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**Requirements for Issuing, Managing and
Reporting Instruments of Assurance**

Policy & Guidelines Paper

Preface

The *Requirements for Issuing, Managing and Reporting Instruments of Assurance Policy* (the Policy) has been prepared by NSW Treasury to assist Agencies with managing and reporting guarantees, indemnities, warranties and letters of comfort (collectively referred to as Instruments of Assurance).

The Policy sets out both the internal record-keeping requirements and Treasury reporting requirements, as well as the extent to which risk management assessments and management procedures must be applied to Instruments of Assurance.

While Instruments of Assurance are a necessary part of the delivery of services and programs by the NSW public sector, Agencies also have obligations to ensure effective and efficient financial management of any instruments that might result in a liability being created for the Agency and for the State.

Commitments of this nature must be supported by robust processes to remove or minimise the risk that a commitment will be entered into without appropriate authority, resulting in breach of an Agency's duties. The absence of proper consideration and management may result in risks arising that a commitment will not be clearly understood and appropriately addressed by an Agency.

This Policy has been developed to encourage enhanced visibility and effective risk management of Instruments of Assurance to assist Agencies to protect the integrity of their financial management.

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Note

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This publication can be accessed from the Treasury website www.treasury.nsw.gov.au.

Contents

	Page
Preface	1
Executive Summary	3
Definitions	4
Part A: Context	6
Purpose	6
Application of the Policy	6
Monitoring of Policy Compliance	7
Part B: Policy	8
Core Requirement 1 - Relevant authority	9
Core Requirement 2 - Risk assessment and management	10
Core Requirement 3 – Instruments of Assurance Register	12
Core Requirement 4 - Reporting Instruments of Assurance	14

Executive Summary

The *Requirements for Issuing, Managing and Reporting Instruments of Assurance Policy* (the Policy) is issued as a Treasurer's Direction to all Agencies.

This Policy outlines reporting requirements and assists Agencies to assess and manage the risks related to issuing Instruments of Assurance. The Policy aims to strengthen governance across the NSW public sector by establishing greater visibility and accuracy of contingent liability exposure through Instruments of Assurance.

To support this purpose, the Policy outlines four core requirements, which detail Agencies' obligations regarding risk assessment, management, and reporting of Instruments of Assurance:

- Core Requirement 1** The Agency Head is responsible for ensuring that an Officer of the Agency, and/or the Agency itself, has the relevant authority to issue a proposed Instrument of Assurance.
- Core Requirement 2** An Agency must undertake and document a risk assessment of any proposed Instrument of Assurance prior to approving the instrument to be issued. The Agency must continue to manage, and regularly assess and review, the risks associated with any Instruments of Assurance for the life-cycle of the instrument.
- Core Requirement 3** Agencies must record all approved Instruments of Assurance with a potential liability exceeding \$100,000 in an internal Agency register, as well as any other Instruments of Assurance that the Agency considers material.
- Core Requirement 4** Agencies must report the details of all issued Instruments of Assurance with a potential liability exceeding \$1,000,000 to Treasury as part of the Agency's financial reporting obligations.

The Policy should be read alongside the other Policy and Guidelines papers as well as relevant Treasury Circulars that apply to Instruments of Assurance, including:

- Accounting Policy: Accounting for Financial Instruments (TPP08-01)
- Applications for Government Guarantees (TC10-14).

This Policy is effective from 1 July 2017.

Definitions

For the purposes of this Policy, the following definitions apply.

Agency: an Entity considered material for whole of government purposes and listed in the budget papers as a “material entity controlled by the NSW Government”.

Agency Head:

- in relation to an Agency that is a Department, the department head as identified in column 2 of Schedule 3 of the PFA Act, or
- in relation to an Agency that is a statutory body listed in Schedule 2 to the PFA Act, the chief executive officer or the person who exercises the functions of a chief executive officer in relation to the statutory body, or
- in relation to any other Entity that is an Agency, the chief executive officer or the person who exercises the functions of a chief executive officer in relation to that Entity, or the person who manages the affairs of the Entity.

Contingent liability:

- a liability that cannot be reliably measured, or
- a potential liability that will only arise as an obligation of the Agency upon the occurrence of a triggering event, or
- a potential liability where an outflow of resources is currently not probable¹.

Crown: the Crown in right of the State of New South Wales.

Department is a reference to a person, group of persons or body specified in column 1 of Schedule 3 to the PFA Act.

Entity includes departments, statutory authorities and other entities falling within the meaning of “authority” for the purposes of the PFA Act, but does not include State Owned Corporations, local government authorities or universities.

Guarantee refers to a promise whereby one party assumes responsibility for the debt, or performance obligations, of another party should that party default in some way. A guarantee will either give rise to a liability or a contingent liability, depending on whether there is present obligation.²

Indemnity refers to a legally binding promise whereby one party undertakes to accept the risk of loss or damage another party may suffer. An indemnity will either give rise to a liability or a contingent liability, depending on whether there is a present obligation.³

¹ This definition is intended to align with the definition of a ‘contingent liability’ contained in AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*

² This definition is intended to align with that contained in Australian Government Department of Finance – Resource Management Glossary and Acronyms at <http://www.finance.gov.au/resource-management/introduction/glossary/>

³ Ibid.

Instruments of Assurance means guarantees, indemnities, warranties and letters of comfort whether they form the whole subject of the instrument or are given as part of a larger transaction document.

Letters of comfort include:

- assurances that are generally intended to offer some reassurance as to a state of affairs short of a legally binding promise; and
- letters of financial support (letters of support) provided to a party. These may be legally binding.

Officer of an Agency:

- a Public Service employee as defined in section 3(1) of the *Government Sector Employment Act 2013* in relation to that Agency, or
- a member of, person appointed to, or person employed by, a statutory authority that is an Agency⁴.
- in relation to the NSW Police Force-a member of the NSW Police Force,
- in relation to the Teaching Service-an officer or temporary employee of that Service.

PFA Act: the *Public Finance and Audit Act 1983* as amended from time to time.

Portfolio Minister: the Minister having administrative responsibility for the Agency or the legislation under which the Agency is constituted.

Triggering event refers to an event, outside the control of the Agency, that causes an existing contingent liability to crystallise into a liability for an Agency.

Warranty refers to a promise whereby one party provides certain assurances to another party. A warranty will either give rise to a liability or a contingent liability, depending on whether there is a present obligation.⁵

⁴ This definition is intended to align with the definition of an 'officer of an authority' contained in section 4(1) of the PFA Act.

⁵ This definition is intended to align with that contained in Australian Government Department of Finance – Resource Management Glossary and Acronyms at <http://www.finance.gov.au/resource-management/introduction/glossary/>

Part A: Context

Purpose

The Policy provides a clear and consistent approach to the management of Instruments of Assurance, through the development and implementation of a risk-based approach to the issuance of such instruments, and clarification of Agency reporting requirements.

The development of an effective management framework for Instruments of Assurance will ensure that Agencies:

- are aware of their contingent liabilities in regards to Instruments of Assurance
- are able to appropriately recognise, measure and disclose such instruments in their accounts and in the Total State Sector Accounts
- are able to reduce the number of Instruments of Assurance with high risk profiles held by the Agency
- comply with relevant laws, policies and regulations, and
- obtain, maintain, report and have access to reliable and timely information to inform their decision-making.

This Policy should be read in conjunction with the following NSW Treasury Policy Papers and Treasury Circulars:

- Accounting Policy: Accounting for Financial Instruments (TPP08-01)
- Applications for Government Guarantees (TC10-14).

Application of the Policy

This Policy is issued as a Treasurer's Direction to:

- 'Department heads' under section 18 of the *Annual Reports (Departments) Act 1985*
- 'Statutory bodies' under section 15 of the *Annual Reports (Statutory Bodies) Act 1984*
- 'Officers of an authority' and 'accounting officers' under section 9 of the *Public Finance and Audit Act 1983*.

This Policy does not apply to local government authorities, universities and Entities otherwise not coming within the definition of Agency for the purposes of this Policy. State Owned Corporations may be requested to apply the Core Requirements of this Policy in their Statement of Corporate Intent.

This Policy applies to all Instruments of Assurance issued by, or on behalf of, Agencies.

This Policy also covers Instruments of Assurance that were not issued by, or on behalf of, an Agency but which subsequently are transferred, or assigned to, or vested in, that Agency.

Monitoring of Policy Compliance

Compliance by Agencies with the Policy allows Treasury to better manage the risks associated with the State's exposure to contingent liabilities.

The Auditor-General may undertake an assurance role in monitoring the sector's compliance with the Core Requirements outlined in the Policy.

Treasury will, on a periodic basis and at least once each five (5) years, review the operation of the Policy to assess the efficiency and effectiveness of the arrangements, as well as to assess Agency compliance with the Core Requirements of the Policy. Version updates to the Policy may also take place between these formal reviews and Agencies will be notified accordingly.

Part B: Policy

This Policy outlines four Core Requirements that must be adopted by Agencies when managing and reporting on their use of Instruments of Assurance.

Instruments of Assurance broadly refer to arrangements that are used by Agencies to:

- guarantee responsibility for a debt or performance obligation of the Agency and/or a third party, in the event of default
- provide promises (in the form of warranties) to a third party relating to an agreement
- indemnify a third party by providing a legally binding promise that the Agency will accept the risk of loss or damage that a third party might suffer, or
- assure a third party as to the financial state of affairs of the Agency.

Instruments of Assurance are an important component of the business of government. Agencies should have the capabilities and resources to enter into Instruments of Assurance where these are necessary to their service delivery obligations. The use of such instruments, however, increases the exposure of the State to liabilities that might arise where the performance of the Agency and/or third party does not satisfy the terms of the assurance provided.

Sound financial management requires that Agencies implement systems, processes and procedures to effectively manage Instruments of Assurance and the risks that arise from utilising such instruments. These responsibilities are supported by various Treasury Policy and Guidelines Papers, including *Certifying the Effectiveness of Internal Controls over Financial Information* (TPP 14-05), and the *Internal Audit and Risk Management Policy for the NSW Public Sector* (TPP 15-03). These Policies require Agencies to certify the effectiveness of their system of internal controls, and to attest to the efficacy of their internal audit and risk management frameworks, respectively. Further guidance on designing and implementing robust risk management frameworks can be found in the *Risk Management Toolkit* (TPP 12-03).

Core Requirements 1 to 4 provide Agencies with specific and clear requirements for issuing, managing and reporting on Instruments of Assurance.

Core Requirement 1 Relevant authority

The Agency Head is responsible for ensuring that an Officer of the Agency, and/or the Agency itself, has the relevant authority to issue a proposed Instrument of Assurance.

- 1.1 Before issuing an Instrument of Assurance, the Agency Head must be satisfied that:
- the Officer of the Agency and/or the Agency itself, has the necessary statutory authority to issue the Instrument of Assurance, and
 - the Agency has legally available sources of funds to support any financial commitment made when issuing an Instrument of Assurance.

If an officer of any authority, as defined in the PFA Act (which includes Officers of an Agency), executes an Instrument of Assurance that involves the commitment of expenditure, that officer is required by s.12 of the PFA Act to hold an appropriate delegation. Section 12(3) of the PFA Act prohibits officers of authorities (Agencies), without Treasurer authorisation, from incurring liabilities that would result in a payment out of the Consolidated Fund in excess of the amount to be provided out of that fund in accordance with an Appropriation Act or the PFA Act.

Agencies should not approve and issue any Instrument of Assurance that may cause the Agency to incur a liability that exceeds the Agency's financial ability to honour.

- 1.2 In the absence of express statutory authority to enter into an Instrument of Assurance, the Agency Head can request that their Portfolio Minister approve the issue of an Instrument of Assurance on behalf of the Agency. The Crown has executive power to issue Instruments of Assurance through Ministers and the Ministers' duly authorised officers with respect to matters falling within the relevant Minister's portfolio, except to the extent that this power has been curtailed by statute⁶. The Agency Head is responsible for ensuring that any potential financial commitment created by an Instrument of Assurance approved by a Portfolio Minister on behalf of an Agency is supported by legally available funds.
- 1.3 Agencies must seek legal advice regarding the authority to issue Instruments of Assurance in any circumstances in which the relevant authority is unclear.

⁶ The Crown Solicitor has advised that there is residual executive power of the Crown to give guarantees to the extent that this power is not regulated by legislation. In particular, the Crown Solicitor has advised that the *Public Authorities (Financial Arrangements) Act 1987* regulates the giving of guarantees with respect to arrangements regulated by that Act.

Core Requirement 2 Risk assessment and management

An Agency must undertake and document a risk assessment of any proposed Instrument of Assurance prior to approving the instrument for issue. The Agency must continue to manage and regularly assess and review the risks associated with any Instruments of Assurance for the life-cycle of the instrument.

- 2.1 Agencies must undertake and document a risk assessment prior to approving the issue of an Instrument of Assurance. Agencies must undertake such an assessment regardless of whether the proposed Instrument of Assurance is to be issued under a statutory power or in reliance of the Crown executive power and whether issued by the Agency or by the Crown in relation to an obligation of the Agency.
- 2.2 Where the Agency did not issue the Instrument of Assurance but the instrument has since been transferred or assigned to, or vested in, the Agency, the Agency must, where possible, prior to the transfer, assignment or vesting of the instrument undertake and document a risk assessment. Where this is not feasible, this risk assessment must be done as soon as possible after the transfer, assignment or vesting has occurred.
- 2.3 The risk assessment must consider the following:
- whether the Agency is the most appropriate entity to be issuing the Instrument of Assurance, or whether there are other more suitable parties
 - maximum financial exposure that would be adopted by both the Agency and the Crown upon issuance of an Instrument of Assurance
 - form of the instrument (guarantee, indemnity, warranty or letter of comfort)
 - nature and type of triggering events
 - the appropriate length of time for which the Instrument of Assurance should apply or be available
 - probability of the occurrence of a triggering event that would give rise to an obligation and/or liability of the Agency and/or the Crown under or in relation to the Instrument of Assurance
 - wider financial position of the Agency, including all existing contingent liabilities held by the Agency
 - implications for the Agency's controlling entity and cluster (if applicable).

The extent and rigour of the risk assessment must be proportionate to the size and complexity of the transaction under consideration.

- 2.4 Agencies must manage the risks identified during the initial risk assessment (Clause 2.1) and any ongoing risks related to any issued Instruments of Assurance, in line with the Agency's existing risk management framework.

For Agencies that are departments or statutory bodies listed in Schedules 2 or 3 of the PFA Act, a risk management framework consistent with the Core Requirements of the *Internal Audit and Risk Management Policy for the NSW Public Sector* (TPP 15-03) must be established and maintained.

Further guidance on the design and implementation of robust risk management frameworks can be found in the *Risk Management Toolkit* (TPP 12-03).

- 2.5 The risks associated with all Instruments of Assurance must be continuously managed and monitored. This management should consider an assessment of whether each Instrument of Assurance is still appropriate and whether it is achieving its purpose. All risks should be reviewed:
- at least annually, until the expiry date of the Instrument of Assurance, or
 - whenever there is a material change in circumstance that would increase the likelihood of a triggering event under, or in relation to, the Instrument of Assurance.

Core Requirement 3 Instruments of Assurance Register

Agencies must record all approved Instruments of Assurance with a potential liability exceeding \$100,000 in an internal Agency register, as well as any other Instruments of Assurance that the Agency considers material.

- 3.1 Agencies must record in an internal register all approved Instruments of Assurance with a potential liability exceeding \$100,000, or those that the Agency considers material. This includes any Instruments of Assurance which may not have been issued by, or on behalf of, the Agency but which have since been transferred or assigned to, or vested in, the Agency.

The format for the register is not prescribed, however, at a minimum it must contain the following information:

- description of the Instrument of Assurance
- inception date of the Instrument of Assurance
- name(s) of the parties involved
- description of any triggering event(s) or key clauses (if part of a contract)
- summary of the potential liability of the Instrument of Assurance or the contingent liability which has been created, quantified to the extent possible
- time limit, or expiry date, of the Instrument of Assurance or contingent liability (if applicable)
- financial limit of the Instrument of Assurance (if applicable)
- likelihood of default (high/medium/low probability of triggering event occurring)
- interest at inception (to allow the reporting of the interest differential as part of Treasury's annual returns process).

Practice Note – Establishing an Instruments of Assurance register

The Instruments of Assurance register information requirements outlined in clause 3.1 should be considered minimum requirements only.

Agencies are encouraged to establish and maintain a register that collects all relevant information that the Agency may require for the management of Instruments of Assurance and for reporting purposes, including reporting to Treasury.

- 3.2 Agencies must record all Instruments of Assurance with a potential liability exceeding \$100,000 or that the Agency considers material, issued by or on behalf of any subsidiaries, in their register.

Practice Note – Measuring Instruments of Assurance

For the purpose of this Policy, Instruments of Assurance should be recorded at their total potential liability value.

If the total potential liability value of the instrument is unknown, an assessment should be made by the Agency as to whether the total potential liability value is likely to exceed \$100,000 and, as such, whether the instrument should be included in the register.

- 3.3 If a contingent liability that is recorded in an Agency's register subsequently crystallises into a liability, the Agency should not remove the entry from the register. Additional information should be included in the register entry to show that the Instrument of Assurance's triggering event has occurred and that the liability has crystallised.
- 3.4 If an Instrument of Assurance that is recorded in an Agency's register expires, the Agency should not remove the entry from the register. Additional information should be included in the register entry to show that the Instrument of Assurance has expired.
- 3.5 Treasury may request to review any agency's internal register at any time for the following purposes:
- to monitor compliance with the Core Requirements of the Policy
 - to monitor the collective materiality of Instruments of Assurance that may individually not be reported to Treasury but are material when considered in aggregate.

Core Requirement 4 Reporting Instruments of Assurance

Agencies must report the details of all approved Instruments of Assurance with a potential liability exceeding \$1,000,000 to Treasury as part of the Agency's financial reporting obligations.

- 4.1 Agencies must report the details of all Instruments of Assurance with a potential liability exceeding \$1,000,000 to Treasury on or before the due date prescribed for the Agency's financial reporting obligations.

This includes any Instruments of Assurance which may not have been issued by, or on behalf of, the Agency but which have since been transferred or assigned to, or vested in, the Agency.

This information will assist Treasury in managing the risks to the sector arising from Instruments of Assurance, and in presenting whole-of-government financial reports.

- 4.2 Reporting must be consistent with any Treasury Circulars issued that relate to an Agency's financial reporting requirements for the relevant financial year.

When reporting, Agencies must complete the most recently issued version of the Instruments of Assurance return that is attached to any Treasury Circular issued for the relevant financial year.

Details of the financial reporting requirements for Agencies that are departments and statutory bodies listed in Schedules 2 or 3 of the PFA Act are provided in sections 41B and 45E of that Act as well as relevant Treasury Circulars.

An Agency's material contingent liabilities must be disclosed in the notes to the Agency's annual financial statements in accordance with Australian Accounting Standards AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* and AASB 139 *Financial Instruments: Recognition and Measurement*.

Agencies should refer to Treasury Policy and Guidelines Paper *Accounting Policy: Accounting for Financial Instruments* (TPP 08-1) for detailed guidance on accounting for financial guarantees.