INTEGRATION OF THE CHART OF ACCOUNTS AND BUDGET CLASSIFICATION

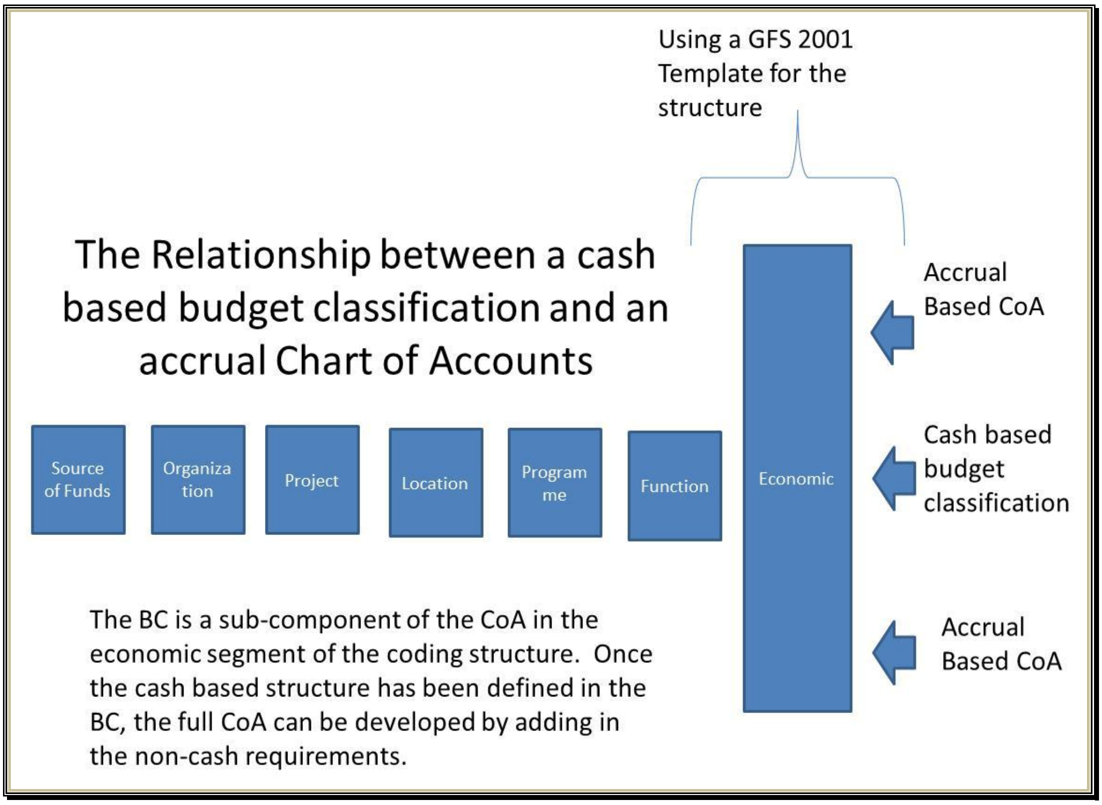
While the **budget process** defines a government's policy priorities, **budget execution** and accounting seeks to ensure the budget is delivered as planned. Managing the flow of funds in compliance with the budget involves mechanisms to control the release of payments and effectively collecting all revenue due. In a good PFM practice environment, accounting policies and procedures underpin strong internal controls. This ensures that sufficient information is available to check compliance and support efficient cash management, as well as provides necessary information for managers to make effective decisions in planning the execution of the budget, delivering services according to government policy choices. **<u>All of these core processes of PFM are strongly interrelated and must be supported by a coding system to allow capture, storage and reporting across the spectrum of requirements.</u>**

The International Federation of Accountants (IFAC) provides the following useful definition of a Chart of Accounts in its Report 14 "*Transition from Cash to Accrual Accounting*":

"..chart of accounts is a systematic coding system for the classification and coding of transactions and events within the accounting system. It defines the organization of ledgers used within the accounting system. For example, the asset classifications available within the chart of accounts may allow assets to be classified by type, term, responsibility centre, location, etc. The chart of accounts may also include codes for recording transactions against budgetary approvals".

In 2008, IFAC amended the public sector accounting standards, both cash and accrual, to specifically require reporting against the approved budget in a country's financial statements. In other words, IFAC recognized the importance of the budget as the major accountability and review process for a country. This move reinforces the importance of integrating budget reporting with a country's financial reporting capacity. It also **<u>reveals an important distinction between public and private sector accounting – that the CoA must first and foremost be designed to meet the budget accountability requirements of a specific country.</u>**

It follows, therefore, that good practice PFM is underpinned by a well-designed CoA which simultaneously supports budget presentation, detailed expenditure accounting, monitoring, and reporting, as well as fiscal and statistical analysis. The CoA should be comprehensive, ensuring integration of all the operations of government, including development partner financing. Reporting in government should also be time sensitive, requiring a well-functioning IFMIS supported by accounting policies and rules to ensure transactions are recorded as they occur (or soon after). This enables reports to be produced and disseminated in a timely fashion to support more effective decision making. Adopting reporting standards such as the cash or accrual IPSAS also ensures consistency and integrity in the way governments disclose financial information.



Typically, a CoA structure that integrates budget reporting requirements would include seven elements:

1. **A source of funds segment** – This segment is used to separate different sources of receipts to allow these to be matched to specific payments. It is particularly useful for development partners who frequently require their grants and loans to be earmarked for identified purposes, and for reporting to be possible even at the component level within a particular project. **Many countries also establish specific funds, such as development and special funds, separately from the general revenue or consolidated fund.** This can be integrated into a well structured source of funds segment.
2. **An organizational segment** – Capturing information for each ministry, department and agency is important as this is generally the way in which a country appropriates the authority to spend public money. If required, it is also possible to codify down to spending units or cost centres, for example, a specific school or health clinic.
3. **A project segment** – This is particularly useful where a development partner requires a separate report or control of its funds. It is also possible to create additional levels of reporting by component or subcomponent (as with the case of a road project where multiple roads are being funded), then this requirement for reporting can be captured in the CoA. This approach eliminates the need to

maintain special reporting systems outside the IFMIS. Frequently, development partner activities are captured outside the main accounting system and this is often due to the inability of the CoA to meet the specific reporting requirements of the development partner. Careful CoA design can ensure this requirement is fully integrated, enabling consolidation of all public financial management into a single system.

4. **A location segment** – This allows both revenues and expenditures to be reported by Oblast, Rayon and local government. Structures can also be created to integrate autonomous territories such as with Gagauzia and Transnistria in Moldova.
5. **An economic segment** – This is the most important segment in any CoA or budget reporting system. The existing segment should be restructured to provide for: a standard budget presentation methodology; a fiscal balance report; and the structure of the primary financial statements. GFSM 2001 can be used as a template to achieve this and to ensure consistency with the statistical framework (discussed further below).
6. **A functional segment** – This utilizes the CoFoG standard for reporting expenditures and can usually be derived via a mapping table from the organizational segment.
7. **A program segment** – This would be used for results-based management. It can normally be added to the structure at a future date, once it is required.

The seven-segment structure will contribute to the achievement of a number of major reporting, accounting and management objectives:

- Consolidated classification and reporting for all government finance, including integration of development partner resources into the general structure;
- Detailed reporting to support analysis and internal control within ministries, departments and agencies;
- Fiscal reporting, including the key report of government, the fiscal balance report, and for macro fiscal analysis;
- More timely provision of financial information with key reports being more easily derived due to the integrated approach;
- The capture of transactions just once, improving accuracy and timelines, with the ability to provide information for a multitude of users and purposes based on the structure of the CoA, including reporting against the budget; and
- Performance-based reporting to allow an improved understanding of the costs and benefits of government activities and programs.

Designing an integrated Economic Segment using GFSM 2001

The economic segment is the most important element of any CoA. It is the segment where budgeting and accounting converge and can be integrated. The structure recommended in the IMF's Government Financial Statistics Manual 2001 provides a sensible and powerful approach for designing an economic segment.

In GFSM 2001, the general structure is as follows:

Class	Description
1	Revenues
2	Expenses
31	Non-Financial Assets
32	Financial Assets
33	Liabilities

GFSM 2001 does not include a class for equity as this represents a balancing item derived from the other classes. As can be seen by the above classes, there is a strong correlation between GFSM 2001 and generally accepted accounting concepts. The major difference is that assets are divided into non-financial and financial, rather than current and non-current, recognizing the importance of separately reporting recurrent and capital spending for government.

This structure is preferred because it aligns better with the structure of a government budget; provides a fiscal balance report – the critical analytical report for macrofiscal analysis and budget management and control; accords with the structure of an IPSAS cashflow statement, while still supporting modified accrual and accrual as the structure also supports reports on the operating result and balance sheet. Following is a discussion of how the GFSM approach is able to achieve each of these reports and outputs.

Budgeting[1] – A budget is developed, firstly, by estimating the revenues that will be collected, and, secondly, by estimating spending in two key areas – operational expenditures and capital (non-financial assets). The coverage of revenues over expenditures represents the operating result. Typically, countries try to ensure a surplus operating result (not borrowing for operational spending)[2]. The coverage of the revenues over operating and capital expenditures is usually defined as the fiscal balance. If a country has a zero or surplus fiscal balance, it decides what it does with the surplus. It can increase its financial assets or reduce its liabilities, or a combination of both. If a deficit exists – revenues are smaller than the combined estimate of recurrent and capital expenditures – the budget should show how the deficit will be financed. The financing of the deficit will show how the gap in cash from government revenues will be sourced, either by reducing financial assets (e.g. spending cash surpluses from former years or through privatisation receipts) or through borrowing (e.g. new loans from development partners).

[1] The assumption here is that the budget and fiscal balance are calculated based on cashflows
[2] Often referred to as the Golden Rule – governments should only borrow to invest

General Structure of a Good Practice Budget

Revenues
Operational Expenditures
Capital Expenditures
Financing the Deficit
Reduction in Financial Assets
New Borrowing

Fiscal Management – A fiscal balance, with the budget reflected above the line and the sources of financing below the line, is a universal structure which a good government CoAs should support. Representing this explicitly in the overall structure at the class level ensures that all decision-makers have a stronger sense of the impact of new spending decisions on the fiscal position of government**.** The fiscal balance report is also the primary structure for medium-term fiscal frameworks, and can be used each day to assist in monitoring performance against the fiscal targets in the budget. Finally, the same format can be used in reports, such as a budget scorecard, to show decision-makers the impact on the fiscal position of any new policy, either within the annual budget process, or even during the year.

General Structure of a Fiscal Balance Report

Revenues	**Above the Line**
Operational Expenditures	
Operating Balance	
Capital Expenditures	
Fiscal balance	
Change in Financial Assets	**Below the Line**
Change in Liabilities	

General Structure of a Budget Scorecard

Current Budget Balance	**New Budget Balance**
Revenues	**Revenues**
Operational Expenditures	**Recurrent Expenditures**
	New policy proposal
Capital Expenditures	**Capital Expenditures**
Fiscal Deficit/Target	*Adjusted Fiscal Deficit/Target*
Source of Financing of Deficit	**Source of Financing of Deficit**

Cashflow Statement – a cashflow statement under the cash based IPSAS, accrual IPSAS (IPSAS Standard 2) or IFRS is the same: operating cashflows, investing cashflows and financing cashflows.

General Structure of a Cashflow Statement

Opening Cash Balance
Revenues
Less: **Operational Expenditures**
Operating Cashflows
Capital Expenditures
Less: **Cash Sales of Non-financial Assets**
Investing Cashflows
Net Cashflows from Financial Assets
Net Cashflows from Liabilities
Financing Cashflows
Closing Balance

Accrual reporting – the structure also supports modified accrual or full accrual reporting, with the economic classes clearly related to the primary financial reports, operating statement and the balance sheet or financial result.

Operating Statement

Revenues
Less: **Expenses**
Operating Balance

Balance Sheet

Assets
Less Liabilities
Equity

While the above analysis represents a simplified approach to the structures of all reports, hopefully, it is clear that the proposed structure is better aligned with all the key reports in government, including the budget, macro fiscal requirements and traditional reports under both cash and accrual accounting. Of note, is that all of these reports can also usually be derived from existing CoA structures in many countries as is reflected in the following table representing the existing and planned structures for the Ukraine. In this case, only part of the economic classification for Ukraine is present.

CoA Class	GFS 2001	Budget Spending Institutions	Economic Classification	Unified CoA
Revenues	1	7		7
Expenses	2	8	2	8

Non-Financial Assets	31	1,2	31	1
Financial Assets	32	3		2,3,4
Liabilities	33	5,6		6
Equity		4		5
Off Balance				9

It is also worth noting that this approach does not focus on either cash or accrual reporting - the economic nature of the stock or flow is recorded. Thus an expenditure (cash only) and expense (accrual) use the same economic classification – only the double entry will change[3]. This will mean that as a country moves down the path towards full accrual, each change in recognition does not impact on the recording of the economic nature of the transaction.

[3] Cash accounting is, in fact, a sub-set of accrual accounting – every cash transaction also gives rise to an accrual transaction. Under cash accounting, the double entry for any cashflow is bank, whereas under accrual accounting the double entry may also be bank or a change in another stock, such as accounts payable or receivable.