INTERNATIONAL FEDERATION OF ACCOUNTANTS

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DATE: 1 JUNE 2004
MEMO TO: MEMBERS OF THE IFAC PUBLIC SECTOR COMMITTEE
FROM: PAUL SUTCLIFFE
SUBJECT: **RESEARCH REPORT ON BUDGET REPORTING**

ACTION REQUIRED

The Committee is asked to:

- **consider** the recommendations made in the Research Report; and
- **provide** directions for the ongoing development of this project, including whether an exposure draft is to be developed and/or areas for further research.

AGENDA MATERIAL:

		Pages
9.2	Extract of Minutes from PSC Meeting of March 2004	9.7-9.9
9.3	Research Report - *Budget Reporting*.	9.10-9.58

BACKGROUND

The PSC determined that the Budget Reporting Project should be developed in two stages. The first stage was to be the preparation of a research report to identify:

- current best practices in budget formulation and reporting under differing budget models and government administrative arrangements;
- whether the development of an IPSAS on budget reporting and/or other budget related matters falls within the PSC's mandate;
- notwithstanding the above, whether there is any precedent, and or arguments, for an accounting standards setter to deal with budget reporting issues; and
- if an IPSAS on budget reporting (or other budget related) matters is to be prepared, the matters which should appropriately be dealt with by that IPSAS.

The second stage of the project was to be developed following consideration of the Recommendations in the Research Report. A Steering Committee was formed in mid 2003 to support the development of this project and Mr. Ron Points, the USA member, was appointed as Chair.

Dr Hughes was engaged as a consultant to prepare the Research Report. The first stage has now been completed. The Research Report, prepared by Dr Hughes with input from the Steering Committee, was issued in late May 2004 after input from PSC Members and staff and final review by the PSC Chair and Steering Committee Chair. It was made clear that the Research Report was primarily an internal document reflecting the views of this author and not necessarily those of the PSC or all Steering Committee members. (The Research Report includes primary text and Appendices. The primary text of the Research Report is attached at

Agenda item 9.3. The Appendices are lengthy and have not been attached. They are available from staff on request or can be downloaded from the IFAC website.)

In respect of this stage of the project, the Steering Committee acted as a Project Advisory Panel, providing input electronically to Dr Hughes, rather than meeting to prepare the Report.

As agreed at the PSC Meeting in March 2004, it is proposed that the recommendations made in the Research Report be discussed at this meeting. Dr. Hughes will be in attendance to discuss the recommendations. Consequent on that discussion, the PSC is requested to provide staff with direction for the ongoing development of this project.

Recommendations from Budget Reporting Report and Staff Views
The Research Report outlined 10 recommendations. They are reproduced below. (The numbering refers to their numbering in the Research Report.) Staff views on the recommendation and PSC actions that should follow are also outlined below.

In short, staff are of the view that the project should be progressed in two parts:

1. Reporting comparisons with budget (ex-post budget reporting). This project should be developed by the PSC itself, with materials prepared for the PSC by staff/consultants. The Budget Reporting Steering Committee members should be requested to act as a Project Advisory Panel in respect to this project. While a separate Exposure Draft on this topic may be issued, it may well be included as a disclosure requirement in IPSAS 1 (where disclosure of comparison of actual and budgets is currently encouraged, and in the Cash Basis IPSAS) rather than a separate IPSAS.

2. Reporting budgets as prospective financial statements (ex-ante budget reporting). The PSC should develop a project brief dealing with this topic and request the Steering Committee to prepare an Invitation to Comment (ITC). The Steering Committee would be expected to meet to deal with this component of the project.

ISSUES
Staff are of the view that the 10 recommendations from the Research Report can usefully be considered in the following groupings:

1. General Purpose Financial Statements
2. Forecast and Prospective Financial Information
3. Budget and Financial Management Issues
4. Reporting Comparisons with Budget
5. Quantitative Characteristics and Framework Issues

General Purpose Financial Statements:

Recommendation *1: The PSC should issue an IPSAS (or IPSASs) on budget reporting since it falls within the mandate identified in the Preface to the PSC. It may be beneficial to issue separate IPSASs on ex-ante and ex-post budget reports.*

Staff Views:

General purpose financial statements (GPFSs) are those intended to meet the needs of users who are not in a position to demand reports tailored to meet their specific information needs. Given the widespread practice in the public sector of publicly reporting and commenting on budgetary information, a strong case can be made that government budgets are general purpose financial statements and there is a need for an IPSAS to be developed on the financial reporting of budget information.

There appears to be strong support and precedent for reporting budget to actual comparisons. However, the nature of an IPSAS that might be issued on reporting future oriented or prospective financial information included in budgets at the time they are proposed or approved (ex-ante budget reporting), is not so clear or well accepted. Staff agree with the recommendation that the project should separated into two components:

- Reporting comparisons with budget (ex-post budget reports)
- Reporting prospective financial information (ex-ante budget reports).

Reporting Forecast and Prospective Budget Information:

Recommendation 2: *An accounting standard should be issued to require that the forecast and other prospective financial information be reported to their constituents in order to keep them informed on future financial implications of government policy.*

Recommendation 3: *The accounting standards should require that the legally approved budget be published with the appropriate supporting budget documentation (e.g. assumptions).*

Staff Views:
The Research Report recommends that governments should report to constituents financial forecasts and prospective financial information developed as part of the medium term financial forecast MTFF (or budget framework), and the legally approved budget, to enable transparent reporting of the government's financial intentions. This is an appealing notion and can be supported. It is a notion embedded in good governance and good government.

Budgets are developed within a legislative framework and reflect different administrative arrangements and political, institutional and cultural systems and processes. As noted in the Research Report, the MTFF and annual and biennial budgets are components of budget formulation. They focus on revenue and expenditure forecasts and are developed to support economic and statistical analysis rather than the objectives of GPFSs. The Research Report explains (page 22), "Budget formulation is the practices and concepts that budget professionals use to create and review a budget until enacted into law."

The Research Report notes (page 39) that "There was a difference of views among Steering Committee members as to what was meant by budget reporting", including whether forecast and other prospective information and legally approved budgets should be the subject of an IPSAS. The Research Report also notes (page 39) that Steering Committee members felt that "accounting standards for budget formulation and execution would probably not be beneficial…" except to ensure that data collection was comprehensive and appropriate.

IPSASs generally prescribe the content of GPFSs and the manner in which specific transactions and events are to be treated. Like a number of Steering Committee members, staff are concerned that budget formulation practices and concepts do not fit with the concepts and practices of IPSASs, and are not convinced that IPSASs should attempt to specify the practices that should be adopted in budget formulation (whether on a cash or accrual basis budgets).

However, as noted under Recommendation 1 above, in many jurisdictions the government presents and comments on future oriented financial information included in its (the government's) proposed and approved budgets. In these circumstances, a strong case can be made that government budgets that are presented publicly are general purpose financial statements and should be presented in accordance with relevant accounting standards to ensure that they satisfy the qualitative characteristics of financial information.

Staff are of the view that the PSC should request the Steering Committee to prepare an ITC which considers whether governments (and government entities) which publicly announce their proposed and/or approved budgets should be required to report future oriented financial information contained in budgets as general purpose financial statements, and whether an IPSAS should be developed to specify requirements for such reports. The ITC could usefully deal with such matters as whether:

- An IPSAS should be developed to require future oriented financial information included in approved budgets to be presented as a general purpose financial statement;
- Any such IPSAS should require that the principles underlying the preparation of the future oriented financial information and the approved budget be clearly communicated to readers, or should be more prescriptive and specify the content of such reports
- Any such IPSAS should require a clear explanation of the scope of the budget or whether the IPSAS should specify requirements for that scope. This would include in respect of the government's budget, disclosure of whether financial information encompasses all government operations or operations encompassed by the general government sector;
- Any such IPSAS should specify:
    - for budgets prepared on the accruals basis, requirements for the definition and recognition criteria for assets, liabilities, revenues and expenses in "forward" budgets, the presentation of such information and related disclosures; and
    - for budgets prepared on the cash basis, requirements on the basis on which projected cash receipts and payments should be included in the budget report, the presentation of that report and the additional disclosures that are required and encouraged.

The Steering Committee should also be requested to consider issues which may arise if the budget and historical financial statements are prepared on different bases and encompass different areas of government operations.

If the PSC supports this recommendation a detailed project brief identifying the scope of the project and the matters to be dealt with should be prepared.

Budget Management and Management Accounting Issues:

Recommendation 4: *The accounting standards should be broad enough to support the integration of budgetary and accounting systems through the use of budgetary accounting procedures. It may be beneficial to issue a separate IPSAS on budgetary accounting procedures.*

Recommendation 5: *In relevant studies and guidance, the PSC should acknowledge and encourage the use of commitment accounting procedures intended to assure that budgetary funds are available prior to release of a purchase order or contract.*

Staff views:
These are matters of budget execution and control. They respond to the aspects of the Dr. Hughes' project brief that referred to research on best practice in budget preparation and execution. While guidance on financial management processes may be most welcome, and while these recommendations may reflect best practice in budget management, they do not fit within the matters being addressed by IPSASs in the standards program itself. These matters may be acknowledged in PSC discussion papers as appropriate, but are not the subject of an IPSAS.

Reporting Comparison with Budget:

Recommendation 6: *Ex-post budget reports reflecting budget to actual comparisons should be part of the general purpose financial statements issued at the end of the fiscal period for each reporting entity at each level of government.*

Recommendation 7: *The Comparative Budget to Actual Statement should include the original budget as approved by the legislative body as well as the final adopted budget.*

Recommendation 8: *Governments should be encouraged to operate their budgeting and accounting systems on the same basis. If the budgetary system is on a different basis than the accounting system, a statement should be developed to reconcile key differences between the two systems.*

Staff views:
Staff are of the view that requiring government entities to include in general purpose financial statements a comparison of budget to actual falls within the mandate of the standards program and should be supported. IPSAS 1 already encourages the disclosure of such comparison and Steering Committee members supported this recommendation. Staff are of the view that it may be possible to include requirements relating to such comparisons as additional disclosure requirements in IPSAS 1 (for the accrual basis) and the cash basis IPSAS. However, whether or not a separate IPSAS is required to deal with budget and actual comparisons should be monitored and considered as the project develops.

The extent to which financial information included in the budget should be aggregated for presentation in IPSASs, how the financial information should be classified for disclosure and whether the comparison of budget to actual should include both the original and finally approved budget should be considered as the project develops. Staff are of the view that initial materials prepared for PSC consideration should adopt classifications and levels of aggregation similar to those currently reflected in IPSAS 1, and should include comparisons of actual to original and final approved budgets.

Staff are also of the view that the PSC should develop this component of the project directly. Input from Steering Committee members should be sought electronically.

While staff support the notion that budget and financial statement data be prepared on the same basis, however this is not happening in many jurisdictions. Accordingly, the development of these aspects of the needs to consider mechanisms to deal with circumstances in which there is a difference between the budget and financial reporting basis.

The PSC is of the view that the accrual basis is superior to the cash basis for financial reporting purposes. The PSC also acknowledges that many governments currently report on the cash basis and has developed a cash basis IPSAS in response. The PSC has not considered the link between budget and historical reporting and whether a case could be established that different bases can be justified. This is a matter that should be considered by the Steering Committee and recommendations included in the ITC.

Qualitative Characteristics:

Recommendation **9**: *Ex-ante and ex-post budget reports should meet the qualitative characteristics (understandability, relevance, reliability, and comparability) of financial reporting specified in IPSAS 1.*

Recommendation 10: *Budget reporting should be incorporated into the conceptual framework for IPSASs.*

Staff Views:
Staff agree with the notion that any general purpose financial statement, whether reporting historical or future oriented financial information, should reflect qualitative characteristics. Staff also agree that the conceptual framework for financial reporting in the public sector should acknowledge the role of reporting future financial information, and the implications of the fundamental concepts for such reports. In this respect, if staff recommendations are adopted, development of the framework will need to articulate with work of the Steering Committee.

BUDGET REPORTING: EXTRACT OF MINUTES – PSC MEETING MARCH 20O4

9. PSC STEERING COMMITTEE – BUDGET REPORTING

The Committee received and considered:
- A memorandum from Dr. Jesse Hughes;
- A draft Research Report prepared by Dr. Hughes; and
- Comments from Steering Committee members.

Ron Points, the Steering Committee Chair, introduced the topic and noted that:
- The draft Research Report had been updated to incorporate comments made by members at the last PSC meeting in November 2003;
- He was of the view that the Research Report was now substantially complete and should be made publicly available as soon as possible. Ron advocated that, following any input provided by members during the course of this meeting, the PSC should request Dr. Hughes to finalize and formally present his Research Report to the PSC and should schedule a discussion of the key recommendations of the Research Report at the next meeting and at that time determine whether the next stage of the project is to be activated, and the process to be adopted;
- There was strong support for the PSC dealing with budget reporting from constituents responding to the PSC Review survey;
- A number of presenters at the FACPCE seminar and a number of Steering Committee members had emphasized the importance of integration of budget and accounting; and
- Constituents from both the financial reporting and budget communities were eager for the paper to be issued and for more formal work to be developed by the PSC.

Ron also reminded members that the PSC had contracted Dr. Hughes to undertake a Research Report to be presented to the PSC identifying best practice in budget formulation, making recommendations on whether developing standards on budget reporting fell within the PSC mandate and, if it did, the nature of the budget reporting standards that should be developed. He emphasized that it was not intended that the Research Report resolve all issues to be addressed in developing such standards. Rather the Research Report was to provide input to the PSC for discussion before determining whether the PSC should move to Stage 2, being the standards development stage. In that sense it was an internal document for the PSC, rather than a document issued by the PSC. Ron also noted that the wider community had great interest in the Report and it should be made accessible by that community. He advocated that members accept the Report.

Dr. Hughes made a presentation to the PSC on the Research Report noting:
- The background to the Report; and
- The recommendations. Dr. Hughes emphasized that the recommendations were his, but he had had significant input from many Steering Committee members and from PSC staff, and thanked all for their input.

The Chair sought general views from members including the process to be adopted going forward. Members commended Dr. Hughes for his work, noted that his recommendations were significant for the PSC and financial reporting by public sector entities, and identified a number of key issues for clarification in the Report including that the Report could usefully:

- Ensure that a clear distinction was drawn between ex-ante and ex-post reporting, and recommendations relating to each identified. Some members were of the view that the issues and principles relating to ex-post and ex-ante reporting were substantially different and that this aspect of issues would need to be further explored;
- Identify whether the same definitions and principles should be applied in ex-ante and ex-post reporting;
- Acknowledge that many governments proposing to adopt accrual accounting , had indicated an intention to maintain their budgets on the cash basis and provide additional guidance on the process for reconciling an ex-ante budget report on the cash basis with ex-post financial statements prepared on accrual basis;
- Provide guidance on the form of the ex-post budget report and whether it should be disclosed as a note to the financial statements;
- Consider whether a separate IPSAS was required for ex-post reporting or whether requirements should be introduced through an amendment to IPSAS 1. Some members were of the view that IPSAS 1 should be amended rather than a separate IPSAS developed;
- Provide recommendations on the level of detail to be disclosed in budget/actual comparisons. Some members were of the view that it was not necessary to disclose the legally approved and final budget and the actual;
- Explore the need to develop the relationship between financial information, whether ex-ante or ex-post and key non-financial performance indicators; and
- Clarify whether the recommendations applied to only whole-of-government reporting entities – whether national, provincial or local – and all other reporting entities. Some members were of the view that the implications of application of the recommendations to governments and to individual entities, such as departments and agencies, may be quite different.

Members then discussed whether the Report should be issued as a PSC document and, if so, what the process should be. It was noted that if it was issued as a PSC document, the PSC would need to work through the Report in detail and develop its own views on the recommendations and issues. After lengthy discussion, it was agreed that there was significant advantage in establishing a demarcation between this stage of the project, which reflected the work of Dr. Hughes in preparing an internal (though publicly available) document for PSC consideration, and subsequent decisions and developments which would reflect PSC views. It was also noted that it would be advantageous to make Dr. Hughes' final report publicly available as soon as possible. Accordingly, it was decided that:

- The Report is to be published as a Research Report prepared for the PSC by Dr. Jesse Hughes. It is to be made clear that the paper has been prepared by Dr. Hughes for consideration by the PSC and reflects Dr. Hughes views and not those of the PSC. It should also be made clear that the PSC will consider the contents of the Report at its July 2004 meeting. The Chair and Steering Committee Chair are to clear the text which explains the status and nature of the Report and its relationship to PSC activities;
- The Report will be widely available from relevant PSC sections of the IFAC website;
- PSC members, observers and staff will provide input to Dr. Hughes regarding their observations on the contents of the Report within 3 weeks. Dr. Hughes will consider these and may amend his paper as a consequence. The IMF observer noted that their Fiscal Affairs Department will provide comments to Dr. Hughes;
- A limited number of hard copies of the Research Report will be produced and provided to members and observers for wider distribution, however the Research Report will be primarily a web-based product;
- Hard copies would be distributed to international organizations and PSC Observers for further distribution;
- At the July PSC meeting members would discuss the Report in substance and determine the next step forward. Dr. Hughes was requested to attend that meeting and participate in the discussions; and
- Staff would also provide input to Dr. Hughes and assist with the finalization of the Report.

Action Required:	***Update draft Research Report and make publicly available. Provide comments to the consultant.***
Person(s) Responsible:	***PSC Chair, Members and Observers, Consultant, PSC Staff.***

Public Sector Committee

Research Report
May 2004

Budget Reporting

International Federation of Accountants

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The Public Sector Committee (PSC) is a standing committee of IFAC. It develops accounting standards for the public sector.

Copies of this Research Report may be downloaded free of charge from the IFAC website at http://www.ifac.org.

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The Research Report

This Research Report was commissioned by the Public Sector Committee (PSC). It was prepared by Dr. Jesse Hughes with input from the Budget Reporting Steering Committee. Dr. Hughes is Professor Emeritus of Accounting at the College of Business and Public Administration, Old Dominion University, Norfolk, Virginia USA.

The objective of the Research Report is to provide input to the PSC's deliberations on such matters as whether developing International Public Sector Accounting Standards (IPSASs) on budget reporting is within the PSC's mandate and whether the PSC should action a project(s) to deal with budget reporting issues.

The Research Report represents the views of the author. At the present time, it does not reflect the views of the PSC nor necessarily of all Steering Committee members

The PSC will consider the recommendations made by Dr. Hughes at its meeting in July 2004 (and subsequent meetings if necessary) and at that time will determine whether and how it progresses this issue.

Acknowledgement

The Public Sector Committee's Standards Program to develop IPSASs commenced in 1996. The Standards Program has received general budget support from the World Bank, the Asian Development Bank, the International Monetary Fund, the United Nations Development Program and IFAC.

The Public Sector Committee and the author wish to acknowledge that the Budget Reporting project, of which this Research Report is a part, has also received additional project specific funding from the European Commission via a grant from the Public Expenditure and Financial Accountability Program (PEFA). PEFA is a partnership program of the World Bank, the European Commission, the UK Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Norwegian Ministry of Foreign Affairs, the International Monetary Fund, and the Strategic Partnership with Africa.

Preface

International Public Sector Accounting Standards

International Public Sector Accounting Standards (IPSASs) deal with issues related to the presentation of annual general purpose financial statements. General purpose financial statements are those intended to meet the needs of users who are not in a position to demand reports tailored to meet their specific information needs. Users of general purpose financial statements include taxpayers and ratepayers, members of the legislature, creditors, suppliers, the media, and employees. The objectives of general purpose financial statements are to provide information useful for decision-making, and to demonstrate the accountability of the entity for the resources entrusted to it.

The Public Sector Committee (PSC) has issued twenty accrual basis IPSASs and a comprehensive Cash Basis IPSAS. The issuance of these IPSASs establish a core set of financial reporting standards for public sector entities.

Budget Reporting

Most governments prepare and issue as public documents, or otherwise make publicly available, their annual financial budgets. The budget documents are widely distributed and promoted. They reflect the financial characteristics of the government's plans for the forthcoming period. Monitoring and reporting on budget execution is essential for measuring compliance with Parliamentary (or similar) authorization. Making budget data publicly available is necessary to enable transparent reporting of the government's financial intentions and of its use of taxes.

Government budgets are generally approved by the legislature. While administrative arrangements can differ from jurisdiction to jurisdiction, in most cases spending units have no authority to commit or spend government funds until the legislation imparting spending authority has been passed by the legislature.

In many respects, and for many external users, the budget documents are the most important financial statements issued by governments. The budget also serves as a key tool for financial management and control, and is the central component of the process that provides for government and parliamentary (or similar) oversight of the financial dimensions of operations. The IPSASs currently on issue do not require the presentation of budget/forecast financial information at the time it is approved by the legislature or other authority, nor do they require the historical general purpose financial statements to report period results against the budget for that period.

Whether or not budget reporting falls within the PSC's mandate and whether an IPSAS (or IPSASs) on budget preparation, or budget execution or other aspects of budget reporting should be issued is a contentious issue. Accordingly, the PSC determined that before committing resources to the development of an IPSAS it should commission the preparation of a Research Report to provide input to its deliberations. Consequently, the PSC commissioned Dr. Jesse Hughes to undertake research on the following matters, and to provide a report to the PSC on his findings together with any relevant recommendations:

- Current best practices in budget formulation and reporting under differing budget models and government administrative arrangements.
- Whether the development of an IPSAS on budget reporting and/or other budget related matters falls within the PSC's mandate.
- Notwithstanding the above, whether there is any precedent, and or arguments, for an accounting standards setter to deal with budget reporting issues.
- If an IPSAS on budget reporting (or other budget related) matters is to be prepared, the matters which should appropriately be dealt with by that IPSAS.

The PSC established a Steering Committee to provide input to Dr. Hughes. The Steering Committee is chaired by PSC member Mr. Ron Points and includes non-PSC members with a wide range of experience in budget preparation, execution and reporting from a number of jurisdictions.

Views Expressed

The views expressed in this Research Report are those of Dr. Hughes and are not those of the PSC nor necessarily of all Steering Committee members.

The PSC commends Dr. Hughes for his work and thanks the Steering Committee for their input to this project. The recommendations are significant for the PSC and financial reporting by public sector entities generally. The Report provides valuable input to the PSC's consideration of how it could progress this critical issue and identifies key issues that will need to be dealt with in any further project development.

The PSC will commence its consideration of this Report at its July 2004 meeting and at that stage consider any further actions that should occur. Readers are reminded that it was not intended that the Report resolve all issues to be addressed in developing IPSASs for budget reporting. Rather, it was developed as an internal document to provide input for the PSC as it considered whether to initiate a project directed at establishing an IPSAS for budget reporting, and the nature of that IPSAS. However, in the interests of transparency of process, and given the wide community interest in this topic, the PSC has decided to make it publicly available to interested parties.

Philippe Adhémar
Chair
Public Sector Committee (PSC)
International Federation of Accountants
May 2004

International Federation of Accountants-Public Sector Committee (IFAC-PSC)
Steering Committee on Budget Reporting

Name	Country	Position
Ron Points (Chair)	USA	Manager, Financial Management for East Asia and Pacific Region, World Bank
William L. Dorotinsky	World Bank	Finance Specialist, World Bank
Philippe Dujardin	Belgium	Director, Ministry of Finance–Budget and Management Control
Ludo Goubert (NATO)	FEE	Head of Internal Audit SHAPE (previously Head of Budgets and Finance Western European Union)
Claes-Goran Gustavsson	Sweden	Senior Expert–Swedish National Finance Management Authority
Geoff Harry	Australia	Partner (Assurance)–PricewaterhouseCoopers
Lou Hong	China	Director, Research and Regulation Division, Treasury Department, Ministry of Finance, Peoples Republic of China
Steve Leith	New Zealand	Principal Advisor–Treasury, Budget and Macroeconomic Branch
Alan Mackenzie	South Africa	CFO–Department of Justice
Sophie Mahieux	France	Former head of the Budget Directorate. Currently senior position in public expenditure execution.
Mike Parry	UK- African focus	Chair of IMG (International Management Consultant Group).
Ms Torun Reite	Norway	Deputy Director General, Norwegian Ministry of Finance
Sietso van der Schaaf	Netherlands	Partner–Deloitte Touche
Christian Iver Svane	Denmark	Ministry of Finance–Special Adviser, Central Government Accounting and Budget
D.Swarup	India	Additional Secretary (Budget) Ministry of Finance
Andy Wynne	ACCA	Head of Public Sector Technical Issues
Associate Members		
Michael Ruffner	OECD	Budgeting, Management and Accountability Division
David Shand	World Bank	Senior Public Sector Management Specialist

Members of the Steering Committee are appointed in their personal capacity rather than as representatives of their nominating body. The views expressed in this study are those of the author, and not those of the members of the Steering Committee, their employers or nominating organization. In arriving at these views, the author has considered input from the Steering Committee members but the views remain those of the author.

RESEARCH REPORT ON BUDGET REPORTING

Table of Contents

Executive Summary

Most governments prepare and issue their annual financial budgets as public documents. Whether there should be an IPSAS that deals with general purpose reporting of the budget as a public document is considered in this Research Report. The objective of the IFAC Public Sector Committee (PSC) is to develop programs aimed at improving public sector financial management and accountability, including developing International Public Sector Accounting Standards (IPSASs) and promoting their acceptance. To meet this objective, the PSC has issued a number of IPSASs which identify the general purpose financial statements that are necessary to meet the needs of users who are not in a position to demand reports tailored to meet their information needs, and specify how a wide range of transactions and events are to be accounted for in those financial statements. The IPSASs note that general purpose financial statements can provide users with information indicating whether resources were obtained and used in accordance with the adopted budget. Yet, current IPSASs only **encourage** governments to include in their financial statements a comparison of the actual results of operations with the approved budget for the reporting period.

The PSC identified budget reporting as an important project to be progressed during the second stage of its standards program. It commissioned the preparation of this Research Report to provide input on whether an IPSAS (or IPSASs) should be issued on budget reporting. The Project Brief is included as Appendix A. The objectives of the research are to identify the following:

- Current best practices in budget formulation and reporting under differing budget models and government administrative arrangements;
- Whether the development of an IPSAS on budget reporting and/or other budget related matters falls within the mandate of the PSC;
- Whether there is any precedent for an accounting standard setter to deal with budget reporting issues; and
- The issues which should appropriately be considered in any IPSAS that might be issued.

The major findings and recommendations of the Research Report are outlined below.

Budget Process

There are three main stages in the budgetary process: (1) During the **formulation** stage, initial budgets and forecasts are developed and submitted to the legislative bodies for consideration. Spending authority is granted by legislative bodies based on the political priorities and fiscal policies of government. These ex-ante budget reports reflect the financial characteristics of the government's plans for the forthcoming period and are used to analyze the potential consequences of those plans on the economy. (2) Implementation of the fiscal policies reflected in these budgets is accomplished through the use of budgetary accounts in the accounting system during the **execution** stage. (3) Public **reporting** of the ex-ante budgets (both legally approved budgets and prospective budgets) permits the government to identify their financial intentions (transparency). Further, ex-post **reporting** of a comparison between the actual results and the approved budget permits the government to identify their adherence to those budgets by comparing performance against the approved budget (accountability) and providing explanations of significant variances.

Budget Practice

This study on budget reporting considers research undertaken and best practices published by many bodies. If the budget is to be effective, it is generally recognized that the budget needs to be comprehensive and encompass all of the expenditures by government for all budget dependent entities. Analysis performed within five African countries indicates that their budgets are prepared on the cash basis and there are varying degrees of transparency in the reporting of budgetary data. Other research has found that some European countries have moved or are in the process of moving toward the accrual basis of accounting but have not expressed significant plans to change from the cash basis of budgeting. Also, a very comprehensive Budget Practices and Procedures survey conducted by the Organization for Economic Cooperation and Development (in collaboration with the IADB, IMF and World Bank) indicates that many countries plan to move toward the accrual basis of accounting. However, some of these countries prepare their budgets on the cash basis and they plan to continue to prepare their budgets on the cash or near cash basis for the foreseeable future although their accounting will be on the accrual basis.

PSC Mandate

The objective of the PSC is identified in the Preface to the IPSASs as follows: “Develop programs aimed at improving public sector financial management and accountability including developing accounting standards and promoting their acceptance.” This Report argues that:

- Inclusion of budgetary information and other budget related matter in the accounting system and reporting budgetary data to constituents is crucial to improving public sector financial management (transparency).
- To assure that government officials are held accountable for their budgetary decisions, it is essential that users be informed on the degree by which their government officials were able to operate within the limits of the approved budget (accountability).
- The best mechanism by which to keep the public informed is through the budget reports (both legally approved budgets and prospective budgets) at the time of their approval as well as the compliance reports issued as a component of the general purpose financial statements.

As such, developing IPSASs to deal with legally approved budgets, prospective budgets, and reporting of actual performance against such budgets fall within the PSC mandate identified in the Preface.

Recommendations

Based on the research conducted in this study, the following is recommended:

1. **The PSC should issue an IPSAS (or IPSASs) on budget reporting since it falls within the mandate identified in the Preface to the PSC. It may be beneficial to issue separate IPSASs on ex-ante and ex-post budget reports.**
2. **An accounting standard should be issued to require that the forecast and other prospective financial information be reported to their constituents in order to keep them informed on future financial implications of government policy.**
3. **The accounting standards should require that the legally approved budget be published with the appropriate supporting budget documentation (e.g. assumptions).**
4. **The accounting standards should be broad enough to support the integration of budgetary and accounting systems through the use of budgetary accounting procedures. It may be beneficial to issue a separate IPSAS on budgetary accounting procedures.**
5. **In relevant studies and guidance, the PSC should acknowledge and encourage the use of commitment accounting procedures intended to assure that budgetary funds are available prior to release of a purchase order or contract.**
6. **Ex-post budget reports reflecting budget to actual comparisons should be part of the general purpose financial statements issued at the end of the fiscal period for each reporting entity at each level of government.**
7. **The Comparative Budget to Actual Statement should include the original budget as approved by the legislative body as well as the final adopted budget.**
8. **Governments should be encouraged to operate their budgeting and accounting systems on the same basis. If the budgetary system is on a different basis than the accounting system, a statement should be developed to reconcile key differences between the two systems.**
9. **Ex-ante and ex-post budget reports should meet the qualitative characteristics (understandability, relevance, reliability, and comparability) of financial reporting specified in IPSAS 1.**
10. **Budget reporting should be incorporated into the conceptual framework for IPSASs.**

Issues Raised by Steering Committee Members

In order to implement the above recommendations, the following key issues need to be resolved:

1. **A clear definition of budget reporting needs to be developed.**
2. **A decision on whether to include ex-ante budget reports (legally approved budgets and prospective budgets) in an IPSAS needs to be made.**
3. **The extent of coverage of budgetary accounting procedures for budgetary execution and control procedures in an IPSAS needs to be defined.**

4. **A decision to include ex-post budget comparative statements as part of general purpose financial statements in an IPSAS needs to be made.**
5. **Where there are differences between the budgetary and accounting bases, the requirement for and format of a reconciling statement needs to be determined.**
6. **When a decision is made to issue an IPSAS on budget reporting, procedures will need to be identified to assure that qualitative characteristics of financial reporting are met.**
7. **Budget reporting procedures will need to be included in the Conceptual Framework for financial reporting of government entities.**

Research Report on Budget Reporting

Objective

The primary objective of this Research Report is to determine if an IPSAS should be issued on budget reporting. In its initial strategy papers prepared in 2000 and 2001, the IFAC Public Sector Committee (PSC) identified budget reporting as a key public sector specific issue to be addressed in the second phase of its standards setting program. With the completion of its core 20 accrual IPSASs and the comprehensive cash basis IPSAS, the PSC actioned[1] this research project to identify and make recommendations as appropriate on the various aspects of budget formulation, execution and reporting.

Scope

This Research Report deals with budgets at all levels of government and for all reporting entities other than Government Business Enterprises (GBEs). Readers should note that the definition of a reporting entity in the IPSASs may differ from the legislative specification of an entity for budget preparation and presentation purposes.

For purposes of this Research Report, budget reporting includes all budget reports issued to the public for transparency and accountability purposes. This would include the budgets approved by the legislative bodies for the government itself and for governmental entities at local, state, and national levels prior to or near the beginning of the fiscal period as well as prospective or forecast budgetary data **(ex-ante)**. In addition, budget reports would include budget to actual comparative statements issued at the end of the accounting period **(ex-post)**.

This study addresses the following:

- Current best practices in budget formulation and reporting under differing budget models and government administrative arrangements;
- Whether the development of an IPSAS on budget reporting and/or other budget related matters falls within the PSC's mandate;
- Notwithstanding the above, whether there is any precedent, and or arguments, for an accounting standard setter to deal with budget reporting issues; and
- If an IPSAS on budget reporting (or other budget related) matters is to be prepared, the issues which should appropriately be dealt with by that IPSAS. The issues to be considered are as follows:
  - The nature and requirements of any IPSAS that might be developed considering budget formulation, execution, and reporting.
  - The application of the recognition and measurement requirements of existing IPSASs in the budget context.

[1] See Terms of Reference in Appendix A.

The qualitative characteristics of financial reporting previously identified in IPSAS 1[2] will be considered in this Research Report. These are as follows:

- Understandability
- Relevance
- Reliability
- Comparability
- Constraints on Relevant and Reliable Information

Some governments prepare tax expenditure budgets. These budgets identify the estimated costs to the tax base due to preferential treatment for specific activities (i.e., deductibility of interest payments on home mortgages to encourage the purchase of homes). However, these tax expenditure budgets are not dealt with in this Research Report since income lost due to preferential tax treatment (i.e., costs) is compiled separately from other budget reports.

Management accounting and reporting of financial information in internal or special purpose reports to governments and senior government officials are significant issues that warrant further study. Budget information may be presented in documents other than general purpose financial statements and a cross-reference from general purpose financial statements to such documents may be appropriate, particularly to link budget and actual data to non-financial budget data and actual service achievements. However, management accounting issues are outside the specific objectives and scope of this study. Consequently, they are excluded from this Research Report.

Definitions

Accounting terms included in this Research Report are defined in the “Glossary of Defined Terms in IPSAS 1 to IPSAS 18” as published in the Handbook of International Public Sector Accounting Standards, 2004 Edition. Budgetary terms that are in common use in the budget literature are defined below and are used with these meanings throughout this paper:

Allocation—part of an appropriation that is designated for expenditure by specific organization units and/or for special purposes, activities, or objects.

Allotment—an internal allocation of funds on a periodic basis usually agreed upon by the heads of government departments or similar entities and the chief executive.

Appropriated Budget—the expenditure authority created by the appropriated bills or ordinances that are signed into law and the related estimated revenues. The expenditure authority is generally considered the legal limit within which a governing body must operate.

Appropriation—an authorization granted by a legislative body to set aside funds for purposes specified by the legislature. It is usually limited in amount and time over which it can be expended.

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2 Appendix 2, Presentation of Financial Statements, IPSAS 1 (May 2000).

Budgetary Definitions:

1. **Line item (or object class) budget**: The budget is separated into expenses by economic classification such as compensation of employees, use of goods and services, etc., as well as the purchase of capital assets.
2. **Program budget**: a budget made up of programs as groupings of activities intended to contribute to identifiable government objectives (e.g., poverty alleviation, literacy, control of contagious disease.).
3. **Performance budget**: a program budget that also presents measures of performance and service delivery (e.g., students graduating, surgical operations performed, tons of cargo unloaded).
4. **Zero-base budget**: a budget that is justified from zero. Each agency has to justify its whole budget as if it were applying for funding for the first time.
5. **Biennial budget**: a budget that provides funds for two years instead of one. Budget allocations do not lapse until the end of the second year.
6. **Multi-year budget**: a budget that takes into account not just the budget year, but two or more subsequent years. Usually lapse of funds occurs at the end of the budget year. Figures for “out years” are indicative.
7. **Medium-term fiscal framework (MTFF)**: a process for improving government expenditure programs that assists decision-makers to gauge what is affordable in aggregate over the medium-term and to reconcile this with spending policies and their costs over the same period.
8. **Capital budget**: a plan of proposed capital outlays, such as for infrastructure, buildings, equipment, and other long-lived assets, and of the means to finance them.
9. **Recurrent budget**: a plan of proposed funding needed to service the ongoing operations of government. Such a plan would include compensation of employees, use of goods and services, etc.
10. **Supplementary budget**: These are budgets that are enacted during or after the end of the financial year to authorize expenditures not within original budgets. These do not normally represent policy changes, but may be necessary where the original budget did not adequately envisage expenditure requirements (e.g., war, natural disasters, etc.).
11. **Development budget:** Typically the development budget is a collection of projects, whether internally or externally funded. The rest of the budget is then described as a recurrent budget. The development budget frequently includes non-capital items, and the recurrent budget often includes capital items.
12. **Below the line items:** In some countries, this term is used to refer to asset and liability accounts (accounts that are “below the line” of budget accounts), and also in some cases to monies that are effectively held in trust by government for some special purpose.

Budgetary Processes:

1. **Budget formulation**: the practices and concepts that budget professionals use to create and review a budget until enacted into law.

2. **Budget execution**: the management activities that take place from enactment of the budget into law until the end of the fiscal period.

3. **Budget reporting**: considered to be of two types: **ex-ante—**the external reporting of the budget approved by the legislative body at or near the beginning of the fiscal period as well as external reporting of prospective or forecast budgetary data; and **ex-post—**the external reporting of the financial activities relative to the approved budget for the fiscal period until the final audit after the end of the fiscal period. The budget to actual comparative statement is generally issued as a component of the historical financial statements.

Commitment (also known as an encumbrance)—There is not a generally accepted single definition of this term. It is sometimes considered to be synonymous with obligations. A commitment is generally acknowledged as the government's responsibility for a possible future liability based on a contractual agreement. It includes outstanding purchase orders and contracts where goods or services have not yet been received. Some governments consider the term "commitments" to only apply to purchase requests or other such pre-obligation documents. As such, outstanding commitments lapse at the end of the fiscal period. For purposes of this report, commitments, encumbrances, and obligations are considered to be intended actions that could result in a possible future liability, and are subject to the same accounting treatment.

Encumbrance—See definition under "commitment."

Estimated Revenue—an amount anticipated to be collected during the accounting period.

Expenditures—the incurrence of a liability for a capital asset or the disbursement of cash during the fiscal period as used in the cash or modified accrual basis of accounting.

Gross Domestic Product—the value of all final goods and services produced in the country within a given period.

Infrastructure Asset—a long-lived asset that normally is immovable, part of a system or network, specialized in nature, does not have alternative uses, and may be subject to constraints on disposal. Examples include roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems.

Prospective budgetary information—financial information based on assumptions about events that may occur in the future and possible actions by an entity. Prospective financial information can be in the form of a forecast, a projection or a combination of both, for example, a one year forecast plus a five year projection.

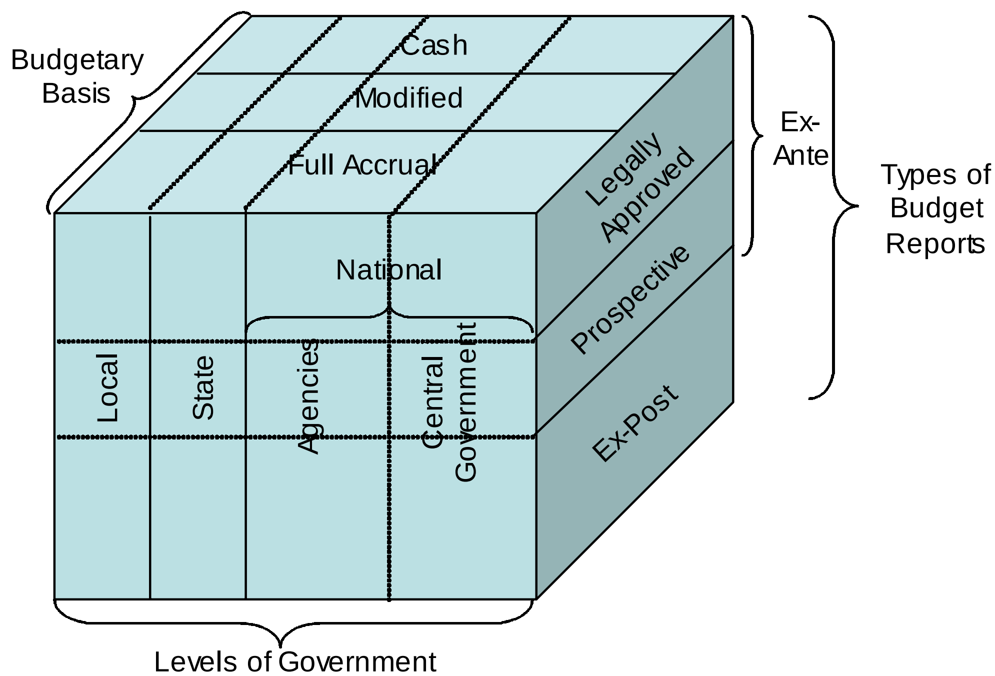
Virements—the transfer of expenditures between budget heads. Normally, these will be constrained by legislation and/or financial rules.

Warranting—the three stages of budgeting are identified as formulation, execution and reporting. In some countries, there is a sub-stage within budget execution of "warranting." The budget as approved does not in itself provide authority for expenditure. Rather, expenditure authority has to be warranted under procedures that will be laid down in the financial procedures. It is often used as a mechanism for cash management.

Budget Overview

Most, but not all, governments prepare and issue their annual financial budgets as public documents, or otherwise make them publicly available. There are three main stages in the budgetary process which may be conducted on a cash or accrual basis at each of the levels of government (local, state, and national): (1) During the **formulation** stage, initial budgets are developed and submitted to the legislative bodies for consideration. Spending authority is granted by legislative bodies based on the political priorities and fiscal policies of government. These budgets reflect the financial characteristics of the government's plans for the forthcoming period and are used to analyze the potential consequences of those plans on the economy. (2) Adherence to these fiscal policies is accomplished during the **execution** stage. (3) Ex-ante public **reporting** of the initial budgets and forecast budgetary data (important for transparency) permits the government to identify its financial intentions. In the ex-post **reporting** stage, a comparison of the actual results with the final budget permits the government to identify its actual performance against the approved budget (accountability) and provide explanations of significant variances. The following budget reporting model is used throughout this Research Report to identify this relationship:

Exhibit 1. Budget Reporting Model



Note: The modified budgetary basis encompasses both the modified cash and modified accrual bases. It could also apply to the commitments/obligations basis that is referred to by some governments.

The Budget

Budget documents are usually published and frequently widely commented upon in the mass media. Given the lateness of issue and complexity of historical public accounts in some countries, **the budget reports (both ex-ante and ex-post) are often the most important source**

of publicly available information on public finance. They reflect the financial characteristics of the government's plans for the forthcoming period and are used to analyze the consequences of those plans on the economy. Making budget data publicly available at the time of approval is necessary to enable transparent reporting of the government's financial intentions. Reporting period results against the budget for the same period is a necessary component of any accountability regime. The matters to be considered in the three stages of budget formulation, execution, and reporting are identified in Exhibit 2 below:

Exhibit 2: Matters to be Considered in the Budgetary Process

Stage	**Possible areas for consideration and guidance**
1. Formulation	Budget formulation is a policy process and there are important aspects of the matters in the budget documents that could be addressed by an IPSAS, e.g., • Basis on which budget revenues and expenditures are estimated and time periods to which budgeted amounts are allocated (linked to accounting base for financial reporting) • Information to be included to achieve transparency, including need to facilitate analysis by external stakeholders • Classification of items –as defined in the chart of accounts • Presentation and aggregation of data - linked to concepts of transparency • Incorporation of non-financial performance targets • Where accrual is the basis for budgeting, inclusion of cash flow data to be able to assess fiscal impact of budget decisions
2. Execution	This tends to be an "internal" government process and not subject to external reporting as indicated below. However, there is a need to consider how "virements" and supplementary budgets will be reported to external stakeholders
3. Reporting	Ex-ante and ex-post budget reporting should be an important part of financial statements. There are many issues to be considered, e.g., • Consistency of definitions between accounting and budget figures • What figures are used as comparators when budgets are adjusted through virements and supplementaries • Incorporation of non-financial information • Achieving transparency and accountability

Fiscal Transparency

Fiscal transparency is a major contributor to the cause of good governance. It should lead to better informed public debate about the design and results of fiscal policy, make governments more accountable for the implementation of fiscal policy, and thereby strengthen credibility and public understanding of macroeconomic policies and choices. Some countries (i.e., Germany) have special mechanisms for reviewing the realism of underlying economic forecasts, as well as related revenue estimates, to assure that the public is fully informed regarding these projections. Fiscal transparency requires disclosure of more than just budget (and actual) figures. It also requires disclosure of information on the assumptions behind budget figures (i.e., economic and other risk factors) that may be subject to audit or review by the external auditors. In a globalized environment, fiscal transparency is of considerable importance in demonstrating macroeconomic stability and high-quality growth. However, it is only one aspect of good fiscal management. Attention has to be given also to increasing the efficiency of government activity and establishing sound public finances.

To encourage countries to publicize their budgetary practices, the International Monetary Fund (IMF) issued a Code of Good Practices on Fiscal Transparency (See Appendix B). The Code recommends the following four key objectives:

- The roles and responsibilities in government should be clear;
- The public should be provided with full information on the past, current, and projected fiscal activity of government in a timely manner;
- Budget preparation, execution, and reporting should be undertaken in an open manner; and
- Fiscal information should attain widely accepted standards of data quality and be subject to independent assurances of integrity.

Financial Management

Many governments provide various guidance documents on the procedures to be followed as part of the budget process. These include the areas to be considered when developing proposals and new initiatives, capital budgeting and working capital management, setting user charges, and output costing. An example of the range of information that a government might provide is available on the New Zealand Treasury's "Managing the Public Sector" section of their website: http://www.treasury.govt.nz/publicsector/.

Some professional organizations publish best practices in public budgeting in order to encourage their members to improve their budgeting procedures. One such set of practices, by the National Advisory Council on State and Local Budgeting in the United States, is summarized in Appendix C. The following four principles are recommended:

1. Establish broad goals to guide government decision making;
2. Develop approaches to achieve goals;
3. Develop a budget consistent with approaches to achieve goals; and
4. Evaluate performance and make adjustments.

The budget also serves as a key tool for financial management and control, and is the central component of the process that provides for government and parliamentary (or similar) oversight of the financial dimensions of operations. For budgetary control by internal management, many governments prepare budget to actual comparative schedules periodically within the budgetary period as well as at the end of the fiscal year. The format of these comparative schedules is generally similar to the following:

Organization	Original Budget	Adjustments	Modified Budget	Actual	Variance
XXXXX	$XXX,XXX	$XXX	$XXX,XXX	$XXX,XXX	$XXX

Note: Some countries compute the variance from the original budget and explain the reason (including in-year updates) for subsequent adjustments. Other countries compute the variance from the modified budget and explain significant differences. (See Appendix J.)

Budget Authorization

Government budgets are approved by the legislature and compliance is a legal matter. At each level of government, these budgets serve as plans for economic governance and controlled use of resources for the governmental entity. While administrative arrangements can differ from jurisdiction to jurisdiction, in most cases, spending units have no authority to commit or spend government funds until the legislation imparting spending authority (the budget) has been passed by the legislature. In some cases, spending authority is granted at the same level as the prior year under a continuing resolution if the budget is not passed prior to the beginning of the fiscal year. In addition, some governments permit purchase orders that have not been filled prior to the end of the fiscal period to be carried forward and funded in the next fiscal year.

Budget Reports

Each level (local, state, or national) of government will issue budget reports to inform users of their fiscal plans. These budget reports include those that are issued at or near the beginning of a fiscal period to reflect the legally approved budget as well as those reports that identify prospective or forecast data (ex-ante). In addition, budget reports are issued at the end of the fiscal period to reflect the actual use of resources compared to those resources that had been approved by the legislative body (ex-post). The relationship between the types of budget reports and the levels of government are identified below:

Types of Budget Reports		**Local**	**State**	**National**	
				Agencies	**Central Govt.**
Ex-Ante	**Legal Limits Approved by Legislature**				
Ex-Ante	**Prospective**				
	Ex-Post				

Budget reports by type may be prepared on the cash, modified cash or modified accrual (including obligation/commitment), or the accrual basis as reflected in the table below:

Types of Budget Reports		Cash	Modified	Accrual
Ex-Ante	**Legal Limits Approved by Legislature**			
	Prospective			
	Ex-Post			

Consistency in Reporting Between Accounting and Budget Systems

Most governments will prepare their budget reports on the cash basis because the cash information is more readily available. In addition, some argue information about only cash is more readily understandable than information about all assets and liabilities. Further, cash systems are simpler to implement and costs are low due to the lower level of accounting skills required. As some governments transition to the accrual basis of accounting, a few prepare their budget reports on the modified accrual basis (which includes current assets and liabilities) in order to plan for the use of financial resources. If the full accrual basis of accounting (which includes total assets and liabilities) is used, some governments may move to the accrual basis of budgeting so that they can plan for the use of total resources. This relationship is reflected in the table below:

		Budgeting Basis		
		Cash	**Modified**	**Accrual**
Accounting Basis	**Cash**			
	Modified			
	Accrual			

Note: The shaded areas identify those governmental entities where the budgeting system and the accounting system use the same basis.

As countries transition to the accrual basis of accounting, some may prefer to retain the cash basis for budgetary reporting purposes. Consequently, the accounting system would retain the cash or near cash basis for budgetary control and use the accrual basis for preparation of the general purpose financial statements. A few countries are in the process of moving the budgetary system from the cash basis to the accrual basis in order for the budgetary system to be consistent with the accounts recorded on the accrual accounting basis. However, this transition period can be lengthy in order to assure that control is retained in the budgetary system. When there is a difference between the budgetary basis and the accounting basis, readers of the financial statements may get confused between the differences reported as surplus/deficit from operating activities in the accrual accounting reports and net cash flows from operating activities in the cash or modified cash/accrual basis budget report.

Current Budget and Accounting Practices

Comprehensive Budgets

To be effective, it is generally recognized that the budget needs to be comprehensive and governmental activities should encompass all of the expenditures by government for all budget dependent entities. Since one objective of this Research Report is to identify guidance on best practices in budget formulation, execution, and reporting, it is necessary to develop some criteria for such best practices. The World Bank Public Expenditure Management Handbook[3] suggests three levels of goals for expenditure management. These are linked to criteria in a matrix provided by Michael Parry (International Management Consultants), as indicated in Exhibit 3 below:

Exhibit 3: Financial Management Goals and Criteria

GOALS	CRITERIA		
Level 1 - fiscal management ➢ Flows - revenues, debt, transfers, capital and recurrent expenditures ➢ Balances - internal and external debt, assets ➢ Risk - contingent liabilities	**Proper use of public resources** In accordance with constitutional, legal and regulatory requirements Avoidance of corrupt practices	**Transparency** Information for stakeholders in a format that facilitates understanding and analysis	**Accountability** Those accountable for the use of public resources made accountable for their actions and stewardship
Level 2 - resource allocation ➢ Optimal resource allocation ➢ In accordance with government policy priorities			
Level 3 - value for money ➢ Management of public resources in order to achieve efficiency, economy and effectiveness in expenditure			

In some jurisdictions, budget formulation and execution is a centralized function. In others, it is decentralized. For example, in Europe, some budgets are prepared and reported for the aggregate of three levels of government: national, state or provincial, and local governments. Where it is decentralized, the national government does not control the state or local government.

Extra budgetary funds weaken the budget both as a resource allocation tool, and as a tool of fiscal management. Many systems, especially in developing countries, have the potential for large extra budgetary expenditures. Some examples include the following:

(i) Funds are received by line agencies that are then available for expenditure, without passing through the consolidated fund. There may be merit on occasions for linking expenditures to revenues raised, but these need to be planned and controlled through a central budget process. In most countries, direct use by agencies of monies they collect is against the Constitution (which requires all monies to be paid into the consolidated fund) but it still

[3] Chapter 2, Public Expenditure Management Handbook, 1998 (The World Bank).

happens. From a managerial perspective, such linkage may be beneficial since it links expenditure to collection efficiency.

(ii) Quasi-fiscal activities of state financial institutions exist to subsidize state enterprises. This includes loans at low interest rates without the expectation of repayment.

(iii) Some government entities permit direct access by projects to donor funds. From a project management perspective, it may be desirable to by-pass the bureaucracy and have direct access to donor funds. In some cases, donors encourage such a system. However, this reduces the effectiveness of the budget process to control expenditures.

(iv) Some government entities have multiple funds outside the consolidated fund that are not included in the central budget process. This includes special funds for ongoing expenditures (e.g. road construction, health care projects, etc.), special funds managed by the central budget authority, budgets of autonomous/decentralized agencies, emergency/contingency funds, etc. In such cases, it is difficult to achieve effective control over these funds.

OECD/World Bank Survey of Current Budgetary Practices

The Organization for Economic Cooperation and Development or OECD (in collaboration with the World Bank, the Inter-American Development Bank, and IMF) developed a very comprehensive survey on Budget Practices and Procedures. They are in the process of surveying 30 OECD Member countries and 30 non-OECD countries on their Budget Practices and Procedures. The goal of this survey is to create a database of quantitative measures that will provide a unique and comprehensive resource for various groups to assist them in making well-informed analyses and enable them to compare and contrast national practices. The OECD/World Bank recently published the results of their Budget Practices and Procedures Survey on their website (see http://ocde.dyndns.org). Forty-four of the 60 polled countries responded by December 31, 2003 although not all the questions were answered in full by each of the countries. Responses are in the process of being verified. The countries responding to the survey were as follows:

Algeria	Argentina	Australia	Austria
Belgium	Bolivia	Cambodia	Canada
Chile	Colombia	Czech Republic	Denmark
Egypt	Finland	France	Germany
Greece	Hungary	Iceland	Indonesia
Ireland	Israel	Italy	Japan
Jordan	Kenya	Korea	Mexico
Morocco	Netherlands	New Zealand	Norway
Peru	Portugal	Slovak Republic	Slovenia
South Africa	Spain	Suriname	Sweden
Turkey	United Kingdom	United States	Uruguay

The results of the survey are grouped under these separate and distinct parts:

1. General Information
2. Formulation
3. Budget Execution
4. Accounting, Control and Monitoring Systems
5. Budget Documentation and Performance Management
6. Fiscal Relations Among Levels of Government
7. Special Relationships/Issues

Selected sections of the survey results that were felt to be especially pertinent to this study are reflected below:

Budgeting, Accounting, and Financial Reporting

Section 4.2 of the survey discusses the Budgeting, Accounting and Financial Reporting practices of the countries. The major findings were as follows:

Number with a unified accounting and budget classification system	35
Authority for determining the technical standards for the budget:	
Internally by Ministry of Finance (MOF) or Central Budget Authority	26
Formal Advisory Board	9
Authority for determining the technical standards for the financial statements:	
Internally by MOF or Central Budget Authority	17
Formal Advisory Board	9
Cash or obligations/commitments basis of accounting for the budget	
Full accrual basis budgeting to be introduced	5
Additional accrual basis information to be presented	11
Planning to change from cash to obligations/commitment basis	2
Not planning any change from the cash or obligations/commitments basis	16
Number indicating public debt interest as highest chance of being on accrual basis	10
Number providing a partial or full statement of their accounting basis in the budget	28
Consolidated, government-wide annual financial statements:	
Number reporting on a cash, or cash with a few exceptions, basis	20
Number reporting on a full accrual, or full accrual with a few exceptions, basis	7
Number not reporting such a statement	4
Government organization annual financial statements:	
Number reporting on a cash, or cash with a few exceptions, basis	18
Number reporting on a full accrual, or full accrual with a few exceptions, basis	8
Number reporting on full accrual basis that capitalize and depreciate all assets	10

Assets not capitalized and depreciated:	
Military assets	11
Historical buildings	9
Highways	7
Basis for valuation of capital assets with readily identified market values:	
Historical cost	13
Current market value or replacement cost	10
Audited final accounts published and available publicly:	
Within three months of the end of the fiscal year	4
Within three to six months of the end of the fiscal year	13
Generally more than six months of the end of the fiscal year	17
Not published and available	2

Types of Data Reported in Budget Documents[4]

In Section 5.2, the countries were questioned on the Types of Data Reported in Budget Documents. The major findings were as follows:

Time period of budget forecasts:	
Forecast of fiscal aggregates for the budget year plus two years	23
Formal rolling medium-term (3-5 years) estimates of expenditures	20
Formal rolling medium-term (3-5 years) estimates of revenues	17
Audited final accounts submitted to the legislature:	
Within six months	20
Within six to 12 months	13
After more than 12 months or not at all	7
Budget to actual comparative statement prepared:	
Yes, for past year	27
Yes, for past two years or more	6
No	2
Other	5
Budget to actual comparative statement legally required:	
Yes	13
No	27

[4] There was no indication that the budget forecasts were subject to external review. Budget information was included in ex-post comparative financial statements. Although it is not specified in the survey instrument, it is assumed that budgetary information is included in the audited final accounts when submitted to the legislature.

Budget Classification

Section 5.3 of the survey addresses Budget Classification. The major findings were as follows:

Classification schemes:	
By function	33
By economic class	35
By line-item or object class	21
Capital/current expenditure breakdown	33
By organization or administrative unit	29
By program	22
UN/GFS functional classification used	14

Budgeting and Reporting

Section 6.5, Budgeting and Reporting, asks questions about the fiscal relationships between the various levels of government. The major findings were as follows:

Common standard for budgeting by national and sub-national governments:	
Yes, same budget classification and accounting rules set by national government	18
No, common standards are not used but national government sets standards for both	11
No, common standards are not used and each authority decides own classification	9
Actual general government figures transmitted to legislature:	
Yes, transmitted and discussed at the end of the financial year	8
Yes, transmitted for knowledge purposes at the end of the financial year	17
No, figures are not transmitted at the end of the financial year	10

Summary of Five African Countries

In 2002, civil society budget analysis organizations from Ghana, Kenya, Nigeria, South Africa and Zambia published the results of a research project on Budget Transparency and Participation in the Budget Process.[5] The purpose of the study was to evaluate the extent to which these countries provided sufficient budgetary information and access to citizens and civil society organizations so that they can participate effectively in the budget process. The study was intended to create a civil society agenda to demand changes in the budget process.

Research Method

The research results were derived from semi-structured interviews with respondents in the executive and legislature branches of government, independent organs of state, civil society and the media. The qualitative data derived from these interviews was supplemented by a survey of budget documentation, audit reports, policy papers and legislation. In addition, a peer review

[5] Details of the project may be found at http://www.internationalbudget.org/resources/africalaunch.htm.

group was established in each country to check the congruency and accuracy of the results. The study framework examined three issues. The first dimension examines the four stages of the budget process – the drafting, legislative, implementation and auditing stages. The second dimension examines each of these stages by looking at the availability of information, the clarity of roles and responsibilities between institutions in the budget process, and the systems and capacity to generate budget information. The third dimension focuses on the legal framework supporting transparency and participation in the budget process.

Results

Although aspects of budget transparency and participation in the budget process were found to be wanting in each country, there were important distinctions between the countries studied. The results suggest that the countries could be classified into three layers. South Africa scored the highest, Ghana and Kenya occupy a second layer, and Nigeria and Zambia a third layer. South Africa scored "good" on the legal framework and "moderate" on transparency and participation in the budget process. This reflects the comprehensive overhaul of the budget process undertaken since 1994 and the substantial improvements in public availability of information. There is a clearer framework for accountability for public resources and delivery and more transparent management of the wider public sector. The primary concern now is the creation of better access for parliament and citizens, and the development of capacity in these institutions to make good use of the information.

The next layer of countries is Kenya and Ghana. Both countries scored "moderate" on the legal framework and "weak," but improving, on participation. The Kenyan legal framework was found to be comprehensive, but outdated and in conflict with government policy. Although substantial public information is generated, it is often late, inaccurate and in formats that are hard to use. The budget process in Kenya does not easily accommodate external participation, but both parliament and civil society are increasingly exploiting opportunities to hold the executive accountable. In Ghana, a moderately good legal framework should ensure greater information and participation. However, this potential is compromised by gaps and the official secrets legislation, and is often outdated. Although public information is more available in Ghana than in Zambia and Nigeria, the information that is produced is frequently late, inaccurate and not particularly useful – in many cases the result of poor capacity to produce information. On the positive side, the introduction of the Medium Term Expenditure Framework (MTEF) and increasing participation by civil society is helping to push the country in the right direction.

In the third layer of countries, Zambia and Nigeria were found to have both "weak" legal frameworks and "weak" transparency and participation. The legal framework in Zambia allows for virtually limitless expenditure with approval after the fact and requires very little information to be published. While transparency is hampered by lack of compliance and cash budgeting, civil society and parliament are starting to forge a space for participation with positive effects. In Nigeria, a contradictory and ambiguous legal framework is a large part of the problem, particularly as it impacts on the comprehensiveness of the budget and the audit process. While civil society participation also remains weak, the increasingly active engagement of the legislature is a positive sign.

Summary of Nine European Countries and the European Commission (EC)

"Reforming Governmental Accounting and Budgeting in Europe" was published in late 2003.[6] To facilitate convergence in the accrual-based reforms, this book describes (at national and sub-national levels) the current and prospective forms of financial reporting and budget preparation for nine countries in Europe: Finland, France, Germany, Italy, Netherlands, Spain, Sweden, Switzerland, and the United Kingdom. In addition, a chapter was added on the reform of the EC's accounting system. The goal of the publication was to spark discussion, highlight areas for action, and present practical solutions. The reform of governmental budgeting and accounting practices was identified as an important and necessary long-term objective.

Research Method

Research was conducted in each of the countries by one or more nationals of the relevant country in a cooperative effort between academe and practice. The intent of the research was to identify current governmental accounting practices, as well as current budgetary accounting principles and procedures. Workshops were conducted throughout the research period to establish a uniform structure for the country studies, to discuss relevant findings, and to assist in developing cross-country conclusions.

Results

All of the countries covered by the study have embarked on reforms of the accounting reporting systems towards full accrual accounting for their core national or local governments. Whereas all local government systems have been or are being reformed, the reform process has not yet started in the national governments of Germany, Italy, and the Netherlands. Six of the national governments (Finland, France, Spain, Sweden, Switzerland, and United Kingdom) have begun the reform process, as has the EC. Three of them (Finland, Spain, and Sweden) have essentially completed the reform by creating the necessary legal requirements and the new system is in regular operation. This also applies to the United Kingdom except that whole-of-government financial statements are not yet in place. The accounting method used impacts on the budgetary reporting practices, especially relative to comparative budget to actual statements if the budget is on a different basis than the accounting system.

The clear pattern was for the local governments in each country to precede the national governments; in none of the countries was national governmental accounting reformed first. "The norm for budgeting is that the accrual accounting either has no influence on budgeting (which retains its basis of cash or cash plus changes in financial assets and liabilities) or the influence is implicit (the accrual accounting is used to report on realization of the budget but the budget itself does not significantly refer to accruals)."[7]

PSC Mandate on Budget Reporting and/or Other Budget Related Matters

This Report focuses on IPSASs that are standards for general purpose financial statements. Recommendations made about the PSC role in developing standards (rather than identifying and

6 Reforming Governmental Accounting and Budgeting in Europe; Klaus Luder and Rowan Jones, editors (Fachverlag Moderne Wirtschaft, Frankfurt, Germany), 2003.

7 Ibid, p. 55.

encouraging best practices) refer to standards that will be complied with in preparation of general purpose financial statements. These statements will be audited to ensure compliance with the IPSASs. Thus, use of these standards is different from benchmarks (or industry standards) identified by international oversight bodies for best budget practice and often relate to matters of process, technique and skill.

Discussion

The objective of the PSC is identified in the Preface to the IPSASs as follows: “Develop programs aimed at improving public sector financial management and accountability including developing accounting standards and promoting their acceptance.”[8] Further, the Preface notes that: “financial statements issued for users that are unable to demand financial information to meet their specific information needs are general purpose financial statements. Examples of such users are citizens, voters, their representatives and other members of the public. The term ‘financial statements’ used in this Preface and in the Standards covers all statements and explanatory material which are identified as being part of the financial statements.”[9]

Inclusion of budgetary information and other budget related matter in the accounting system and reporting budgetary data to constituents is crucial to improving public sector financial management (transparency). To assure that government officials are held accountable for their budgetary decisions, it is essential that users be informed on the degree by which their government officials were able to operate within the limits of the approved budget.

International Public Sector Accounting Standards[10]

IPSASs deal with issues related to the presentation of annual general purpose financial statements at each level of government (local, state, and national) and for public sector entities other than GBEs. General purpose financial statements include those that are presented separately or within another public document such as an annual report. The objectives of general purpose financial statements are to provide information useful for decision-making, and to demonstrate the accountability of the entity for the resources entrusted to it. IPSAS 1 notes that users include taxpayers and rate payers, members of the Legislature, creditors, suppliers, the media, and employees. Elected representatives act on behalf of their constituents and use the financial statements to hold the government and the civil service to account for the resources that they were allocated to provide the agreed level of goods and services. Where the financial information needs of members of government for these purposes differ from the needs of other users, and where governments are dependent on general purpose financial statements for such information, their information needs should dominate.

In addition, general purpose financial statements can have a predictive or prospective role since they can provide information useful to predict the level of resources required for continued operations. Further, these statements provide users with information indicating whether resources were obtained and used in accordance with the legally adopted budget. Currently, the IPSASs

8 “Preface to International Public Sector Accounting Standards”, Handbook of International Public Sector Accounting Standards (2003 Edition), International Federation of Accountants, p. 18.

9 Ibid, p. 19.

10 Sections from the existing IPSASs pertaining to budgets or budget reporting are identified in Appendix D.

encourage governments to include in the financial statements a comparison of the actual results of operations with the approved budget for the reporting period.[11]

The current IPSASs prescribe standards for the presentation of annual general purpose financial statements on the cash or the accrual basis of accounting. The accrual basis is preferred[12] for the following reasons: improved resource allocation, strengthened accountability over all resources, enhanced transparency on total resource costs of government activities, and more comprehensive view of government's impact on the economy. A Cash Basis IPSAS has been issued to prescribe financial reporting requirements where the countries do not prepare financial statements of public sector entities on the accrual basis. The Cash Basis IPSAS requires an annual Statement of Cash Receipts and Payments. If their financial statements are prepared on the cash basis, the government entities are **encouraged** to transition to the accrual basis as soon as proper procedures and systems can be established.[13]

Recommendation #1: The PSC should issue an IPSAS (or IPSASs) on budget reporting since it falls within the mandate identified in the Preface to the PSC.[14] It may be beneficial to issue separate IPSASs on ex-ante and ex-post budget reports. An IPSAS (or IPSASs) on Budget Reporting will provide guidance on information that should be disclosed in general purpose financial reports about budgetary actions (both legally approved budgets and prospective budgets) at the time of their approval as well as the comparative reports issued as a component of the general purpose financial statements at the end of the fiscal period. The IPSASs should also provide guidance on the format of disclosure.

Budget Formulation and Ex-Ante Reporting

Budget formulation is the practices and concepts that budget professionals use to create and review a budget until enacted into law. Ex-ante budget reporting includes the external reporting of the budget approved by the legislative body at or near the beginning of the fiscal period as well as prospective or forecast budgetary data. The approved budget and forecast budgetary data are generally issued as separate reports at or near the beginning of the fiscal period.

Prospective Financial Information and Medium Term Fiscal Framework (MTFF)—also known as Medium Term Budget Framework (MTBF)

Fiscal targets are now widely accepted as a useful guide to sound public financial management and are increasingly required under such mechanisms as fiscal responsibility/transparency laws. These targets may cover a range of variables (budget balance, net public debt, net worth, etc.) and they are invariably medium term covering more than one year. Given that governments have medium term targets (under a MTFF or other documents), governments are encouraged to report on future projections beyond the current year in their budget reports.

11 Paragraph 22, IPSAS 1, Presentation of Financial Statements (May 2000).
12 Government Finance Statistics Manual, International Monetary Fund (2001).
13 For further guidance, see Study 14—Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities, IFAC Public Sector Committee (December 2003).
14 It is interesting to note, at meetings in July 2003 and November 2003, the PSC expressed the view that compliance reporting was in its scope. However, PSC members had different views about an IPSAS on Budgetary Reporting. PSC members agreed not to prejudge the outcome of the research on this subject.

A MTFF includes both revenue and expenditure forecasts. If the forecasts only deal with expenditures, it is referred to as a Medium Term Expenditure Framework (MTEF). To ensure consistency in taxing and spending policies from one fiscal period to another, it is beneficial to have a planning horizon of at least three years. This planning horizon can be assisted by the work of macroeconomists to assure comparability in reporting from country to country. **Accurate accounting systems** are critical to providing good information for computing a country's gross domestic product and other key statistics used by macroeconomists.

Each country hopes to improve their standard of living over time. Dividing GDP by the population is a good guide to measure average living standards. The degree of improvement in the standard of living from year to year is measured by the percentage change in the per capita GDP. Decision makers use this information to develop their taxing and spending policies (i.e., fiscal policy) for future years. Some countries incorporate this information into a MTFF to assist in preparing future budgets. The objectives of a MTFF (as identified by the World Bank[15]) are as follows:

- Improve macroeconomic balance by developing a consistent and realistic resource framework;
- Improve the allocation of resources to strategic priorities between and within sectors;
- Increase commitment to predictability of both policy and funding so that ministries can plan ahead and programs can be sustained; and
- Provide line agencies with a hard budget constraint and increased autonomy, thereby increasing incentives for efficient and effective use of funds.

A MTFF is generally prepared for at least a three-year period. The stages for the preparation and implementation of a MTFF have been identified as follows by the World Bank:[16]

1. Link economic projections to fiscal targets on what is fiscally affordable and construct a macroeconomic model.
2. Perform sector review of ministry objectives, outputs, and activities with agreement on programs and their costs over a three year period.
3. Conduct series of hearings between the Ministry of Finance and sector ministries to go over the outputs of the sector reviews.
4. Develop strategic expenditure framework to provide the basis for the sector expenditure ceilings for the upcoming budget year as well as the two outer years.
5. Ceilings approved by the main decision-making body in government (i.e., Cabinet) in order to make medium term sectoral resource allocations on the basis of affordability and inter-sectoral priorities.
6. Ministries adjust their budget estimates to make them fit within the approved ceilings.

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[15] Page 46, Public Expenditure Management Handbook, Poverty Reduction and Economic Management, The World Bank, 1998.

[16] Ibid, Pp. 47-52.

7. Revised ministerial budget estimates are reviewed again by the Ministry of Finance and presented to the Cabinet and the Parliament for final approval.

At least one country (New Zealand) requires that prospective financial information be prepared and presented to its constituents.[17] Its objectives are to assist users:

(a) In assessing the entity's prospective financial performance, prospective financial position and prospective cash flows;

(b) By informing them of the entity's actual or future likely compliance with legislation, regulations, common law and contractual arrangements, as these relate to the assessment of the entity's prospective financial performance, prospective financial position and prospective cash flows; and

(c) In making decisions about providing resources to, or doing business with, the entity.

Recommendation #2: An accounting standard should be issued to require that the forecast and other prospective financial information be reported to their constituents in order to keep them informed on future financial implications of government policy. Preparation of a MTFF or other prospective financial information so that the "predictive or prospective role" provided by the general purpose financial statements can be met and one of the purposes of financial statements specified in IPSAS 1[18] can be achieved. The elements of historical financial information used in the preparation of a MTFF and other prospective financial reports primarily include revenue and expense data. In some cases, the value of fixed assets and their age is also included in order to compute the anticipated cost for replacement of those assets and to plan for new construction. In addition, the repayment (both principal and interest) of debt is an essential component of the MTFF and other prospective financial reports. This information is very beneficial to the users in the ongoing debate of government policy. If this recommendation is adopted, issues associated with the recognition and measurement of the data will need to be identified and the extent of external validation by auditors will need to be determined.

Annual or Biennial Budget Formulation

Funds are appropriated on an annual or biennial basis to permit control of funds within a fiscal period. The United Nations Development Program has identified some of the key factors that contribute to making the budget preparation process effective in practice. These are as follows: transparency, management, decentralization, co-ordination and co-operation, integration, flexibility, discipline, link to medium term framework, accountability and credibility, and comprehensive. Specifically, it recommends that the budget contain information on the previous and current years' expenditures. (See Appendix E.)

To permit comparisons between countries, the IMF encourages the use of prescribed codes that assist in computing analytic measures for fiscal policy decisions. The reporting system prescribed by the IMF is a statistical system to measure fiscal performance but it is not an accounting system. The functional classification of expenses is the same as that used by the

[17] Financial Reporting Standard No. 29, Prospective Financial Information, Institute of Chartered Accountants of New Zealand (October 2001).

[18] Paragraph 14, IPSAS 1.

United Nations in their System of National Accounts. The breakout of the revenue and expense codes is summarized below:[19]

- Classification of Revenue
  - Taxes
  - Social Contributions
  - Grants
  - Other Revenue
- Economic Classification of Expenses
  - Compensation of Employees
  - Use of Goods and Services
  - Consumption of Fixed Capital
  - Interest
  - Subsidies
  - Grants
  - Social Benefits
  - Other Expenses
- Functional Classification of Expenses
  - General Public Services
  - Defense
  - Public Order and Safety
  - Economic Affairs
  - Environmental Protection
  - Housing and Community Amenities
  - Health
  - Recreation, Culture, and Religion
  - Education
  - Social Protection

Note: Countries and regions (i.e., the European System of Accounts) may provide alternative economic and functional classifications. Although the classifications may differ slightly from those specified above, they can generally be converted to the classifications desired by the IMF and the UN.

In those countries in which a MTFF or other prospective financial information is prepared, the initial efforts to formulate the annual budget and set the spending limits is taken from the

[19] Summarized from pages 178-179, 182-183 of the Government Finance Statistics (GFS) Manual 2001, International Monetary Fund. See http://www.imf.org/external/pubs/ft/gfs/manual/ for detailed breakout.

forecast information for the upcoming budget year. This planning budget is revised, based on input from responsible decision makers (i.e., ministers, etc.), to reflect any major changes in priorities due to changes in economic or political situations. In those countries in which a MTFF or other prospective information is not prepared, a budget call is sent to responsible decision makers in order that they might identify their needs for the upcoming fiscal period.

Historical accounting records are used to identify the revenues received and expenses incurred for each fiscal period. This historical data is critical to assure that proposed budgets are consistent with prior periods and that the proposed budgets might be sustainable in future periods. These records are maintained at a sufficiently low level of detail to establish spending limits by functional and economic expense classifications.

As soon as the decision makers have identified their needs to the Minister of Finance, a series of meetings and hearings are held to give all concerned parties an opportunity to assist in establishing spending priorities for the upcoming budget year. Depending on the amount of revenue anticipated, spending limits are established and the budget is sent to the legislative body for deliberation (with revisions, as necessary) and approval. Once approved, a law is passed that legally authorizes the expenditure of funds for the upcoming fiscal period. If the financial management system is automated, this approved budget is then loaded into the accounting system in order to assure that budget users operate within their authorized budgetary authority and to provide commitment control over expenses.

As a result of the African study mentioned earlier, numerous reforms were proposed. Across all countries included in the study, growing civil society and legislative demand for transparency, access and better results were shown. Given the shift in the political climate towards democratization, the study argues that now is a fortuitous time for budget reforms, provided that they pay attention to the principles of transparency and participation. Although greater civil society and legislative monitoring of budgets is a relatively recent development, their intervention can contribute to modest first steps on the road to more open systems and can help kick-start a virtuous cycle of transparency, participation and better spending results. In addition to recommendations for each country, the study concludes with the following cross-country recommendations for budget reform:

- The improvement of budget documentation is a critical first step. Budget documentation should include fiscal policy statements, explain the policy base of allocation decisions and be framed in the previous years' actual spending and non-financial information.
- Repeal official secrets legislation and replace it with legislation that guarantees appropriate citizen access to state-held information.
- Entrench the provision of comprehensive and timely information on estimated and actual expenditure and revenues in a budget law that also sets out a clear budget process and clarifies roles and responsibilities.
- External reporting during the spending year should be obligatory, including a cash budgeting system. This should include departmental reporting on achievements. If late audit information makes early annual reports at central government and spending agency level unfeasible, interim mechanisms should be created.

- Extra-budgetary spending should be brought onto budget. If this is difficult, comprehensive and accurate information on these activities should be included with the budget.
- The enhancement of external transparency should coincide with efforts to build internal transparency. Often political decision-makers and their administrative advisors make decisions on very imperfect information.
- The capacity of auditors general should be enhanced. Parliamentary capacity to scrutinize budget proposals and oversee implementation should be institutionalized.

Recommendation #3: The accounting standards should require that the legally approved budget be published with the appropriate supporting budget documentation (e.g., assumptions). The following documentation and procedures are suggested**:**

- Clearly identify the assumptions used and their rationale, risks associated with those assumptions, sensitivities, etc.
- Use of asset, liability, net assets, revenue, and expense codes in accordance with IPSASs and statistical classification bases to the maximum extent possible. Although attempts have been made to harmonize the statistical bases with the IPSAS, some differences may exist particularly in respect of the reporting entity. In those instances, the procedures prescribed by the IPSAS should prevail. Further, budgets may be prepared on the basis of programs relevant for financial management and service delivery in some jurisdictions and the need to complete statistical returns should not undermine that role of the budget.
- Preparation of an annual budget in sufficient time to establish spending limits prior to the beginning of the fiscal period. It is expected that the annual budget would use the prior year financial statements in the preparation stage of the budget. As stated in paragraph 74, IPSAS 1, “An entity should be in a position to issue its financial statements within six months of the reporting date.”
- The scope of the budget should be comprehensive including all aid, government business enterprises, revolving funds, income of dedicated funds, etc.

Budget Execution and Control

Budget execution is the management activities that take place from enactment of the budget into law until the end of the fiscal period. Budget control is assuring that the budget is executed within the legal limits established by the legislative body.

Inter-Relationship between Accounting and Budgeting Systems

The World Bank has developed a diagnostic tool (called a Country Financial Accountability Assessment or CFAA) to enhance the Bank’s knowledge of public financial management (PFM) arrangements in client countries.[20] The CFAA supports both

- The Bank’s fiduciary responsibilities by identifying the strengths and weakness of PFM arrangements so that the likelihood that all public funds, including those provided by the Bank and development partners managed through the country’s PFM system, are appropriately managed, and

[20] Guidelines to Staff, Country Financial Accountability Assessment, Financial Management Sector Board, World Bank (March, 2003).

- The Bank's development objectives, by facilitating a common understanding by the borrower, the Bank, and development partners that leads to the design and implementation of capacity-building programs to improve the country's PFM system.

The key issues to be examined in the CFAA in the areas of external fiscal reporting and transparency (including the standards to be used in their preparation—GFS, IPSAS or modifications of either) are identified in Appendix F. Integration between the financial reporting and budgeting systems are essential for budgetary control as explained below.

There is a close relationship between accounting systems and budgetary systems in order to identify whether funds are expended in the manner desired by the legislature. This close relationship has been identified in an OECD document on Best Practices for Budget Transparency. The Best Practices are in three parts: Part I lists the principal budget reports that governments should produce and their general content. Budget reports identified were as follows: the budget, pre-budget report, monthly reports, mid-year report, year-end report, pre-election report, and long-term report; Part II describes specific disclosures to be contained in the reports; and Part III highlights practices for ensuring the integrity of the reports. The budget is identified as the government's key policy document and should include a medium-term perspective illustrating how revenue and expenditure will develop during, at least, the two years beyond the next fisca year. The year-end report is identified as the key accountability document showing compliance with the level of revenue and expenditures authorized by parliament in the budget. The OECD Report recommends that the year-end report be audited by the Supreme Audit Institution and released within six months of the end of the fiscal year. The document further states that "All fiscal reports referred to in these Best Practices should be made publicly available."[21]

The OECD Report also argues it is essential that these systems be integrated to the maximum extent possible. These integrated systems are sometimes referred to as Government Financial Management (GFM) systems. The objectives of a well-performing budget resource allocation and management system are to:

- Control aggregate spending and the deficit;
- Facilitate strategic prioritization of expenditures across policies, programs, and projects for allocative efficiency and equity; and
- Encourage better use of budgeted resources to achieve outcomes and produce outputs at the lowest possible cost.

As explained in a World Bank document,[22] "management of these three objectives is integrated through a perspective that goes beyond the annual budget cycle. This is achieved by linking policy, planning and budgeting in a medium term expenditure framework at both the overall government and sectoral levels. GFM systems provide decision-makers and public sector managers with a set of tools to support these objectives. The architecture of the information systems network is determined by the basic functional processes that public sector managers

[21] Par. 3.4, OECD Best Practices for Budget Transparency, 19 September 2000, http://www.oecd.org.
[22] Page 9, Information Systems for Government Fiscal Management by Ali Hashim and Bill Allan, The World Bank, 1999.

employ to achieve these objectives and the overall regulatory framework that underpins these processes." (See Appendix G for the basic functional processes including budget preparation, execution, accounting, and fiscal reporting.)

The overall regulatory framework for operating the various component modules of the GFM system consists of the following elements:

- Control Structure—Generally derived from a legislative framework with basic principles laid down in financial provisions in the constitution and laws related to the management of public finances.
- Accounts Classification—The code structure for classification of accounts is a methodology for consistently recording each financial transaction for purposes of financial control and costing as well as economic and statistical analysis. This structure is needed to provide a consistent basis for the following:
    - Consolidating government-wide financial information;
    - Integrating planning, budgeting and accounting;
    - Capturing data at the point of entry throughout the government; and
    - Compiling budget allocations as well as program and project costs within and across various government agencies.
    - Reporting Requirements—Generally specified in two areas: (1) external reporting to provide information to the legislature, the public, and other interested parties, and (2) internal management reporting for government policy makers and managers.

Members of the World Bank and the IMF explain the importance of the relationship between accounting and budgetary information as follows:[23]

> The Treasury System is used to produce periodic fiscal reports that give a consolidated picture of all receipts and expenditures and progress against budget targets. For these reports to be comprehensive, all items of receipts and expenditure need to be captured. The Government Chart of Accounts is the basis of the fiscal reporting process. These include the Fund, organizational, functional and economic classifications structure of the budget and the classification of account groups, assets and liabilities. . . . On the basis of this data, the MOF can prepare overall fiscal reports that compare actual expenses and receipts with the budget estimates. These reports provide a status report and recommendations and action plans for corrective action during the course of the year.

Recommendation #4: The accounting standards should be broad enough to support the integration of budgetary and accounting systems through the use of budgetary accounting procedures. It may be beneficial to issue a separate IPSAS on budgetary accounting procedures. Budgetary accounting procedures may include separate accounts for estimated revenues, appropriations, allotments, allocations, and commitments. The elements of financial information (especially revenue and expenses) used in the accounting system should be the same

[23] Page 176, Treasury Reference Model by Ali Hashim (World Bank) and Bill Allan (IMF), http://www1.worldbank.org/public sector/pe/trmodel.htm (3/14/2001).

as that used in the budgeting system in order to compare the results of operations with the approved budget. For maximum benefit, these comparative results should be reported in the general purpose financial statements although such comparative information is not currently required by the IPSASs. This does not mean that the budgetary system and the accounting system need to be on the same basis. It does mean that the accounting system needs to support the preparation of a comparative statement on the same basis as the budgetary system. For example, if a cash budget is approved by the legislative body and the accounting system is on an accrual basis, the revenue and expenses in the accounting system would need to be reported in the comparative statement on the cash basis in order to be comparable to the budgetary data.

Budgetary Control

To assure that spending limits are not exceeded, the approved budget is entered into the accounting system at the beginning of the fiscal period at the level of control desired (i.e., by economic and functional expense classifications) in a fully integrated financial management system. Then, as transactions occur, the actual revenue and expenses can be compared to the budgeted revenues and expenses in order to provide assurance that the spending limits have not been exceeded. For those budgetary systems that are not well integrated with the accounting module, a separate budget or funds control module is often maintained. In addition, a separate cash management module is used to assure that cash is available to compensate employees or pay invoices when payment is due. Consequently, proper cash planning is critical to the overall management process.

Compensation of employees (an economic expense classification in GFSM 2001) is generally the largest recurring expense item in any government. Funds are set aside in the approved budget to assure that sufficient funds (by functional expense classification) are available for periodic payment of employees. As actual payrolls are processed, the financial managers within each function can monitor this economic expense and be assured that the expense will not exceed the approved levels during the fiscal period.

Repayment (both principal and interest) of debt is often another large outlay of funds. Funds are set aside in the approved budget for this purpose. Fiscal discipline by the financial managers in their respective areas of responsibility is critical in order to assure that sufficient funds are available for payment of debt when due. In this manner, the country is able to maintain a good credit rating that will generally contribute to lower interest payments on future debt.

The use of goods and services, as well as expenditures for capital projects, is also budgeted at the beginning of each fiscal period. To assure that these spending limits are not exceeded, some countries use “commitment” accounting procedures. This technique permits a financial manager to compare budgetary fund availability to the anticipated expenses for the goods or services or the approved budget for capital projects **prior to** the release of a purchase order or a contract. Once approved and released, the financial manager can be assured that budgetary funds will be available for the payment of the goods or services at the time they are received or the payment on capital projects when due. There is some inconsistency throughout the world in the use of “commitment” accounting procedures. To clarify these procedures and lessen the confusion over the terminology, see Appendix H for a more complete discussion of this technique as explained by IFAC in a previous study.[24]

Recommendation #5: In relevant studies and guidance, the PSC should acknowledge and encourage the use of commitment accounting procedures intended to assure that budgetary funds are available prior to release of a purchase order or contract. Although budgetary accounting procedures are not presently included in an accounting standard, effective use of commitment accounting procedures will lessen the explanatory notes at the end of the fiscal period when actual expenditures exceed the approved limits. Further, these procedures can be beneficial in a budgetary system for the acquisition of infrastructure and military special assets, as well as the control of government grants.

Ex-Post Budget Reports

Ex-post budget reporting would include external reporting of the financial activities relative to the enacted budget for the fiscal period until the final audit after the end of the fiscal period. The budget to actual comparative statement is generally issued as a component of the historical financial statements.

Part of General Purpose Financial Statements

In a prior IFAC study, the following user needs[25] were noted:

> "49. Although the users described above have a range of information needs, and some groups may place a higher or lower priority on certain types of information than other groups, the user groups also have similar information needs. The PSC considers that, taken as a collective group, users expect that governmental financial reports will help them to:
>
> - Assess the sources and types of revenues;
> - Assess the allocation of and use of resources;
> - Assess the extent to which revenues were sufficient to cover costs of operations;
> - Predict the timing and volume of cash flows and future cash and borrowing requirements;
> - Assess the government's long term ability to meet financial obligations, both short and long term;
> - Assess the government's or entity's overall financial condition;
> - Provide the public with information concerning those assets held on behalf of taxpayers, specifically information on ownership and control, composition, condition and maintenance;

24 Study 11, Government Financial Reporting, May 2000. IFAC Public Sector Committee.
25 Ibid. Pp. 11-12.

- Assess the financial performance of the government or entity in its use of resources;
- Assess the economic impact of the government on the economy;
- Evaluate government spending options and priorities;
- **assess whether resources were used in accordance with legally mandated budgets and other legislative and related authorities such as legal and contractual conditions and constraints;** and
- assess the government's or entity's stewardship over the custody and maintenance of resources."

[emphasis added]

The present IPSASs **encourage** comparisons with budget but do not specify any financial reports that would satisfy user needs in assessing "whether resources were used in accordance with legally mandated budgets and other legislative and related authorities such as legal and contractual conditions and constraints." To fill this void and provide a higher degree of transparency, almost all countries prepare and publish "Budget to Actual Comparative Statements." Differences between the actual expenses and the final (or original) budget are reflected in the comparative statements in order to assist the user in determining how close the government came to meeting the budget expectations. The budgetary comparisons are generally made at the major levels of control as approved by the legislature. Since approved budgets are considered law in many countries, explanations are generally required in those instances where expenses exceed budgetary authority. Guidance in the present IPSAS[26] is as follows:

> General purpose financial statements can also have a predictive or prospective role, providing information useful in predicting the level of resources required for continued operations, the resources that may be generated by continued operations, and the associated risks and uncertainties. Financial reporting **may** also provide users with information (emphasis added):
>
> (a) indicating whether resources were obtained and used in accordance with the legally adopted budget, and
>
> (b) indicating whether resources were obtained and used in accordance with legal and contractual requirements, including financial limits established by appropriate legislative authorities.

The scope of general purpose financial statements is usually clearly designed and defined in the statements (with a list of entities covered by the statements, and the description of the method used to built that list). It is not always the case for budgetary reports, which are not necessarily based on the "control" approach described in IPSAS 6. The budget scope can be broader or narrower than the scope of the financial statements based on the "control" approach, to the extent that the budget reflects the financial relationships between the government and a range of national or international entities. Moreover, budgetary reports don't deal with consolidation aspects. Sometimes national accounting systems are also built on a different basis, concerning the links between governments and other entities. In the event of conflict between the budgetary

[26] Paragraph 14, IPSAS 1, Presentation of Financial Statements.

reporting system and the IPSAS, the IPSAS definition of a reporting entity would be expected to prevail. However, the budget to actual comparative statement would need to be prepared on the basis of the approved budget.

Recommendation #6: Ex-post budget reports reflecting budget to actual comparisons should be part of the general purpose financial statements issued at the end of the fiscal period for each reporting entity at each level of government. Inclusion of the budgetary information in the general purpose financial statements will "meet the needs of users who are not in a position to demand reports tailored to meet their specific information needs."[27] While it is appropriate to advocate inclusion in general purpose financial statements of comparisons between budget and actual data, it is acknowledged that further guidance is needed in the following areas:

- How budget data should be summarized to avoid information overload. To ensure that reports are not too voluminous, any future IPSAS should specify that only major classes be included in the comparative reports that would include the primary and secondary levels of control identified by the legislature. This would apply to the whole-of-government statements as well as the statements covering general and sub-national governments.
- How an IPSAS should deal with comparisons if the scope of the budget entity and the IPSAS reporting entity differ. The reporting entity needs to be clearly defined so that the budget to actual comparisons relate to the same entity.
- How extra-budgetary funds that may be excluded in government financial statements should be handled. It is essential that comprehensive budgets be presented in order to reflect the actual results of operations as compared to the budgetary authority.
- How an IPSAS should deal with comparisons if different measurement bases were adopted for such items as inventory, investments, and provisions in budget document and financial reports.

Format of Comparative Statement

Since budgets are prepared in advance of the current fiscal year, natural disasters, political, or economic conditions may dictate a need for revisions to the initially approved budget during the fiscal year. Consequently, most countries identify those procedures necessary for budgetary revisions. In some countries, this authority is delegated to the Minister of Finance (within specified limits); in other countries, the revisions must be approved by the legislature. In some of those countries where comparative statements are encouraged (see Appendix J for an illustration from the United States), the initial budget as approved by legislation is expected to be included in the comparative statement along with the final, revised approved budget.

Guidance in the present IPSAS[28] is as follows:

> Public sector entities are typically subject to budgetary limits in the form of appropriations or budget authorizations (or equivalent), which may be given effect through authorizing legislation. General purpose financial reporting by public sector entities may provide information on whether resources

[27] Paragraph 2, IPSAS 1.
[28] Paragraph 22, IPSAS 1, Presentation of Financial Statements.

were obtained and used in accordance with the legally adopted budget**. Where the financial statements and the budget are on the same basis of accounting, this Standard encourages the inclusion in the financial statements of a comparison with the budgeted amounts for the reporting period.** *(Emphasis added)*. Reporting against budgets may be presented in various different ways, including:

(a) the use of a columnar format for the financial statements, with separate columns for budgeted amounts and actual amounts. A column showing any variances from the budget or appropriation may also be presented, for completeness; and

(b) a statement by the individual(s) responsible for the preparation of the financial statements that the budgeted amounts have not been exceeded. If any budgeted amounts or appropriations have been exceeded, or expenses incurred without appropriation or other form of authority, then details may be disclosed by way of footnote to the relevant item in the financial statements.

Recommendation #7: The Comparative Budget to Actual Statement should include the original budget as approved by the legislative body as well as the final adopted budget. Significant variances should be appropriately identified and justified. This would include comparison of actual expenditure and income with the budgeted amounts agreed by parliament, variances for each line between these two items considering budget assumptions, and explanations for all variances (positive and negative) above a certain significant level (e.g. 5%). Clarification is needed in the following areas:

- Whether comparisons of actual should be made with original and/or revised budgets (and which revision if the budget was revised periodically during the reporting period to reflect changing policies, economic environment and experience);
- What impact a change in policy settings might have if comparisons were to be made against original budgets and how such changes should be dealt with if comparisons were to be made with revised budgets;

Reconciling Budgetary Basis with Accounting Basis

Some countries that have adopted the accrual basis of accounting as their generally accepted accounting principle (GAAP) continue to prepare their budgets on the cash basis. If the accounting basis (i.e., accrual) is different from the budgetary basis (i.e., cash), the comparative statement is generally prepared on the budgetary basis. A reconciliation is made so that the reader is informed about the differences between the budgetary and accounting balances in the general purpose financial statements. Some of the more common differences are identified in Appendix I. An example from the US of a comparative statement is shown in Appendix J. In addition, the UK includes the requirement for a "reconciliation of resources to net cash requirement" in their Summary of Resource Outturn Report.[29] The present IPSASs do not specify the action to be taken in those instances where the budget and accounting are on different bases. However, a similar reconciling statement is encouraged in IPSAS 2 when the Cash Flow Statement is prepared using the direct method. An illustrative note (reproduced below) is

[29] Paragraph 12.1.12, Schedule 1 – Summary of Resource Outturn, UK Accounting Manual. Schedule 1 is the parliamentary control schedule comparing outturn with Estimate for both resource expenditure and the overall cash requirement. (See http://www.accounting-manual.gov.uk)

included in the Appendix to IPSAS 2 and reflects a reconciliation of the surplus/deficit from ordinary activities with the net cash flow from operating activities.[30]

Notes to the Direct Method Cash Flow Statement in the Appendix

(c) Reconciliation of Net Cash Flows from Operating Activities to Net Surplus/(Deficit) from Ordinary Activities (in thousands of currency units)

	20X2	***20X1***
Surplus/(deficit) from ordinary activities	*X*	*X*
Non-cash movements	*X*	*X*
Depreciation	*X*	*X*
Amortization	*X*	*X*
Increase in provision for doubtful debts	*X*	*X*
Increase in payables	*X*	*X*
Increase in borrowings	*X*	*X*
Increase in provisions relating to employee costs	*X*	*X*
(Gains)/losses on sale of property, plant, and equipment	*(X)*	*(X)*
(Gains)/losses on sale of investments	*(X)*	*(X)*
Increase in other current assets	*(X)*	*(X)*
Increase in investments due to revaluation	*(X)*	*(X)*
Increase in receivables	*(X)*	*(X)*
Extraordinary item (that falls within the definition of operating activities)	*(X)*	
Net cash flows from operating activities	*X*	*X*

Recommendation #8: Governments should be encouraged to operate their budgeting and accounting systems on the same basis. If the budgetary system is on a different basis than the accounting system, a statement should be developed to reconcile key differences between the two systems. Since the accrual financial reports include cash flow statements, a reconciliation may be achieved by ensuring these cash flow statements articulate with the cash budget. In those instances where the budgetary system is transitioning to accrual budgeting, a separate reconciliation procedure with the accrual financial reports will be necessary. Further guidance is needed on how an IPSAS should deal with comparisons if differences in the basis of accounting were adopted in budget and historical financial reports.

Qualitative Characteristics of Financial Reporting

Budget reports would be expected to meet the qualitative characteristics of financial reporting specified in IPSAS 1.[31] These are discussed below:

Understandability

Budget reports should be clearly and concisely presented in sufficient detail in order for users to comprehend its meaning. Taxing and spending policies of the government should be adequately

[30] Paragraph 29, IPSAS 2 and Note (c), Appendix, p. 112, Cash Flow Statements.
[31] Appendix 2, IPSAS 1 – Presentation of Financial Statements.

explained in the budget reports so that the average user, after due study, can apprehend the economic impact of the entity's activities and the environment in which it operates. Complex economic concepts should not be excluded from the financial statements merely on the grounds that it may be too difficult for certain users to understand.

Relevance

Information included in the budget reports should be provided in a timely manner and relevant to the decision-making needs of users by helping them evaluate past, present, or future events. To prevent information overload, only the information that is material to the user's needs should be included in the budget reports. Materiality implies that omission or misstatement of information could influence the decisions of users or assessments made on the basis of the budget reports. For example, information about financial position and past performance is frequently used as the basis for predicting future financial actions in which users are directly interested. The ability to make predictions on budget reports is enhanced, by the manner in which information on past transactions and events is displayed.

Reliability

To be reliable, budget reports must be free from material error and bias so that they can be depended on by users to represent faithfully that which they purport to represent. This implies that information in budget reports be complete and presented in accordance with their substance and economic reality; not merely their legal form. Further, the budget reports should be free from bias and presented in such a manner that a user would not be unduly influenced in making a decision or judgment in order to achieve a predetermined result or outcome. In addition, preparers of budget reports do have to contend with the uncertainties that inevitably surround many events and circumstances in which budget forecasts are made. Consequently, prudent judgment needs to be exercised in making the estimates required under conditions of uncertainty.

Comparability

Users must be able to compare the budget reports of a governmental entity through time in order to identify trends in their financial position and performance. In addition, users must be able to compare the budget reports of different governmental entities in order to evaluate their relative financial position, performance, and changes in net assets. An important implication of comparability is that users be informed of the accounting policies employed in the preparation of the budget reports, any changes in those policies and the effects of such changes.

Constraints on Relevant and Reliable Information

To be useful, budget reports must be presented in a timely manner. All information needed to prepare complete and accurate budget reports may not be available in time for preparation of the budget or legislative action may delay the approval of the budget. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable but of little use to users who have had to make decisions in the interim. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the decision-making needs of users. In addition, a balance must be maintained between benefit and cost to assure that the benefits derived from the budget reports do not exceed the cost of providing it. Further, professional judgment must be applied to achieve a balance between the qualitative characteristics in order to meet the objectives of the budget reports.

Recommendation #9: Budget reports should meet the qualitative characteristics (understandability, relevance, reliability, and comparability) of financial reporting specified in IPSAS 1. In order to assure that these qualitative characteristics are achieved, external validation (after considering the constraints on relevant and reliable information) of the budgetary data by the external auditor will be necessary.

Developing a Conceptual Framework

As this research progressed, it became obvious that a conceptual framework was needed on which to build an IPSAS or IPSASs on Budget Reporting. Such a framework could identify how a new IPSAS (or IPSASs) would be used and by whom, as well as specify what the new IPSAS would do and what specific guidance it would provide. An attempt in made in this section to discuss some of the issues for such a framework.

The International Accounting Standards Board has not established accounting standards for budgetary reporting by private sector entities. Budgetary reporting in the public sector is different from and more significant than budgets of commercial entities for many of the following reasons:

- Because many governments deal with non-exchange transactions, financial measures must be combined with non-financial performance measures to provide a comprehensive model. Budget standards must recognize the importance of such non-financial measures and address how they are to be incorporated within budget reporting. In the public sector, planned income and expenditure in future years together with information on unfunded current and future priorities is as (if not more) important as historical actual to budget reports. The attainment of projected service delivery, measured against predetermined objectives, is also central to performance evaluation. Productivity in delivering outputs in support of desired outcomes should be and can be measured by setting measurable objectives in advance.
- Investment in and lending to commercial entities is voluntary with the major financial consequences of the actions of those entities impacting on investors, lenders, employees, customers, and suppliers. While governments may borrow, most funding comes from taxes, fines and fees and is not usually provided voluntarily. Therefore, stakeholders in government encompass a much broader range of constituents and the decisions made impact on current and future generations. Consequently, information needs, on a planned future, are as important as information needs on historical actual to budget performance.
- Options for the volume, nature and form of delivery of services in the public sector are also wider and different than the private sector—for example, additional funds may be collected to provide addition services. Alternatively, current collections and services may be reduced. Possible service providers include the public and private sectors as well as Public/Private Partnerships. The spending level, in itself, does not guarantee service delivery and thus the provision of performance indicators on preset measurable objectives are needed in much the same way as private sector shareholders may look to an Earnings

Per Share indicator. Budget reporting is not only about finance. It is also about meeting measurable performance promises and about offering choice, in the prioritization of the use of available funding, with the medium term fiscal framework.

There is then a sound basis for acknowledging that budget reporting (both ex-ante and ex-post) fits within the public sector financial reporting conceptual framework, and should be developed as that framework is developed. Budget reporting on historical and future budget allocations enables stakeholder involvement in exercising choice in the setting of equitable share slices to ministries. The reporting of budget needs, marginal priorities, and unfunded priorities support the revenue collection decision. These and other characteristics could form the basis for identifying issues that need to be addressed in budget reporting standards. The matrix in Appendix K is the beginning of such an exercise.

At the present time, IPSAS 1 only encourages countries to prepare budget to actual comparative schedules. Many countries routinely prepare such schedules for budgetary control purposes. If the comparative schedules were required as part of the general purpose financial statements, they would require external validation. This would provide users of the financial statements with the assurance that the budgetary information is fairly presented and that budgetary authority had not been exceeded unless otherwise annotated.

PSC Study 14 provides guidance on migration from a cash to an accrual basis of financial reporting. A similar publication could provide guidance on the “reform path” to assist countries further develop their budget formulation and execution processes and to adopt “best practices” as recommended and updated, from time to time. Such a guide would give leadership, alignment and direction, as well as promote the achievement of the objectives and qualitative characteristics set out earlier in this Research Report.

The allocation of funding between governmental units is mostly a subjective decision driven by policy and political priority on disparate needs, productivity improvements, and functionality growth. Disclosure of information about future financial commitments and financial prioritization decisions could usefully be reported upon by the presentation of a management report. A report of progress against the “Code of Good Practices on Fiscal Transparency” as presented in Appendix B and the “Best Practices in Public Budgeting” as presented in Appendix C of this Research Report could also usefully be included in such a management report.

Recommendation #10: Budget reporting should be incorporated into the conceptual framework for IPSASs. The recommendation in this Research Study to require the reporting of financial actual to budget performance is but one aspect of concern to stakeholders on budget matters. Reporting on the planned future is as important as reporting on the past. A case study on South Africa has been published by the International Consortium of Governmental Financial Managers[32] to demonstrate the actions taken in one country to strengthen budget reporting.

[32] See http://www.icgfm.org/digest.htm, Vol. IV, No. 1, 2004 for article by Alan Mackenzie titled “Case Study on South Africa.”

Issues Raised by Steering Committee Members

Definition of Budget Reporting.

There was a difference of views among Steering Committee members as to what was meant by budget reporting. Some members felt that budget reporting included the budgets submitted to and approved by the legislative body during the budget formulation stage. Some members believed that budget reporting included the budget to actual comparisons made during the fiscal period in the budget execution stage. Other members felt that budget reporting only related to the final approved budget as compared to the actual revenues and expenses for the entire budgetary period (the budget reporting stage). While conducting due process through Invitations to Comment or Exposure Drafts for an IPSAS (or IPSASs) on Budgetary Reporting, these positions need to be clarified.

Inclusion of Ex-ante Budget Reports in an IPSAS.

The position taken in this Research Report is that budget reporting referred to the external reporting of the budget approved by the legislative body at or near the beginning of the fiscal period as well as the external reporting of the financial activities relative to the enacted budget for the fiscal period until the final audit after the end of the fiscal period. The approved budget is generally issued as a separate report at or near the beginning of the fiscal period while the budget to actual comparative statement is generally issued as a component of the historical financial statements.

Coverage of Budgetary Execution and Control Procedures.

Current best practices in budget formulation, execution and reporting among international financial institutions and developed countries indicate a high degree of consistency in those practices. However, the Steering Committee members generally felt that the budget formulation and execution practices reflect significantly different administrative arrangements as well as political, institutional and cultural systems and processes. Consequently, accounting standards for budget formulation and execution would probably not be beneficial except to ensure that data collected through the use of budgetary accounting procedures will support the preparation of the budget with the financial information desired for comparison to actual performance. Further, the use of commitment accounting procedures for budgetary control purposes should be clarified.

Inclusion of Ex-post Budget Reports in an IPSAS and Format of Comparative Statements.

There was a high degree of consensus among Steering Committee members for an accounting standard on ex-post budget reporting. Further, it was believed that such a standard falls within PSC's mandate for general purpose financial statements and that it meets the qualitative characteristics of financial reporting (i.e., understandability, relevance, reliability, comparability, and constraints on relevant and reliable information). However, the format of such a statement needs to be clarified.

Country specific laws[33] and accounting standard setters (i.e., Croatia, France, Ghana, Honduras, Nigeria, Sweden, Tanzania, Uganda, United Kingdom, United States and many others) encourage the preparation of comparative "budget to actual" financial statements. In addition, such a standard would permit comparability of budget reports over time and between governments. For such comparisons to be beneficial, disclosures in the general purpose financial statements would need to identify the basis of accounting used for the budgetary reports and whether they were in compliance with the cash or accrual IPSASs. Additional information would be needed to identify the government business enterprises included in the budget, as well as the functions (identified in the GFS Manual) included within general government.

Reconciling Budgetary Basis and Accounting Basis Where Differences Exist.

In those instances where the budget is prepared on a basis (i.e., cash) different than the accounting basis (i.e., accrual), the Steering Committee members believed the proposed accounting standard should identify the need for a reconciliation between the cash increase/(decrease) projected in the budgetary report and the net surplus/(deficit) reflected in the Statement of Financial Performance. Such a reconciliation would disclose the cause for the differences between the cash and accrual basis of accounting. However, there was no consensus that the budgetary reports should address the recognition and measurement requirements of the existing IPSASs in the budget context.

Assuring That Qualitative Characteristics of Financial Reporting Are Met.

The Steering Committee members felt that the standards would need to be explicit enough to provide guidance to preparers of budget reports that will meet the qualitative characteristics identified in IPSAS 1. These budget reports could be subject to external audit by the auditor if specified as general purpose financial statements.

Developing a Conceptual Framework.

Substantial input was provided by Steering Committee members to assure that budget reporting was incorporated into a conceptual framework for IPSASs. Such a framework would then provide the guidance needed in the development of future standards pertaining to the extremely critical area of budget reporting.

33 See Appendix L for highlights of the Budgetary Law in Sweden, Appendix M for Budget Preparation Procedures in Denmark, and Appendix N for Budget Procedures in France.