrowing | Beginning balance | Term | | Ending balance |
|---------------------|-------------------|----------|----------|----------------|
| | | Increase | Decrease | |
| Financial loan fund | xxx | xxx | xxx | xxx |
| ___ Bank | xxx | xxx | xxx | xxx |
| ... | ... | ... | ... | ... |
| Total | xxx | xxx | xxx | xxx |

| Public bonds | Beginning balance | Term | | Ending balance | Coupon rate |
|---------------------------|-------------------|----------|----------|----------------|-------------|
| | | Increase | Decrease | | |
| Issue of ___ public bonds | xxx | xxx | xxx | xxx | xxx |
| Issue of ___ public bonds | xxx | xxx | xxx | xxx | xxx |
| ... | ... | ... | ... | ... | ... |
| Total | xxx | xxx | xxx | xxx | xxx |

Form 5

| | |
|---|--------|
| Items related to guarantee arrangements, etc. | Amount |
| Amount | xxx |
| Guarantee for the principal of borrowing by ___ | xxx |
| Guarantee for the principal of borrowing by ___ | ... |
| Total | xxx |

| | | |
|--|---------|--------|
| Items related to other major contingent liabilities and losses | Outline | Amount |
| ... | ... | xxx |
| ... | ... | xxx |
| Total | | xxx |

Form 6

| ___ program | | | | | |
|-----------------|--------|---------------------|--|--|---------|
| Counterparties | Amount | Type of expenditure | Connection with the state | | Purpose |
| | | | Capital connection | Personnel connection | |
| ___ Corporation | xxx | Subsidies | 50% contributed by the general account | Two of the three directors were previously employed at the Ministry of ___ | |
| ___ Corporation | xxx | Grants | 20% contributed by ___ special account | The chief director was previously employed at the Ministry of ___ | |
| Total | xxx | | | | |

5. Worksheets for public sector major financial statements

The Guidelines for the Preparation of Financial Documents for the Special Account, etc., assumes the use of worksheets in order to clarify the positioning of accounting (recording) which is interlinked throughout the entire system of public sector major financial statements. Refer to the attached worksheets for details.

Worksheets

| Item | Beginning balance | Recording no. | Debit | Recording no. | Credit | Ending balance |
|---|-------------------|---------------|-------|---------------|--------|----------------|
| Balance sheet | | | | | | |
| Assets | | | | | | |
| I. Funds | | | | | | |
| Cash | | 27 | 5 | | | |
| Cash equivalents: short-term receivables and payables (during the settlement period) | | | | | | |
| II. Non-fund assets | | 25 | 450 | | | |
| Receivables | | | | | | |
| Receivables and accrued income | | | | | | |
| General account retained specific resources | | 10 | 70 | | | |
| (exemption) Reversal of general account retained specific resources | | | | 12 | 70 | |
| Lending | | 25a | 30 | | | |
| Tangible fixed assets | | | | | | |
| Public assets (infrastructure assets) | | 25b | 330 | | | |
| (exemption) Accumulated direct capital consumption | | | | 18 | 50 | |
| Capital formation by tax funds (specific resources) | | 2 | 70 | | | |
| (exemption) Accumulated direct capital consumption | | | | 4 | 7 | |
| Capital formation by funds transferred from the general account | | 16 | 210 | | | |
| Assets belonging to the general account (such as harbors) | | | | | | |
| (exemption) Accumulated direct capital consumption | | | | 19 | 20 | |
| Capital formation by public bonds (special account bonds) | | 7 | 50 | | | |
| (exemption) Accumulated direct capital consumption | | | | 8 | 5 | |
| Public asset (infrastructure asset) elimination and sales | | | | | | |
| (exemption) Recording of public asset (infrastructure asset) elimination and sales | | | | 13 | 100 | |
| Recording of accumulated direct capital consumption elimination and sales | | 13 | 20 | | | |
| Re-evaluation differences: public assets (infrastructure assets) | | 23 | 10 | 20 | 15 | |
| Investments, etc. | | | | | | |
| Government contributions, etc. | | 25c | 90 | | | |
| Liabilities | | | | | | |
| Public bonds (special account bonds) | | | | | | |
| Accumulated issues of public bonds (special account bonds) | | | | 6 | 50 | |
| Accumulated public bond (special account bond) principal redemptions | | 9 | 1 | | | |
| Debts transferred to the general account | | 28 | 50 | | | |
| General account adjustments | | | | | | |
| I. Capital formation by funds transferred from the general account | | | | | | |
| Liabilities collateral to asset formation by funds transferred from the general account | | | | 17 | 210 | |
| (exemption) Liabilities collateral to asset formation by funds transferred from the general account (amount equivalent of direct capital consumption) | | 22 | 20 | | | |
| II. Transfers of debts to the general account, etc. | | | | 28 | 50 | |
| III. Liabilities collateral to general account retained specific resources | | | | 10 | 70 | |
| (exemption) Reversal of general account retained specific resources (changing to resource budgets) | | 11 | 70 | | | |
| Taxpayers' equity | | | | | | |
| I. Capital formation by tax funds (specific resources) | | | | | | |
| Liabilities collateral to asset formation by tax funds (specific resources) | | | | 3 | 70 | |
| (exemption) Liabilities collateral to asset formation by tax funds (specific resources) (total of direct capital consumption) | | 5 | 7 | | | |
| Resource budgets changed from liabilities collateral to asset formation by tax funds (specific resources) in a lump sum (in case of elimination or sales) | | 14 | 80 | | | |
| II. Accumulated resource budget increase and decrease (financial resource surpluses) | | | | | | |
| III. Accumulated direct capital consumption | | | | | | |

| | | | | | | |
|---|--|-----|-----|-----|-----|---|
| IV. Accumulated asset and liability re-evaluation differences | | | | | | |
| V. Unidentified balance at the commencement (no change in principle) | | | | | | |
| | | | | | | |
| Net operating cost statement | | | | | | |
| | | | | | | |
| Expenses | | | | | | |
| I. Operating expenses | | 24a | 550 | | | |
| Personnel expenses | | | | | | 1 |
| Traveling expenses | | | | | | 2 |
| Non-personnel expenses | | | | | | 3 |
| Subsidies and commissions | | | | | | 5 |
| Interest payment expenses | | | | | | 9 |
| II. Non-fund operating expenses | | | | | | |
| Depreciation expenses (in case income corresponding to depreciations is expected) | | | | | | |
| III. Non-operating expenses | | 24b | 170 | | | |
| Fixed asset elimination and sales losses (in case income corresponding to depreciations is expected) | | | | | | |
| | | | | | | |
| Income | | | | | | |
| I. Operating income | | | | | | |
| II. Non-operating income | | | | | | |
| Fixed asset sales profits (in case income corresponding to depreciations is expected) | | | | | | |
| | | | | | | |
| Operating income and expense | | | | | | |
| Non-operating income and expense | | | | | | |
| Net operating costs (total of operating income and expense and non-operating income and expense) | | | | 15 | 600 | |
| | | | | | | |
| Changes in net assets (taxpayers' equity) statement | | | | | | |
| | | | | | | |
| Decrease of net assets (taxpayers' equity) | | | | | | |
| I. Decrease of resource budgets | | 26a | 800 | | | |
| Resource budgets for net operating costs | | 15 | 600 | | | |
| Resource budgets for capital formation by tax funds (specific resources) | | 3 | 70 | | | |
| Resource budgets for capital formation by funds transferred from the general account | | 17 | 210 | | | |
| Social capital elimination and sales losses | | 13c | 30 | | | |
| II. Direct capital consumption (amount equivalent of depreciations) | | 18 | 50 | | | |
| Direct capital consumption for capital formation by tax funds (specific resources) | | 4 | 7 | | | |
| Direct capital consumption for capital formation by funds transferred from the general account | | 19 | 20 | | | |
| Direct capital consumption for capital formation by public bonds (special account bonds) | | 8 | 5 | | | |
| III. Asset and liability re-evaluation losses | | 20 | 15 | | | |
| | | | | | | |
| Increase of net assets (taxpayers' equity) | | | | | | |
| I. Increase of resource budgets | | | | 26 | 805 | |
| Tax funds (specific resources) | | | | 1 | 100 | |
| Funds transferred from the general account | | | | 21 | 300 | |
| Reversal of liabilities collateral to general account retained specific resources (changing to resource budgets) | | | | 11 | 70 | |
| Transfers of capital formation (net assets collateral to asset formation) to resource budgets | | | | | | |
| Resource budgets changed from liabilities collateral to asset formation by tax funds (specific resources) (amount equivalent of direct capital consumption) | | | | 5 | 7 | |
| Resource budgets changed from liabilities collateral to asset formation by tax funds (specific resources) in a lump sum (in case of elimination or sales) | | | | 14 | 80 | |
| Resource budgets changed from liabilities collateral to asset formation by funds transferred from the general account (amount equivalent of direct capital consumption) | | | | 22 | 20 | |
| Social capital elimination and sales profits | | | | 13d | 15 | |
| II. Asset and liability re-evaluation profits | | | | 23 | 10 | |
| | | | | | | |
| Resource budget increase and decrease (financial resource surpluses) | | 26b | 5 | 27 | 5 | |
| Direct capital consumption | | | | | | |

Classification by expenditure purposes (code numbers)

1
2
3
5
9

| | | | | | | | | |
|---|--|-----|---------------|-----|-------------------|--|--|-------|
| Asset and liability re-evaluation differences | | | | | | | | |
| Changes in net assets (taxpayers' equity) | | | | | | | | |
| Public sector accounting cash flow statement | | | Fund revenues | | Fund expenditures | | | |
| Current revenues and expenditures | | | | | | | | |
| I. Current expenditures | | | | 24 | 720 | | | 10 |
| Current expenditures (narrow sense: non- ordinary transfer expenditures) | | | | | | | | |
| Personnel expenses | | | | | | | | 11 |
| Traveling expenses | | | | | | | | 11 |
| Non-personnel expenses | | | | | | | | 12 |
| Subsidies and commissions | | | | | | | | 40 |
| Ordinary transfer expenditures (transfers to local entities and to other accounts) | | | | | | | | 70 30 |
| Public bond (special account bond) interest payment expenses | | | | | | | | 95 30 |
| II. Current revenues | | | | | | | | |
| Tax fund (specific financial resource) revenue | | 1 | 100 | | | | | |
| Revenue from reversal of general account retained specific resources | | 12 | 70 | | | | | |
| Revenue of funds transferred from the general account (excluding issues of construction bonds) | | 21b | 120 | | | | | |
| Special account short-term borrowing revenue | | | | | | | | |
| Social capital elimination and sales revenue | | 13b | 50 | | | | | |
| Social capital elimination and sales revenue | | 13d | 95 | | | | | |
| Current revenues and expenditures | | | | | | | | |
| Cash | | | | | | | | |
| Short-term receivables and payables (during the settlement period) | | | | | | | | |
| Capital revenues and expenditures | | | | | | | | |
| I. Capital expenditures | | | | 25 | 450 | | | |
| Capital expenditures (narrow sense: non-capital transfer expenditures) | | | | | | | | |
| Capital formation expenditures | | | | 25b | 330 | | | 20 |
| Expenditures for public assets (infrastructure assets) | | | | | | | | |
| Expenditures for capital formation by tax funds | | | | 2 | 70 | | | 20 |
| Expenditures for capital formation by funds transferred from the general account | | | | 16 | 210 | | | 20 |
| Expenditures for capital formation by public bonds (special account bonds) | | | | 7 | 50 | | | 20 |
| Purchases of land or intangible assets | | | | | | | | 94 |
| Civil servants' housing expenses | | | | | | | | 93 |
| Contributions | | | | 25c | 90 | | | 95 30 |
| Long-term lending | | | | 25a | 30 | | | 95 |
| Public bond (special account bond) principal redemption expenditures | | | | 9 | 1 | | | 95 30 |
| Capital transfer expenditures (transfers to local entities and to other accounts) | | | | | | | | |
| Capital transfer expenditures to local entities | | | | | | | | 82 |
| Other capital transfer expenditures | | | | | | | | 92 |
| II. Capital revenues | | | | | | | | |
| Revenue from funds transferred from the general account (issues of construction bonds) | | 21a | 180 | | | | | |
| Revenue from issues of public bonds (special account bonds) | | 6 | 50 | | | | | |
| Special account long-term borrowing revenue | | | | | | | | |
| Capital revenues and expenditures | | | | | | | | |
| Cash | | | | | | | | |
| Short-term receivables and payables (during the settlement period) | | | | | | | | |
| Fund revenues and expenditures (total of current revenues and expenditures and capital revenues and expenditures) | | | | | | | | |
| Cash | | | | | | | | |
| Short-term receivables and payables (during the settlement period) | | | | | | | | |