The EU & Greece

“No Accountability for Debt Relief and Failed State-Building”

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JAPONICA PARTNERS

JAPONICA PARTNERS is an entrepreneurial investment firm that makes concentrated investments in underperforming global special situations.

JAPONICA PARTNERS core competency is ***D-C-C:***

Discovering value gaps.
Changing cultures and misperceptions.
Creating value through hands on management.

JAPONICA PARTNERS IS A PRIVATE FIRM AND IS NOT A FUND, NOR DOES IT PROVIDE INVESTMENT ADVICE. JAPONICA IS A LARGE INVESTOR IN GREECE GOVERNMENT BONDS.

The “Trinity” for Prosperity in Greece

#1. For prosperity in Greece, the Greece ministers’ first priority must be to **build trust and confidence** with all stakeholders.

#2. To build trust and confidence, Greece ministers **must make transparency and accountability** of government finances their most important reform.

#3. And, the starting point for transparency and accountability in Greece is accurate government financial information **obtained through international public sector accounting standards and audits**.

Accurate Debt Numbers Really Matter

Greece debt numbers really matter – big time – in no small part because this number is used to drive:

#1. Greece **revenue and spending policies** designed by the "Partners". Depending on your perspective, these policies are either needed reforms or inhumane austerity.

#2. Greece out of the **ECB's quantitative easing** programs and caused higher collateral haircuts, which stifle liquidity and increase borrowing costs. See Bagehot-principle and ICMA papers.

#3. IMF Greece DSA 2015. Each point in debt to GDP above 60% increases **borrowing costs** four basis points. See FN 3, Laubach.

“True & Fair” is the Law

You would be shocked to learn how many people do not know that **“true and fair” financial accounts are the law** irrespective of codification of accounting methods.

Inaccurate Numbers are More the Norm than Accurate Numbers

Research findings on **opposing perspectives** of stakeholders:

Many (not all) politicians, economists, lawyers, and bureaucrats see creative accounting and form over substance financial information as a positive virtue.

Most (if not all) accountants and non-clientele stakeholders view creative accounting as illegal fraud and contrary to good public policy.

Hiding Debt Relief for Political Reasons

Creditors have the misguided belief that hiding the debt relief losses from their financial statements provides political gain.

Debtor has the misguided belief that hiding the reduction in debt from relief will gain more hand-outs from the EU and provide excuses for poor performance.

Some Have Addressed Greece Debt Relief but Do NOT Include in Creditor or Debtor Financial Statements

ESM estimates debt relief at "49% of Greece's 2013 GDP" using a 10-year historical bund and theoretical market spread methodology. Annual Report 2014.

IMF in unmarked June 2015 Greece DSA notes that debt relief is in net present value terms from a market perspective but that this does not imply "budgetary costs for creditors". Page two of 25 June Preliminary DSA for Greece.

Respected think-tank analyst notes that Greece has received massive debt relief, but does not believe that creditors should be required to show a symmetrical loss or – indeed – any loss (also known as a capital transfer in ESA/SNA) on the performance statement, and especially disagrees with using market rates to measure the loss.

Manual on Government Deficit and Debt (MGDD): Misinterpretations

The MGDD, which claims to provide "necessary clarification" and "useful practical guidance" for national accountants in the context of calculating restructured and concessional debt, misinterprets ESA 2010 and 2008 SNA and should be corrected. (See MGDD 2014 page 354.)

The misinterpretations lead to incorrect accounting for Greece restructured and concessional debt.

A comparison of the MGDD interpretation of the sections cited with the actual section text confirms the misinterpretations and the importance of correcting the text.

ESA 2010 and 2008 SNA are harmonized.

ESA Rescheduling

Debt operations

20.221 Debt operations can be particularly important for the general government sector, as they often serve as a means for government to provide economic aid to other units. The recording of these operations is covered in Chapter 5. The general principle for any cancellation or assumption of debt of a unit by another unit, by mutual agreement, is to recognise that there is a voluntary transfer of wealth between the two units. This means that the counterpart transaction of the liability assumed or of the claim cancelled is a capital transfer. No flow of money is usually observed, this may be characterised as a capital transfer in kind.

Other debt restructuring

20.236 Debt restructuring is an agreement to alter the terms and conditions for servicing an existing debt, usually on more favourable terms for the debtor. The debt instrument that is being restructured is considered to be extinguished and replaced by a new debt instrument with the new terms and conditions. If there is a difference in value between the extinguished debt instrument and the new debt instrument, it is a type of debt cancellation and a capital transfer is necessary to account for the difference.

Chapter 5: Valuation

5.19 Financial transactions are recorded at transaction values, that is, the values in national currency at which the financial assets and/or liabilities involved are created, liquidated, exchanged or assumed between institutional units, on the basis of commercial considerations.

5.20 Financial transactions and their financial or non-financial counterpart transactions are recorded at the same transaction value. There are three possibilities:

(c) neither the financial transaction nor its counterpart transaction is a transaction in cash or via other means of payment: the transaction value is the current market value of the financial assets and/or liabilities involved.

5.21 The transaction value refers to a specific financial transaction and its counterpart transaction. In concept, the transaction value is to be distinguished from a value based on a price quoted on the market, a fair market price, or any price that is intended to express the generality of prices for a class of similar financial assets and/or liabilities. However, in cases where the counterpart transaction of a financial transaction is, for example, a transfer and therefore the financial transaction may be undertaken other than for purely commercial considerations, the transaction value is identified with the current market value of the financial assets and/or liabilities involved.

SNA Rescheduling

Debt reorganization

22.106 There are four main types of debt reorganization:

b. Debt rescheduling or re-financing. A change in the terms and conditions of the amount owed, which may result or not in a reduction in burden in present value terms.

Debt rescheduling and refinancing

22.109 *Debt rescheduling (or refinancing)* is an agreement to alter the terms and conditions for servicing an existing debt, usually on more favourable terms for the debtor. Debt rescheduling involves rearrangements on the same type of instrument, with the same principal value and the same creditor as with the old debt. Refinancing entails a different debt instrument, generally at a different value and may be with a creditor different than that from the old debt.

22.110 Under both arrangements, the debt instrument that is being rescheduled is considered to be extinguished and replaced by a new debt instrument with the new terms and conditions. If there is a difference in value between the extinguished debt instrument and the new debt instrument, part is a type of debt forgiveness by government and a capital transfer is necessary to account for the difference.

22.111 *Debt rescheduling* is a bilateral arrangement between the debtor and the creditor that constitutes a formal deferment of debt-service payments and the application of new and generally extended maturities. The new terms normally include one or more of the following elements: extending repayment periods, reductions in the contracted interest rate, adding or extending grace periods for the repayment of principal, fixing the exchange rate at favourable levels for foreign currency debt, and rescheduling the payment of arrears, if any.

22.112 The treatment for debt rescheduling is that the existing contract is extinguished and a new contract created. The applicable existing debt is recorded as being repaid and a new debt instrument (or instruments) of the same type and with the same creditor is created with the new terms and conditions.

22.113 The transaction is recorded at the time both parties record the change in terms in their books, and is valued at the value of the new debt.

MGDD vs ESA: Rescheduling

Manual on Government Deficit and Debt

Implementation of ESA 2010

VII.3.3.2 Rescheduling of a loan

22. There is no real guideline for trea0ing such a case in ESA 2010. Mention is only made of debt restructuring in ESA 2010 20.236 which states the same principle related to the difference in value (without specifying that it is in nominal terms). It is mentioned in 2008 SNA but in a rather descriptive way indicating only in 20.107 b that it "may or may not result in a reduction in present value terms" whereas there is no mention of a possible capital transfer. Therefore, this manual brings a necessary clarification and in useful practical guidance for national accountants.

ESA 2010

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MGDD vs SNA: Rescheduling

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System of National Accounts 2008

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MGDD vs ESA: Concessional Loans

Manual on Government Deficit and Debt

Implementation of ESA 2010

V.6.1 Background of the issue

1. As a part of public policy activities, governments provide loans at a lower interest rate than the market rate observed at the time of loan issuance (sometimes called "concessional loans").

V.6.2 Recording of low interest rate loans at inception

6. In this context, the interest has to be recorded on the basis of the contractually agreed interest rate. Consequently, no implicit benefit for the debtor is recorded in national accounts.

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ESA 2010

20.241 Debt issued on concessional terms. There is no precise definition of concessional loans, but it is generally accepted that they occur when units of the general government sector lend to other units in such a way that the contractual interest rate is intentionally set below the market interest rate that otherwise would apply. The degree of concessionality can be enhanced with grace periods, frequencies of payments, and a maturity period favourable to the debtor. Since the terms of a concessional loan are more favourable to the debtor than market conditions would otherwise permit, concessional loans effectively include a transfer from the creditor to the debtor.

20.242 Concessional loans are recorded at their nominal value just as other loans, but a capital transfer is recorded as a memorandum item at the point of loan origination equal to the difference between the contract value of the debt and its present value using a relevant market discount rate. There is no single market interest rate that should be used to measure the capital transfer. The commercial interest reference rate published by the OECD may be applicable when the loan is issued by one of its member countries.

MGDD vs SNA: Concessional Loans

Manual on Government Deficit and Debt
Implementation of ESA 2010

MGDD 2014 Comment on 2008 SNA: **[**Contains no comment on SNA.**]**

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System of National Accounts 2008

22.123 *Debt issued on concessional terms.* There is no precise definition of concessional loans, but it is generally accepted that they occur when units lend to other units and the contractual interest rate is intentionally set below the market interest rate that would otherwise apply. The degree of concessionality can be enhanced with grace periods, frequencies of payments and a maturity period favourable to the debtor. Since the terms of a concessional loan are more favourable to the debtor than market conditions would otherwise permit, concessional loans effectively include a transfer from the creditor to the debtor.

22.124 Loans with concessional interest rates to a foreign government could be seen as providing a current transfer equal to the difference between the actual interest and the market equivalent interest. If such a transfer were recognized, it would usually be recorded as current international cooperation, and the interest recorded would be adjusted by the same amount. However, the means of incorporating the impact within the SNA and international accounts have not been fully developed, although various alternatives have been advanced. Accordingly, until the appropriate treatment of concessional debt is agreed, information on concessional debt should be provided in supplementary tables.

Debt Relief of €340 Billion Granted to Greece: 2010-2013

	Creditor Funds Provided	Value of Creditor Funds Post Debt Relief	Debt Relief
Private Investors	€199 billion	€50 billion	-€149 billion
Official Investors	€243 billion	€52 billion	-€191 billion
Total	€442 billion	€102 billion	**-€340 billion**
% of GDP			**189%**

Debt Measurement Frameworks

	International Accounting Standards		International Statistics Systems		Lender Rules			
	IPSAS/IFRS/US GAAP		2008 SNA/ESA 2010		IMF GFSM 2014		Maastricht EDP	
	Initial	**Subsequent**	**Initial**	**Subsequent**	**Initial**	**Subsequent**	**Initial**	**Subsequent**
Publicly Traded Debt Securities	Fair Value	Amortized Cost	Market	Market	Market	Market	Nominal	Nominal
Restructured Securities	Fair Value	Amortized Cost	Market	Market	Market	Market	Nominal	Nominal
Restructured Loans	Fair Value	Amortized Cost	Market	Cost	Nominal	Nominal	Nominal	Nominal
Concessional Securities	Fair Value	Amortized Cost	Market	Market	Market	Market	Nominal	Nominal
Concessional Loans	Fair Value	Amortized Cost	Nominal	Nominal	Nominal	Nominal	Nominal	Nominal
Refinanced Debt	Fair Value	Amortized Cost	Market	Market	Market	Market/Cost	Nominal	Nominal
Refinanced Debt - Official Sector	Fair Value	Amortized Cost	Market	Market	Nominal	Nominal	Nominal	Nominal

Greece Balance Sheet Matrix of Valuation Alternative by Type of Debt and Financial Assets

(€, Billions; Numbers for Illustrative Purposes)

SN	Type of Instrument	IPSAS/IFRS Value	Face/Nominal Value	Amortized Cost	Market Value	Face/Nominal Value
				Yes Indicates Selected Valuation Methodology		
	DEBT INSTRUMENTS					
1.	T-Bills	€ 15	€ 15			
2.	GGBs - Publicly Held	€ 14	€ 32			
3.	GGBs - ECB/NCB Held	€ 7	€ 27			
4.	GLF/EFSF Loans	€ 45	€ 195			
5.	IMF Loans	€ 16	€ 24			
6.	Other Bonds	€ 3	€ 3			
7.	Other Loans - Officially Held	€ 12	€ 12			
8.	Derivatives	€ 5	€ 5			
9.	Repos	€ 9	€ 9			

SN	Type of Instrument	*Valuation Method TBD*	Amortized Cost	Market Value	Face/Nominal Value
			Yes Indicates Selected Valuation Methodology		
	FINANCIAL ASSETS				
1.	Currency & Deposits	€ 17			
2.	Debt Securities Held for Trading	€ 2			
	Debt Securities Held to Maturity	€ 16			
3.	Loans	€ 4			
4.	Equity Investment - Listed	€ 7			
5.	Equity Investment - Private/Other	€ 21			
6.	Insurance Reserves	€ 0.1			
7.	Financial Derivatives	€ 0			

Correctly Calculating Debt Relief from Prior Restructurings

(€, Billions)

SN	Type of Debt	Before Debt Relief	Debt Relief 2010-2012 *(Four events: 2010, 2011, and two in 2012)*	After Debt Relief
1.	Loans	€ 213	Interest rates reduced from over 5% to as low as 0%. Maturities extended from as short as five years to as long as 45 years.	€ 60
2.	Bonds	€ 63	Interest rates reduced from as high as 7.5% to as low as less than negative 4%. Maturities extended from as short as less than one year to as long as 30 years.	€ 20
3.	Other Debt, incl. T-bills	€ 44	No change.	€ 44
4.	Gross Debt	€ 319		€ 124
5.	Gross Debt as % of GDP	175%		68%
6.	Financial Assets	€ 91		€ 91
7.	Net Debt	€ 228		€ 33
8.	Net Debt as % of GDP	125%		18%
9.	GDP Estimate	€ 182		

As of 31 December 2013. Highlights summarize the range of terms.

Net Debt to GDP Using International Accounting Standards was 1/4 of Peers

(€, billions; 2013 data except as noted.)

		Greece	Peer Average	Post-Programme Countries			
				Ireland	Spain	Portugal	Italy
1.	Maastricht Debt/GDP	**175%**	**120%**	124%	94%	129%	133%
2.	GDP	€ 182		€ 164	€ 1,023	€ 166	€ 1,560
3.	Maastricht Debt (EDP)	€ 319		€ 203	€ 961	€ 214	€ 2,069
	IPSAS/IFRS:						
4.	Gross Debt	€ 124		€ 189	€ 940	€ 185	€ 2,069
5.	Financial Assets	€ 91		€ 65	€ 292	€ 69	€ 317
6.	Net Debt	€ 33		€ 125	€ 647	€ 116	€ 1,752
7.	Net Debt/GDP	**18%**	**80%**	76%	63%	70%	112%
8.	IAS Impacted Debt	€ 275		€ 62	€ 41	€ 72	€ 0

GREECE IPSAS/IFRS NET DEBT HAS BEEN INDEPENDENTLY VERIFIED ON 15 AUGUST 2014.

Note: Financial Assets data from Eurostat, Financial Balance Sheets 2013 data (accessed on 31 May 2014), except Ireland, Italy, and Spain (2012); Greece data also noted in the IMF, 5th Review for Greece, June 2014, page 51.

Accountants and Auditors Must Show Their Value-Add to Decision-Makers

1. Educate economists on how **analyzing financial statements** **provides valuable insights**.
2. Educate politicians and bureaucrats on how using the financial statement framework **improves performance**.
3. Educate stakeholders on how independent audits **builds trust and confidence**.