

FINANCIAL INSTRUCTION: LIABILITIES

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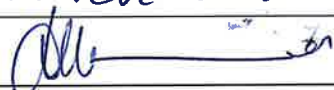
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Republic of Nauru

Financial Instruction

Liabilities

November 2021

Financial Instruction: Liabilities

ABBREVIATIONS

ADB	Asian Development Bank
AUD	Australian Dollar
CA	Chief Accountant
CSD	Chief Secretary Department
DoF	Department of Finance
DoP	Director of Processing (Payments)
DSA	Debt Sustainability Analysis
EUR	Euro
EXIM	Export Import Bank
FMIS	Financial Management Information System (Finance One)
GDP	Gross Domestic Product
GFS	Government Finance Statistics
GoN	Government of Nauru
IMF	International Monetary Fund
JPY	Japanese Yen
NITF	Nauru Intergenerational Trust Fund
NPRT	Nauru Phosphate Royalties Trust
NSDS	National Sustainable Development Strategy
PAD	Planning and Aid Division (DoF)
PO	FMIS-based Purchase Order
ROC	Republic of China (Taiwan)
RONPHOS	Republic of Nauru Phosphate
SOE	State-owned Enterprise
USD	US Dollar

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Financial Instruction: Liabilities

1. Overview

- 1.1 This Financial Instruction provides the guidelines on the methodology for the management of Government of Nauru (GoN) liabilities including, public debt, provision of loan guarantees, and other liabilities.
- 1.2 Public debt as shown in Attachment 1 covers the debts (external and domestic) of the GoN and public nonfinancial corporations (i.e. Government Agencies and State-Owned Enterprises (SOEs)). Efficient management of public debt is required to (i) maintain accountability over the raising, recording, servicing, and reporting of public debt; (ii) the monitoring of associated risks to ensure that GoN debt remains sustainable; and (iii) to minimise the costs of servicing debt within an acceptable level of risk.
- 1.3 Liabilities are the future sacrifices of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events. A liability should be recognised when:
 - a. it is probable that the future sacrifice of economic benefits will be required; and
 - b. the amount of the liability can be measured reliably.
- 1.4 Liabilities consist of both Current Liabilities and Non-Current Liabilities. Current Liabilities are those liabilities which are normally due and payable within one year, whereas, Non-Current Liabilities are those liabilities which become due and payable after one year or more.
- 1.5 Contingent Liabilities are either:
 - a. A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.
 - b. A present obligation that arises from past events but is not recognized as a liability because:
 - It is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - The amount of the obligation cannot be measured with sufficient reliability.
- 1.6 This Instruction is applicable to all officers that undertake the management and have responsibility for GoN liabilities including Heads of Departments and the Treasury Division and Executive Management of Government Agencies and SOEs.

2. Context

- 2.1 The GoN must ensure that appropriate records are maintained of all public debt and liabilities owed by Government Agencies and SOEs. This includes records or registers containing sufficient information to enable identification, management, repayment/settlement of obligations, and reporting of all liabilities.
- 2.2 Government Agencies and SOEs should not commit the Republic of Nauru to obligations which have a financial impact upon the GoN without appropriate authorisation. Obligations include both engaging in a formal loan arrangement with another party, as well as, making a commitment to another party which may arise from day-to-day transactions that are of an operational nature.
- 2.3 The GoN must ensure that there are strong controls with raising of public debt to ensure compliance with the laws and regulations of Nauru.
- 2.4 The main purpose is to ensure that the GoN meets all its debt servicing obligations with payment of principal, interest, and associated charges on or prior to the due dates. This is to ensure that the GoN does not default on its public debt.
- 2.5 It is the responsibility of the Department of Finance (DoF) to ensure that accurate and timely records for all public debt are maintained, and that all debt service payments are recorded.
- 2.6 It is the responsibility of the DoF to ensure that a register of all loan guarantees is maintained.

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3. Legal Framework

- 3.1 The legal framework covering public debt is set out in the *Constitution of Nauru 1968, Constitution of Nauru -Parliamentary Amendments- Act 2009, Government Loans Act 1972, Public Finance (Control and Management Act) 1997, and Treasury Fund Protection Act 2004.*

Constitution of Nauru 1968

- 3.2 Section 67 (1): *All debt charges for which Nauru is liable are a charge on the Treasury Fund.*
- 3.3 Section 67 (2): *For the purposes of this Article, debt charges include interest, sinking fund charges, repayment or amortisation of debt and all expenditure in connexion with the raising of loans and the service and redemption of the debt thereby created.*

Constitution of Nauru -Parliamentary Amendments- Act 2009

- 3.4 Section 58A (2): *The annual budget and budgetary processes shall promote transparency, accountability and the effective management of the economy, debt, and the public sector.*
- 3.5 Section 58A (3)(d): *The budget shall contain an indication of cabinet's intentions regarding borrowing and other forms of public liability that will increase public debt during the ensuing year.*

Government Loans Act 1972

- 3.6 Part II Raising of Government Loans: *Cabinet provides authority for the Minister to raise on behalf of, and for the purpose of, the Republic loans of such amounts of money as the Cabinet considers necessary or expedient. It also stipulates that "a fund to be known as the Government Loans fund is hereby established to which shall be credited all moneys received in respect of loans raised by the Minister on behalf of the Republic." "The payment of all interest, sinking fund charges, repayment or amortisation of debt and all expenditure in connection with the raising of loans and services and the redemption of the debt shall be made from the Government Loans Fund." "The Liabilities of the Government Loans Fund shall be a charge on the Treasury Fund."*
- 3.7 Part III Nauru Government Stock: Cabinet provides authority for the Minister to create Nauru Government Stock and the terms and conditions of issue.
- 3.8 Part IV Government Bonds: Cabinet provides authority for the Minister to issue Treasury Bonds and the terms and conditions of issue.

Public Finance (Control and Management) Act 1997

- 3.9 Section 4 (2) Powers and responsibilities of the Minister and responsible Ministers: *The Minister shall supervise the income, expenditure, assets and liabilities of the Republic to which this Act applies so as to ensure that a full accounting is maintained and for that purpose shall have the management of the Treasury Fund, the Trust Fund and the Government Loans Fund.*

Treasury Fund Protection Act 2004

- 3.10 Section 7 (1): *All revenues and monies raised or received by Nauru in accordance with Section 58 of the Constitution of Nauru including, loans, soft loans, grants, etc, shall strictly be paid into the Treasury Fund and properly recorded. If the President, Minister or the Cabinet directs otherwise or if any public servant (including a consultant) on his own volition or on the instructions of the political functionaries stated above, does anything contrary to the provisions of this section, he or she commits an offence. Penalty: \$10,000 or imprisonment for 3 years or both.*
- 3.11 Section 8: Cabinet not to authorise the mortgage of property of the Republic or instrumentalities or give guarantees without Parliamentary approval.
- 8(1) No mortgage or other charge over property of the Republic or of an instrumentality of the Republic has any force or effect at law or equity unless the mortgage or charge and the purpose thereof have been approved by Parliament.*
- 8(2) No guarantee given by the Cabinet on behalf of the Republic has any force or effect or binds the Republic unless and until the guarantee and the purpose therefor have been approved by Parliament.*

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8(2A) The provisions of subsections (1) and (2) hereof shall apply to any mortgage or other charge over property of the Republic or of an instrumentality of the Republic and to any guarantee given by the Cabinet on behalf of the Republic whether such mortgage, charge or guarantee was made or given before or after the commencement of this Act.

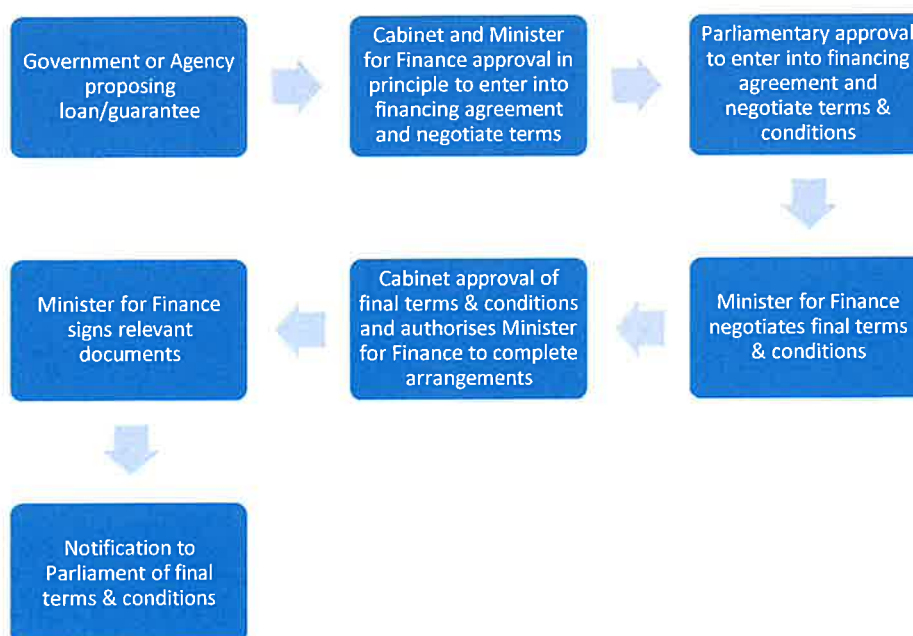
8(3) This section has effect notwithstanding anything to the contrary in any other Act or law.

8(4) Any person (including the President and a Minister) who gives or purports to give any mortgage or charge or guarantee in contravention of this section or that is not made or given subject to its being approved by the Parliament within a period of 90 days commits an offence.

Penalty: \$10,000 or imprisonment for 3 years or both.

4. Raising of Loans

- 4.1 GoN can only raise a government loan if such borrowing has been incorporated in the budget as submitted by the Cabinet and approved by Parliament.
- 4.2 The Minister responsible for Finance ("the Minister"), on behalf of the GoN, may borrow money if it appears to the Minister to be necessary or expedient in the public interest to do so.
- 4.3 The Minister may borrow money from any person, organisation, or government (either within or outside Nauru).
- 4.4 The Minister must not delegate the power to borrow money under section 4.3.
- 4.5 The proceeds of all money borrowed must be paid into the Treasury Fund, under Head 12 Public Debt.
- 4.6 Current Government policy is for no new loans to be agreed. Any proposal for a new loan must be authorised by Parliament, Cabinet, and the Minister for Finance, and be consistent with the Fiscal Strategy. Loans are only likely to be agreed in exceptional circumstances, and must be on concessional terms, for example, offset by direct budget support from donors.
- 4.7 The process to be followed with the raising of a loan or provision of a guarantee is as follows:



Loan Formulation and Authority to Negotiate

- 4.8 All borrowing proposals must be submitted to the Department of Finance (DoF).
- 4.9 The DoF will undertake the initial appraisal to ensure that each project meets the necessary requirements and complies with GoN policies such as stipulated in the National Sustainable Development Strategy and Fiscal Strategy. The DoF will also undertake informal discussions with

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potential development partners (lenders or donors) to agree on the funding source to meet repayments if this has not already been identified.

- 4.10 A negotiation team comprising the Minister, Deputy Minister, Secretary for Finance, Deputy Secretary for Treasury, and representatives from the relevant Line Ministry(s) and Legal (Department of Justice) will be formed to undertake loan negotiations.
- 4.11 A report will be prepared by the Treasury Division and signed-off by the Deputy Secretary Treasury and Secretary for Finance and submitted to the Minister and the Cabinet to agree to proceed with loan negotiations.
- 4.12 The Minister will submit a "Leave of the House to Move a Motion in regard to raising a loan" to Parliament, setting out the basic terms and conditions of the loan. Parliament will provide authority to the Minister, Secretary for Finance, and other Officers of Government to do all that is required to give effect to the Motion to raise a loan including executing agreements with the lender.
- 4.13 A letter will be prepared by the Treasury Division and signed-off by the Deputy Secretary Treasury and Secretary for Finance for the Minister to formally notify the lender along with the list of the negotiation team.

Loan Negotiations

- 4.14 The DoF through the Secretary of Finance will lead contract negotiations, while involving the Minister and Deputy Minister when required, to:
 - agree technical components of the project
 - agree loan terms and conditions and conclude the loan agreement
 - negotiate and agree legal documentation
 - prepare loan agent's warrant/power of attorney (if the Minister cannot sign)
 - finalize all documentation including a letter to the lender confirming agreement to the project subject to approval by the Cabinet
 - forward to the Minister for agreement and submission to the Cabinet for approval

Loan Approval, Signing, Ratification, Effectiveness and Recording

- 4.15 The DoF in consultation with the Department of Justice must ensure that all legal and loan documentation is completed.
- 4.16 Upon approval from the Cabinet, the Minister or an appointed loan agent under a warrant or power of attorney can sign the agreement(s) and associated documents.
- 4.17 This initiates the ratification process whereby the signed agreements are sent to the Chairman of the Cabinet for signing.
- 4.18 The Department of Justice must prepare the legal opinion, which is then sent to the DoF, Line Ministry and lender for effectiveness.
- 4.19 Upon signing of all loan documentation, the DoF must record all the loan details in Tech1: Finance One (the Financial Management Information System (FMIS)) that is operated in the Treasury Division and signed off by the Deputy Secretary of Treasury.

5. Issuing Securities

- 5.1 The Minister must not issue securities in the international markets.
- 5.2 The Minister can issue securities in the domestic market subject to approval by the Cabinet of a prospectus setting out the terms and conditions of such securities. Such securities can be targeted to either institutional or retail investors that are resident in Nauru.
- 5.3 The Budget and Annual Appropriation from Parliament must set out the authority for the Minister to issue securities in the domestic market. Current Government policy is not to issue any securities.

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- 5.4 The DoF will prepare a prospectus (prepared by staff in the Treasury Division and signed-off by the Deputy Secretary Treasury) setting out the terms and conditions of the instrument(s) to be issued including issuance and settlement dates, principal and interest payment dates, coupon interest rate(s), maturity date(s) and other details.
- 5.5 The DoF will submit the prospectus to the Minister for obtaining approval from the Cabinet.
- 5.6 Upon the Cabinet approval, the DoF will manage the issuance and ensure that the proceeds are credited to the Treasury Fund.
- 5.7 The DoF will record all details of the securities issued in Tech1: Finance One that is operated by the Treasury Division and signed off by the Deputy Secretary of Treasury. In addition, the DoF will maintain a registry of all holders of the securities.

6. Provision of Loan Guarantees

Submission of a Loan Guarantee Proposal

- 6.1 The DoF will be responsible and participate in a process for assessing, approving, and monitoring loan guarantees.
- 6.2 All government agencies and SOEs seeking a government guarantee must submit a request to the DoF setting out details of the loan to be guaranteed along with both a technical and financial plan for the investment project/program. In addition, they must ensure that the:
 - financial plan provides (1) analysis of cash inflows (net revenue) and outflows (operational expenses, depreciation, taxes, interest costs, and other payables), (2) analysis of capacity to service debt obligations (principal, interest and fees/expenses), and (3) analysis of sources of investment capital (including owner capital, borrow capital) and the capacity to repay the obligations of the project.
 - guarantee complies with the laws and regulations of Nauru.
 - project benefiting from the guarantee has been chosen in the normal planning process, and the firm undertaking the project has been chosen in a fair competition.
 - guarantee does not breach any budget limits.
 - guarantee has greater net benefits for Nauru than alternative uses of the government's money, including other kinds of subsidy.
 - guarantee is as transparent as is consistent with good targeting, and the guarantee contract will be made public, along with a description of its possible fiscal implications.

Review of Loan Guarantee by Department of Finance

- 6.3 The DoF will ensure that the:
 - guarantee proposal submitted by the government agency or SOE provides all the necessary documentation and meets the criteria set by the GoN.
 - loan guarantee has been assessed in the context of the GoN's public and publicly guaranteed debt levels and the associated foreign currency and interest rate risks.
 - GoN has acted to limit the cost and risk of the guarantee and, if appropriate, will charge a fee for the guarantee.
- 6.4 The DoF will prepare a report (prepared by staff in the Treasury Division and signed-off by the Deputy Secretary Treasury and Secretary for Finance) to submit to the Minister with a recommendation to agree to or decline the loan guarantee proposal. If the Minister agrees, the proposal will be submitted to Cabinet for approval.
- 6.5 The Minister will submit a "Leave of the House to Move a Motion in regard to the provision of a guarantee" to Parliament, setting out the basic terms and conditions of the loan guarantee. Parliament will provide authority to the Minister, Secretary for Finance, and other Officers of Government to do all

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that is required to give effect to the Motion to agree to the guarantee including executing agreements with the lender.

Loan Guarantee Negotiations

- 6.6 The DoF through the Secretary of Finance will participate in loan guarantee contract negotiations, while informing the Minister and Deputy Minister when required, to:
- agree technical components of the project
 - agree loan guarantee terms and conditions and conclude the loan guarantee agreement
 - negotiate and agree legal documentation
 - prepare loan agent's warrant/power of attorney (if Minister cannot sign)
 - finalize all documentation including a letter to the lender confirming loan guarantee agreement for the project
 - forward to the Minister for submission to the Cabinet for approval

Government Approval, Signing, Ratification and Recording

- 6.7 The DoF in consultation with the Department of Justice must ensure that all legal and loan guarantee documentation is completed.
- 6.8 Once completed, the DoF will submit the loan guarantee documents to the Minister and the Cabinet for submission to Parliament for approval of all loan guarantee terms and conditions and generation of a Parliamentary Order for the signature of the President of Nauru.
- 6.9 Upon approval from the Cabinet, the Minister or an appointed loan agent under a warrant or power of attorney can sign the loan guarantee agreement(s) and associated documents.
- 6.10 Upon signing of all loan guarantee documentation, the DoF will record all the loan guarantee details in Tech1: Finance One (FMIS) that is operated in the Treasury Division and signed off by the Deputy Secretary of Treasury.
- 6.11 If the loan guarantee is subject to a guarantee fee, staff in the Treasury Division of the DoF will prepare an invoice and signed-off by the Secretary for Finance to send to the guaranteed entity setting out the guarantee fee amount and due date(s).

Monitoring of Loan Guarantees by Department of Finance

- 6.12 The Treasury Division of the DoF will monitor the outstanding amount of each guarantee covering the disbursed amounts and repayment profiles.
- 6.13 The guaranteed entity is required to submit a report to the Treasury Division of the DoF for the period ending 30 June and 31 December (within one month of the end of the period) setting out all loan guarantees, the amount outstanding under the loan guarantee, and loan disbursements and repayments over the preceding six-month period.

Reporting of Loan Guarantees by Department of Finance

- 6.14 The DoF will prepare a report (prepared by staff in the Treasury Division and signed-off by the Deputy Secretary Treasury) at least annually and submit to the Minister covering:
- The GoN's gross financial exposure and, where feasible, an estimate of the likely fiscal cost of called guarantees.
 - Payments made, reimbursements, recoveries, financial claims established against beneficiaries, and any waivers of such claims.
 - Guarantee fees or other revenue received.
 - Forecast of new guarantees to be issued in the budget year.

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7. Borrowing by Government Agencies and SOEs

Submission of Borrowing Request by Government Agencies and SOEs

- 7.1 Given that the GoN is the equity owner of the Government Agency or SOE, there is an implicit guarantee that the GoN will need to provide financial support if the Government Agency or SOE is unable to meet its borrowing payment obligations. The DoF will be responsible for protecting the GoN's risk by participating in a process for assessing and monitoring Government Agency and SOE borrowings and advising the Minister of the associated fiscal risks.
- 7.2 All Government Agencies and SOEs seeking to borrow must submit a request to the DoF setting out details of the borrowing and the impact on their balance sheet, profit and loss, and ability to service the borrowing obligations.
- 7.3 The DoF will prepare a fiscal risk report (prepared by staff in the Treasury Division and signed-off by the Deputy Secretary Treasury) to submit to the Minister with a recommendation to approve or decline the Government Agency or SOE borrowing proposal. The report will set out the GoN's gross financial exposure and, where feasible, an estimate of the likely fiscal cost of the Government Agency or SOE default.
- 7.4 Upon approval from the Minister, the SOE can proceed with the borrowing proposal.

Recording, Monitoring and Reporting of Government Agencies and SOE Borrowings by Department of Finance

- 7.5 Upon signing of each Government Agency or SOE borrowing agreement, the Treasury Division of the DoF will record the borrowing details as provided by the Government Agency or SOE in the Tech1: Finance One (FMIS) that is maintained in the Treasury Division and signed off by the Deputy Secretary of Treasury.
- 7.6 The Treasury Division of the DoF will monitor the outstanding amount of Government Agency and SOE borrowings covering the disbursed amounts and repayment profiles.
- 7.7 Government Agencies and SOEs are required to submit a report to the Treasury Division of the DoF for the period to 30 June (within three months of the end of the period) setting out all new borrowings for the financial year and the total amount of borrowings outstanding at the end of the period.
- 7.8 The DoF will include details of the total borrowings by Government Agencies and SOEs in the Debt Strategy Report prepared in section 8.1.

8. Other Liabilities

- 8.1 In accordance with section 8 of the Treasury Fund Protection Act 2004, the GoN cannot pledge security/collateral, whether property, a financial asset, or any other instrument of the GoN, against a loan or loan guarantee contracted by the GoN or a Government Agency or SOE.
- 8.2 The GoN shall ensure that appropriate records are maintained of other liabilities that are owed by government agencies to another person or organisation.
- 8.3 Liabilities under this category could include:
 - (i) accounts payable
 - (ii) accrued expenses
 - (iii) employee entitlements
 - (iv) lease commitments
 - (v) unearned revenue
 - (vi) deposits held
 - (vii) any other liabilities of material value

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- 8.4 The “appropriate records” with sufficient information to identify the full extent of the liabilities may be contained within the Finance One (FMIS), e.g. accounts payable, and employee entitlements. In such instances no further records would have to be maintained.
- 8.5 With respect to other liabilities such as accrued expenses, lease commitments and unearned revenue, these balances would normally be determined at a point in time (e.g. end of financial year) for reporting purposes. In general, financial management information systems do not maintain ongoing (running) balances for these liabilities, however, may contain information to identify them, in order to calculate the financial obligation outstanding.
- 8.6 The term “appropriate records” is intended to imply those that are sufficient to identify the nature of the liability, record the date in which the commitment arose, the value of the obligation, any transactional details (e.g. payments made, prepaid services rendered) which reduce the obligation and when the liability is extinguished.

9. Debt Strategy Report

9.1 The DoF will prepare a debt strategy report for inclusion in the budget to include the following information:

- Overview of public debt and the implementation of the Debt Action Plan including Bank of Nauru liquidation and any other relevant debt repayment programs
- Stock of domestic and external debt in AUD: actual for past 2 fiscal years and projected for the next 3 fiscal years
- Total debt service principal and interest payments in AUD: actual for past 2 fiscal years and projected for the next 3 fiscal years
- Total government liabilities and net debt in AUD: current and past 2 years
- Total government guarantees in AUD
- Risk indicators covering exchange rate, interest rate, and refinancing risks as set out in the international standard risk indicator matrix

9.2 In preparing the debt strategy report, the Treasury Division of the DoF will undertake an annual cost and risk analysis to set appropriate targets or limits on each of the risk categories.

9.3 The debt strategy report will be prepared by staff in the Treasury Division and signed-off by the Deputy Secretary Treasury. It will be submitted to the Minister for consideration and approval by the Cabinet before incorporation in the budget.

10. Debt Reporting

10.1 In addition to the debt strategy report as set out in section 8.1, the DoF will also prepare a mid-year debt report as at 31 December each year (prepared by staff in the Treasury Division and signed-off by the Deputy Secretary Treasury) to include the following information:

- Overview of public debt and changes for the first 6-months of the fiscal year
- Stock of domestic and external debt as at 31 December
- Total debt service principal and interest payments: for the period 1 July to 31 December
- Total government liabilities and net debt as at 31 December
- Total government guarantees as at 31 December
- Risk Indicator matrix with comparison with the targets or limits set for each of the risk categories covering foreign exchange, interest rate, and refinancing risks

10.2 The Treasury Division will publish the debt reports on the DoF’s website.

11. Debt Service Payments

Debt Service Payments

- 11.1 Debt servicing activities cover the payment of principal, interest and other charges associated with all external and domestic loan obligations of the GoN. The payment process is initiated by the Treasury Division, which is responsible for recording government debt obligations.
- 11.2 There must be available appropriation to cover any principal and interest payments under Head 12. For those payments that are met by donor budget support payments, the expected revenue and outlay should be recorded in the budget.
- 11.3 For external loans, payment advices are received by the Treasury Division of DoF from the development partner or lender. The Treasury Division should check with their debt recording system the amount to verify and if there is any discrepancy, they should contact the development partner or fiscal agent to reconcile the difference.
- 11.4 The Treasury Division will prepare a payment order, which is checked by the Deputy Secretary Treasury and approved by the relevant authority and sent to the Director of Processing (Payments) to arrange payment through Bendigo Bank.
- 11.5 Once payment has been made, the Director of Processing (Payments) will notify the Treasury Division that will update the public debt records and GoN's public accounts in the Finance One (FMIS).
- 11.6 For domestic loans or securities, the Treasury Division will prepare a payment order, which is checked by the Deputy Secretary Treasury and approved by the relevant authority and sent to the Director of Processing (Payments) to arrange payment through Bendigo Bank.

Debt Service Tracking and Reporting

- 11.7 The Treasury Division will be responsible for tracking actual debt service payments against the budget provision and to identify the expected outcome for the fiscal year. A debt service report will be prepared at the end of each quarter, checked by the Deputy Secretary Treasury, and submitted to the Minister. The report will include the variances against the budget provision along with an explanation for the variances.

12. Cash Management

Cash Balance Strategy

- 12.1 The GoN will be very risk averse in the maintenance and management of cash balances. It will maintain a minimum cash liquidity buffer and will only increase the rate of return by investing long-term cash holdings in term deposits at Bendigo Bank.

Cash Balance Management

- 12.2 The Treasury Division of the DoF will be responsible for tracking and managing the cash balances in the GoN bank accounts (currently held at Bendigo Bank). Cash balances will be classified as (1) total donor funds; (2) total available funds; (3) treasury available funds; and (4) cash buffer requirement.
- 12.3 The Treasury Division will determine the amount of surplus funds that can be invested to obtain a return on those funds. Any such investments will be agreed by the Deputy Secretary Treasury and approved by the Secretary for Finance.
- 12.4 The Treasury Division will maintain a list of approved investments that is updated annually and approved by the Minister.

Minimum Cash Balances

- 12.5 The Treasury Division of the DoF will identify the minimum cash balances that the GoN will maintain as a liquidity buffer.
- 12.6 The minimum cash liquidity buffer is set at two months of adjusted expenditure, as advised by the

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IMF.

- 12.7 The calculation of adjusted expenditure is: Total expenditure, less Regional Processing Centre costs (Head 42 total expenditure) and non-expense items. All Head 42 expenditure relates to the RPC which is operated in partnership with Australia, and most costs are reimbursed by Australia, and therefore excluded. The adjusted expenditure is divided by 12 to determine the average monthly expenditure that needs to be covered by Treasury cash holdings. This figure is then multiplied by two to get to the minimum buffer.
- 12.8 The cash liquidity buffer is held in term deposits to increase the rate of return on the holding. In addition, a minimum cash balance is also maintained in the Treasury Operating Account. The level of this balance reflects expected account transaction volumes in a month.

Cash Balance Reporting

- 12.9 The Treasury Division of the DoF will prepare a cash balance report at the end of each week, which will be checked by the Deputy Secretary Treasury, and submitted to the Secretary for Finance and the Minister.

13. Reporting of Contingent Liabilities

- 13.1 The DoF will prepare and submit a report to the Minister covering contingent liabilities under each of the categories set out below. The report will be prepared by staff in the Treasury Division and signed-off by the Deputy Secretary Treasury after consultation with the other divisions of the DoF.

Risk Identification and Measurement

- 13.2 Contingent liabilities are costs that the GoN will face if a particular event occurs (quantifiable liabilities or present liabilities that are unable to be measured with sufficient reliability to be recorded in the financial statements (unquantifiable liabilities). The contingent liabilities facing GoN are a mixture of operating and balance sheet risks, and they can vary greatly in magnitude and likelihood of realisation. Quantifiable contingent liabilities will be classified as such if a monetary value can be placed on the liability should the event occur (for example, a loan guarantee). Unquantifiable contingent liabilities will be classified as such if a monetary value cannot be estimated for the liability (for example, an environmental disaster or climate event affecting the nation), in which case these will be recorded with a description of the liability and a potential estimate of the maximum exposure should the event occur.
- 13.3 The following are the categories that will be recorded by the GoN.

Uncalled Capital

- 13.4 As part of the commitment to a multilateral approach to ensure global financial and economic stability, Nauru, as a member country of the Asian Development Bank (ADB), International Bank for Reconstruction and Development (IBRD), and International Monetary Fund (IMF) contributes capital by subscribing to shares in these institutions. The capital (when called) is typically used to raise additional funding for loans to member countries, or in the case of the quota contributions to directly finance lending to members. For the RON and other donor countries, capital contributions comprise both "paid-in" capital and "callable capital or promissory notes".
- 13.5 Nauru's subscription to the ADB, IMF and IBRD is partly paid in cash and partly in promissory notes (being uncalled capital). The respective levels of called and uncalled capital change when calls are made by these institutions to provide loan packages to borrowing countries. Even though promissory notes are technically "at call", they are treated as contingent liabilities, as there are significant restrictions on the actual ability to call them, and there is no realistic estimate of either the amount or the timeframe of any call. Details are provided in Attachment 4.

Guarantees and Indemnities

- 13.6 Guarantees are legally binding promises that have been made to assume responsibility for a debt, or performance of an obligation of another party, should that party default. Guarantees generally relate to the payment of money but may require the performance of services.

Financial Instruction: Liabilities

- 13.7 Indemnities are legally binding promises where there is an undertaking to accept the risk of loss or damage that another party may suffer and to hold the other party harmless against loss caused by a specific stated event.

Legal Proceedings and Disputes

- 13.8 The amounts under quantifiable contingent liabilities for legal proceedings and disputes will be listed. These will include claims arising from deposits with the Bank of Nauru and outstanding payments from the GoN that are being validated. The amount to be recorded will be the maximum potential cost; noting that it will not represent either an admission that the claim is valid or an estimation of the possible amount of any claim.

Unquantifiable Contingent Liabilities

- 13.9 Unquantifiable contingent liabilities will include indemnities, legal claims and proceedings, environmental liabilities, workplace health and safety compensation, land claims, and impact of adverse climate events that cannot be quantified. These will be identified and listed on a case-by-case basis.

14. Penalties

- 14.1 Compliance with these Instructions is required by all employees of the Government. Non-compliance will be regarded as misconduct under the Public Service (Disciplinary Procedures) Regulations 2016. The Treasury Fund Protection Act 2004 sets out the penalties for non-compliance of the Act.

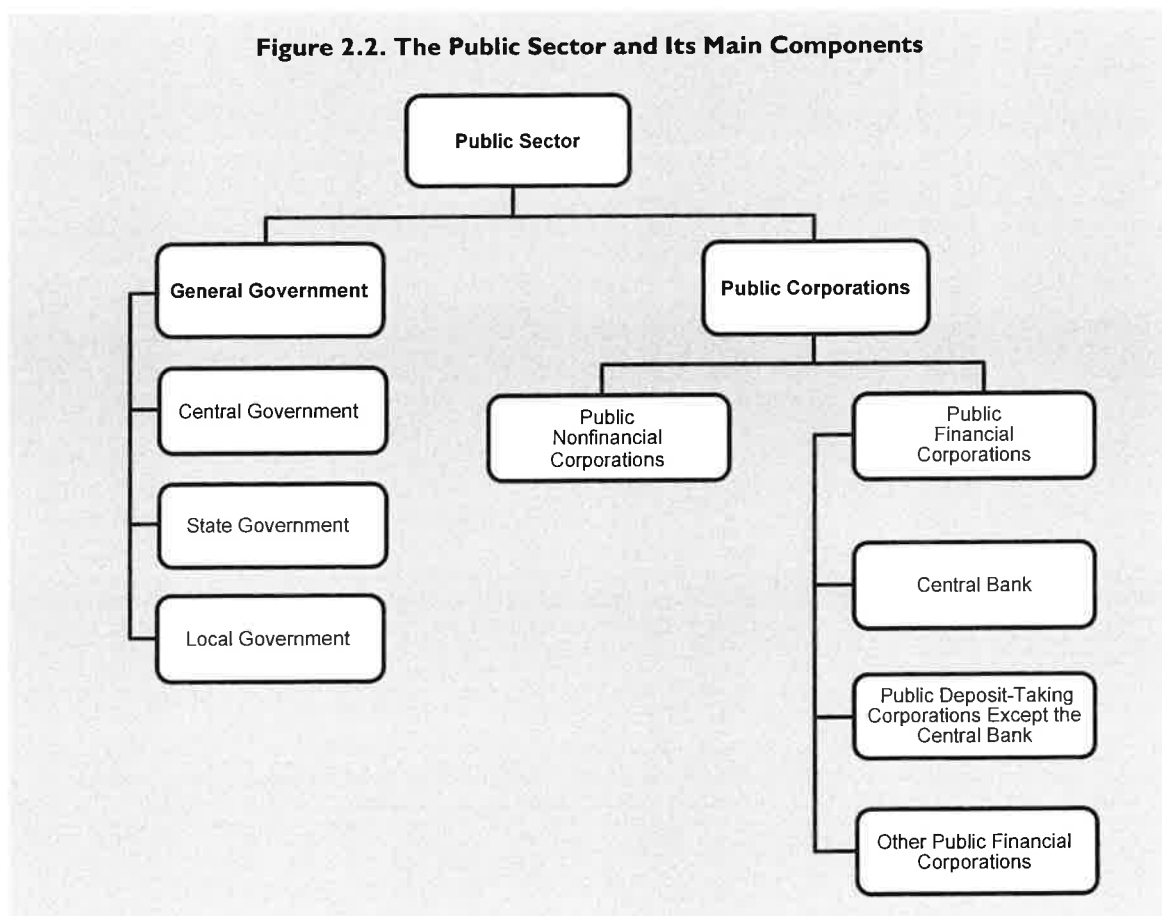
15. Review

- 15.1 These instructions will be reviewed at least every two years.

Government of Nauru – Public Debt Classification

The classification of public debt is defined in the *Public Sector Debt Statistics: Guide for Compilers and Users* published by the International Monetary Fund in 2011.

The following table has been extracted from the Guide. The only components currently applicable in Nauru are Central Government and Public Nonfinancial Corporations.



Total gross debt—often referred to as “total debt” or “total debt liabilities”—consists of all liabilities that are debt instruments. A debt instrument is defined as “a financial claim that requires payment(s) of interest and/or principal by the debtor to the creditor at a date, or dates, in the future.” The following instruments are debt instruments:

- Special drawing rights (SDRs)
- Currency and deposits
- Debt securities
- Loans
- Insurance, pension, and standardized guarantee schemes
- Other accounts payable

Financial Instruction: Liabilities

Debt liabilities owed by residents to residents of same economy are domestic debt, and debt liabilities owed by residents to nonresidents are external debt.

For risk management, debt liabilities and assets may be dealt with in an integrated manner, focusing on net debt. For example, debt may have been incurred to fund assets that will generate income to meet liabilities. Net debt is calculated as gross debt minus financial assets corresponding to debt instruments.

Table 2.1. Calculation of Net Debt

Gross debt (liabilities in the form of debt instruments) (a)	Financial assets corresponding to debt instruments (b)	Net debt (c)=(a)-(b)
SDRs	Monetary gold and SDRs	
Currency and deposits	Currency and deposits	
Debt securities	Debt securities	
Loans	Loans	
Insurance, pension, and standardized guarantee schemes	Insurance, pension, and standardized guarantee schemes	
Other accounts payable	Other accounts receivable	
Total gross debt	Total financial assets corresponding to gross debt	Total net debt

Government of Nauru – Promissory Notes

The following provides details of Nauru's subscription to the ADB, IMF and IBRD paid in promissory notes (being uncalled capital):

Asian Development Bank: Nauru joined the ADB in 1991 and has 426 shares (0.004% of the total shares). The overall capital subscription is US\$5.89 million of which US\$0.29 million is paid-in capital subscription. This implies that there is a contingent liability for uncalled capital of US\$5.60 million.

International Bank for Reconstruction and Development: Nauru joined the IBRD or World Bank in April 2016. The paid-in subscription as at 30 June 2020 was SDR2.016 million (US\$2.432 million) of which SDR 1.814 million (US\$2.189 million) was the capital subscription paid-in national currency (held as promissory notes). The Articles of Agreement of the IBRD require that members maintain the value of the portion of their subscriptions to IBRD paid in national currency from the date of initial subscription. The value of such currency is to be maintained against the standard value of IBRD's capital based on the 1974 SDR. In most cases, IBRD calculates members maintenance of value (MOV) positions as of 30 June each year and members have until the following 30 June to settle any obligation they may have. As of 30 June 2020, Nauru had an MOV obligation to IBRD in the amount of A\$295,953.97, which RON is required to pay to IBRD on or before 30 June 2021.

International Monetary Fund: Nauru joined the IMF in April 2016 and has a quota of SDR 2.8 million (0.001% of the total quota). The total holdings as at 30 April 2020 was SDR 0.2 million with total cumulative allocations of SDR 0.9 million. This implies that there is a contingent liability for uncalled capital of SDR 0.7 million.