

**DRAFT PROPOSAL FOR CONSIDERATION OF PSC NOVEMBER 2002**  
**THE BUDGET ACCOUNTING STEERING COMMITTEE**  
***SCOPE OF THE BUDGET ACCOUNTING PROJECT***  
***Staff paper for consideration by the PSC (November 2002)***

*This paper proposes the creation of a Budget Accounting Steering Committee to consider a standard for general purpose budget accounting reports and to study certain issues of budget presentation in order to identify good practices and enhance consistent presentation and interpretation of budget information.*

## **Introduction**

1. Subsequent to the previous PSC meeting, staff has identified issues for discussion by the PSC with respect to the scope of activities to develop a standard for reports covering the status of the budget – budget accounting. Such an international standard would address the quality of information provided by budget accounting such that the data provided can be interpreted in a consistent manner from budget period to budget period within and outside the country.
2. The budget presents the government's financial plan for the immediate future (the current budget period). Consequently it usually shows the anticipated financial position, the expected inflows and the limit on outflows – including information on contingent liabilities, borrowing and debt service. The budget<sup>1</sup> (or budgets) as approved by the Parliament/Legislature is a public document against which all subsequent financial transactions are recorded.
3. “Budget accounting” is used here to mean the system (process) of maintaining budgetary accountability that provides the means for measuring actual performance compared to budget estimates. It also provides the means for budgetary and management control. Its concern is to record and report against legislative and regulatory controls (enacted budget and spending rules). Government budgets are unique in that they are enacted as laws and compliance is a legal matter. Therefore, because budget accounting provides the financial execution and control information, it is a major component of ongoing financial management.
4. It follows that budget accounting provides information on the amount that the budget authorises to be spent or committed, the amount of spending authority currently authorised for use, the amount of spending authority used (actual spending and commitments), the current amount available to be spent or committed, and the amount that has not yet been authorised for use. Generally, because of the organic budget law, spending units have no authority to commit or spend government funds until the distribution of spending authority (budget) has occurred. This formal distribution of spending authority aligns the rate of spending with the availability of funds. On the revenue side, budget accounting provides information on the planned revenues by source, the amount collected, and the amount still to be collected for the budget period. The revenue plan, unlike the expenditure plan, does not represent a limit for inflows. These budget (appropriation) accounts that track the status of the budget do not affect the value of assets, liabilities, receipts or expenditures accounts.

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<sup>1</sup> By budget is meant the budget proposal and resulting budget document determining the appropriation and/or the obligation authority, the associated expenditures and the associated financing plan.

5. Budget accounting is oriented to the future and tracks the implementation of budget proposals using budget concepts and principles appropriate to the basis of budgetary accounting employed. Financial accounting, shows the financial status for a previous period using accounting standards and regulations appropriate to the basis of accounting employed. The budget accounting system, as part of the planning and control system, tracks and reports the status of the budget on a day-to day basis during the entire budget cycle in order to ensure that conditions specified in the budget will be met and internal reports are made more frequently. Periodic budget reporting is also necessary to show that agencies are spending funds effectively and efficiently, to show progress toward meeting the budgeted performance objectives (if these are part of the budget), and to show that policy priorities of government are receiving the level of resources as approved by the legislative body.
6. Other organisations have provided guidance in this area and the Committee will undoubtedly want to draw on this work. Two documents have been developed by multi-national organisations that provide guidance regarding the transparency of the national government budget process. The *IMF Code of Good Practices on Fiscal Transparency* sets down the principles and general practices for fiscal transparency. The *OECD Best Practices for Budget Transparency* identifies the conditions to be met for each of the specified budget reports (budget documents and subsequent execution reports) to ensure transparency and integrity of the budget process and budgetary information
7. The World Bank's "Public Expenditure Management Handbook" broadly covers 1) guidelines for improving budgetary and financial management, and 2) diagnosing the weaknesses and improving budgetary and financial management in the public sector.
8. Some regional standards have been developed that cover selected aspects of budget reporting, such as the West African Economic and Monetary Union (WAEMU) convergence criteria that seek to standardise budget reporting. These also will be valuable sources upon which to draw, but need to be broadened.
9. Additionally, within a country, an organic budget law or other legislation exists to describe the oversight and the process to be followed for the development of the budget proposal and the execution of the budget. Some countries have very detailed budget laws and some do not. There are major differences in budgetary practices across countries. These have been observed to be caused by differences in constitutional, legal and administrative heritages such that there are, for example, British-based, French-based, Latin American and U.S.-type budgetary systems.<sup>2</sup> With the reforms in financial management practices of the past decade these differences may have lessened. Most OECD countries now use baseline budgeting and a medium-term expenditure framework and some form of program format that reduces the visibility of expenditure object line items. According to a recent survey by the OECD, three quarters of all OECD countries have performance data in their budgets<sup>3</sup>.

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<sup>2</sup> International Monetary Fund. *A Manual on Government Finance Statistics, 1986*. Washington, D.C., International Monetary Fund, 1985, p. 87.

<sup>3</sup> A brief comparison of the budgeting systems in the G7 countries, OECD, PUMA, The Budget and Management Division, Tuesday, 09 April 2002. Paris, France, Ref. JKK.

10. Until now there has been no attempt to develop an international standard for budget accounting reports. There is no need for this effort in the private sector since the budget is an internal management tool. However, in the government sector the budget is a public document. Perhaps the budget is even of greater interest than historical financial reports because its focus is on the immediate future. Also comparative budget reports (from year to year) are of greater interest than are comparisons of net position. As a general purpose financial report it should allow for clear and consistent interpretation within and, since communication among governments is increasingly global, outside the country. This can only be accomplished through consistent definitions, treatment and presentation.

### **Scope of the Steering Committee**

11. Staff recommends that the scope of the Budget Accounting Steering Committee be to develop a standard that covers budget accounting. The standard should address the content and frequency of regular general-purpose budget accounting reports. More details on the issues to be considered by the Steering Committee are identified in the following section.

One member of the Advisory Panel has suggested that the alternative approach to developing a separate budget accounting standard is to expand IPSAS 1 to include comprehensive budget accounting information. Staff research to date does not support this alternative. Especially in developing countries, there is a need for the clarification and visibility of budget accounting issues and definition of terms within the budget and budget accounting context.

12. In addition, because the budget presentation determines the structure and affects how compliance may be measured, some technical aspects of budget formulation/presentation will need to be researched and their good practices studied. It would seem that good financial management requires the integration of the budget and the financial accounting systems so that financing and spending authority information from the budget flows easily to the financial accounting system and allows associated commitments and expenditures to be recorded. Likewise, to improve the planning capability, information in a usable format must easily flow from the financial accounting system to the budget analysts. This can only be accomplished if there is an integration of the two systems and the classifications used by each can be expressed as part of the same system. More detail on the formulation/presentation issues for consideration is found in the appropriate section below.

13. Staff recommends that there be a division of the Committee into two task groups: 1) Studies of good practices for issues of budget formulation and 2) Development of a standard to cover budget accounting. The division of this task also reflects the frequent practice of separating these responsibilities within government operations. In many governments, for purposes of checks and balances or out of tradition, the planning of the budget is administratively separated from budget accounting. The makeup of the Committee for the formulation/presentation task as well as for the budget accounting task will require the participation of budget professionals.

14. In developing a study of good practices for the formulation/presentation issues, the different bases of budgeting - such as cash basis, cash plus obligation basis and accrual budgeting basis - may require consideration. The recommendation of a budget accounting standard will also have

to differentiate between these or, at least, identify differences in treatment. Certainly, the guidance documents will have to be specific with regard to each budgeting basis.

15. Staff strongly recommends that the Steering Committee not consider the political aspects of budgeting nor suggest a path of reform for any country with respect to the budget process or structure. Its work should concentrate on providing guidance with respect to definitions, presentation formats and tracking procedures to allow for consistent interpretation of budget documents and budget accounting reports.

16. For the Committee to research appropriate issues, suggest good practices and develop a standard, if appropriate, time will be needed. In the following section staff have compiled issues for consideration by the Steering Committee. The numbering of the issues reflects a logical ordering of topics, not priorities and the list is not exhaustive. Unlike the development of the IPSAS to date, this effort does not have a body of existing international standards to draw on. It is interesting to note that, in exploring these issues since the last PSC meeting, staff has found major support for standardised and globally-applicable budget term definitions, support for improved direction in co-ordinating budget and financial reports, and, more in the developing economies, interest in standardising budget accounting practices. Staff expects that the Steering Committee may wish to modify this list as the research goes on.

### **Project Timetable**

17. Staff estimates that two to three meetings of the Steering Committee will be required for each stage, except that the members of the Steering Committee developing budget formulation guidance may require an additional meeting, possibly two, for Developing the Exposure Draft.

The stages are:

2003	Develop Invitation to Comment
2004 (July)	Review responses to Invitation to Comment and Develop Exposure Draft
2005 (July)	Review responses to Exposure Draft and Develop IPSAS
2005 (Dec.)	Issue IPSAS

### **Issues for consideration by the Steering Committee with respect to the budget accounting standard**

18. *What budget reports should be covered by the standard?*

Should the standard pertain only to general purpose budget accounting reports or should it also include internal accounting reports – this would be especially helpful to the developing countries. The Committee will have to consider what reports should be included and what information they should provide. Budget and budget accounting summaries can be variously classified: for example, baseline, new and improved programs funding, total recurring, total non-recurring, and obligations for future years. Other reports may include cash flow schedules, medium and long term budget revenue and expenditure reports, and so forth.

19. *What level of aggregation will the standard require of general-purpose budget accounting reports?*

Budgets tend to be programmatic so that each appropriation item focuses more upon the end purposes of the expenditures rather than on objects of expenditure. The budget accounting system builds the bridge between the budget and the financial system and associates the budget plan with explicit receipt and spending accounts.

There is agreement that the budget should be transparent. Existing transparency guidelines provide that the budget and its associated documents should include sufficient information for the citizen, the legislator, the press, the budget analyst, and the government official to understand how the government estimated the resources available and how it intends to spend these resources. Therefore, the budget documents and budget accounting reports should meet not only needs of internal government management and control but also those of the general public. In other words, there should be general purpose reports – reports prepared for external users who are unable to require or to contract for the provision of special reports to meet their specific information needs.<sup>4</sup> To be sure, internal and general-purpose reports may differ, *especially in the amount of detail and frequency*, but they should give the same results at some aggregate level for the same time period. A decision must be made regarding the aggregation level of the general-purpose budget accounting report.

20. *When should transactions be recognised as using budget expenditure authority and when are receipts recognised within the budget accounting system? Are there definitional differences between the terms used in budget accounting and those used in financial reporting?*

Here the Committee would research and agree on global definitions, timing and measures relating to the recording of obligations, commitments and expenditures on the expenditure side and receipts on the revenue side. Some issues to review are the techniques for developing a chart of accounts, creation of spending plans to allow for budget control, booking and tracking the enacted budget: appropriation, commitments, expenditures, revenues, and borrowings. Another issue to consider may be good practice for recording changes to the enacted budget and to the “treasury budgets”.

21. *What will be required to reconcile budget accounting reports to financial reports for the same period? How do each of the existing IPSAS relate to the budget reports and is reconciliation possible?*

Authoritative global definitions for budgeting terms and processes, as well as recognition of instances where budget term and financial term definitions vary from each other, should improve the integration of budget and accounting systems. This requires the examination of the existing IPSAS for financial reporting requirements within the budget context in order to assess the degree to which budget accounting can be reconciled with financial statements and to identify the reports that may be required in cases where reconciliation may not be possible.

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<sup>4</sup> 2001 IFAC Handbook of International Public Sector Accounting Pronouncements, NY, IFAC, 2001, p.41.

## **Issues for consideration by the Steering Committee with respect to Budget formulation/presentation**

### *22. Consistent global definitions for budgeting terms and concepts.*

A number of developing countries have not used the budget for control purposes in the past, instead controlling expenditures through *ad hoc* approvals of specific expenditures. Consequently, many of budgeting concepts and practices are new to them. These countries are primarily on cash budgeting systems and using external controls. Because of the lack of globally accepted definitions, some of these countries have made interpretations of budget terms and concepts that have resulted in inconsistent information in the budget documents. The need for accepted global definitions of even basic terms such as “budget,” “extra-budgetary unit,” “consolidated budget” has long been known.

### *23. What are the attributes of a budget classification and how should it relate to the accounting classification?*

Consistency of budget presentation and budget accounting is affected by the budget classifications that are used. Staff recommends that these classification<sup>5</sup> schemes be reviewed and good practice developed in order to assist developing countries in setting up stable budget presentation and budget accounting reports. Currently there are misunderstandings in this area and authoritative guidance would be helpful. The relationship between internal classification systems and external reporting requirements should be addressed in this issue. Specifically, the Steering Committee should address the relationship between the GFS system (both the 1986 and 2001 GFS) and the classifications used to ensure that budgetary accounting provides the data required for this specialised macroeconomic analysis and that the differences between the GFS 2001 and accrual IPSAS are understood and the harmonisation project monitored.

### *24. Issues of consistent budget presentation*

It is inconceivable to think that all budget formulation procedures and processes could be standardised. Budgeting practices reflect political systems. There are different requirements in countries with strong legislative branches. Budgeting also differs based on the structure of government. A federal system would have greater complexity compared to a centralised system, and complexity is more if the government performs more functions. Complexity also increases with the size of the country so that one could hardly expect that procedures in a very small country to be the same as those in a very large country. Likewise, even in countries of similar size and government structure, different budget bases and formats would result in very different budgets. (Consider accrual budgeting or a performance-based budget system or whether the country’s budget considers expenditure limits at a very aggregate level such as a program or an expenditure area.)

Nevertheless, staff recommends that the Committee consider the presentation of budget information. Studies should yield authoritative global definitions and recommendations for

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<sup>5</sup> By budget classification is meant here the various coding schemes used under various names in budget formulation and budget accounting such as functional, economic, program, activity, expenditure areas and so forth.

presentation within the budget document and budget accounting reports. Issues to be considered should include treatment of permanent appropriations, treatment of previous year's liabilities (arrears), treatment of budget transfers, treatment of budget grants, treatment of foreign grants and donations, treatment of capital use charges, treatment of transactions with the public and/or with other government units. In some cases existing IPSAS will provide guidance. Other issues will likely be added as the Committee proceeds in this work, such as a study of good practices for budget treatment of military objects and government-owned enterprises.

#### *25. Presentation of future obligations and commitments*

A number of specialised budgeting issues are receiving current scrutiny. These are the issues that concern contingent liabilities as well as those that concern assets and liabilities with major future effects such as insurance, pensions, loans, stock purchases, and fixed capital items. Research and wide examination of practices will be helpful to achieve greater consistency in presenting these issues within the budget and for including appropriate information in budget accounting reports.

#### *26. Treatment of foreign currency and non-cash items in the budget.*

The budget frequently includes anticipated inflows from outside the country, such as proceeds from loans, grants and donations. The committee should address the inflows and outflows in foreign currency. Additionally, the budget may include in-kind donations such as equipment donations or the payment for services or products by agencies outside the country. The Steering Committee should recommend the treatment of these non-cash inflows and outflows. Wherever possible, the recommended good practice should include the presentation and budget accounting aspect and should be consistent with existing IPSAS; the Committee should identify instances where this is not possible.

#### *27. The treatment of hyperinflation*

The Committee should recommend good practices for treatment of hyperinflation in budget formulation/presentation.

#### *28. What narrative explanations should be included in the budgets and budget accounting reports?*

Like the notes to financial reports, there are a number of cases where a narrative explanation is used to explain and specify a budget item or condition. The Committee should review this issue and recommend the items to be covered by narrative explanations.