

Government finances in transition

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Introduction

Experiences during financial crises in a number of countries have reiterated the importance of the early detection of sources of vulnerability in governments' financial management, and emphasised the value of introducing timely corrective measures. However, identifying vulnerability is impossible without adequate, timely and reliable data. Institutions such as the International Monetary Fund (IMF) and the International Federation of Accountants' Public Sector Committee have done a lot of work to improve the availability of key data sets and to standardise reporting formats. One result of this was the introduction of the Special Data Dissemination Standard (SDDS) by the International Monetary Fund. The IMF has also made extensive revisions to a number of their manuals on the compilation of macroeconomic statistics, aimed at improving the way in which statistics reflect economic reality.

This paper explores the impact of these reforms, investigates the challenges facing governments on the African continent with implementing these reforms and assesses the current South African stance with regard to these reforms.

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Data standards

In October 1995 the IMF's International Monetary and Finance Committee approved the establishment of standards to guide member countries in the compilation and release of economic and financial data. The IMF decided to introduce two standards, namely the General Data Dissemination System (GDDS) and the Special Data Dissemination Standard (SDDS).

Subscription to the SDDS opened in April 1996. This standard prescribes that data in a number of categories must be released on a regular basis with a predetermined timeousness. These categories of data include information on government finance statistics, monetary aggregates, national accounts, balance of payments and labour statistics. The standard also prescribes that the data should be compiled in accordance with the guidelines contained in various IMF Manuals and that full disclosure of methodologies used in the compilation should be provided by every country subscribing to the standard.

The standard was established with the purpose to guide member countries of the IMF in the compilation of data that would reflect transparency, openness and an awareness of high quality. It was envisaged that the release of the standardised data sets would benefit countries seeking access to the international capital markets and would contribute to enhancing the functioning of the financial markets. The SDDS also supports ready and equal access to data and assists users of data to assess the integrity of the data.

The South African Minister of Finance signed an agreement with the IMF in 1996 according to which South Africa agreed to subscribe to the SDDS and comply with the requirements by the end of the transition period. On 18 September 2000, it was announced that South Africa fully complies with the requirements. It should be noted that South Africa is currently the only African country listed by the IMF to be in full compliance with the SDDS.

In 1997, the IMF also introduced the General Data Dissemination System (GDDS). The system was introduced as a means to encourage IMF member countries to systematically evaluate and improve their data systems, working towards compliance with the SDDS. The GDDS focuses on assessing current data compilation practices with the aim to compile plans for improvements within the limitations of each country's development needs. Special GDDS projects were initiated by the IMF in collaboration with the World Bank, generously sponsored by the United Kingdom's Department for International Development (DFID) and Japan. Three of these projects focused specifically on needs in clusters of African countries (Anglophone, Lusophone and West Africa). The focused attention on the development needs of data systems in these countries in itself serves to illustrate the challenges ahead.

However, the current methodology used in almost all countries for the compilation of fiscal data generally relies on the cash or modified cash accounting system that complies with the 1986 version of the IMF's *Manual on Government Finance Statistics*.

Although a move towards accrual accounting for government business enterprises was contemplated in the early 1980s, it was only towards the 1990s that a general quest for accountability by government units spurred interest in accrual accounting for the public sector. A Working Paper by the IMF released in 1996, titled *The case for accrual recording in the IMF's government finance statistics system* echoed this accounting perspective and advocated a movement towards the use of accrual accounting records in the compilation of government finance statistics.

Government Finance Statistics Manual 2001

The *Government Finance Statistics Manual 2001 (GFSM 2001)*, released by the IMF, was one of a series of manuals that was thoroughly revised to set a standard for the compilation and presentation of statistics. The revision was done following the identification of deficiencies in the reporting framework of traditional government reporting systems as portrayed in the IMF's *Manual on Government Finance Statistics 1986 (GFS 1986)*. *GFSM 2001* aims at providing improved flows of information that can be used to optimally guide policy decisions, and was released in December 2001 after extensive consultation.

Background to the revised manual

In its time, *GFS 1986* gave valuable guidance regarding the compilation of government finance statistics. The compilers of this manual had drawn from other publications such as the *System of National Accounts* of 1968, the

United Nations' *Classification of the Functions of Government* of 1980 and the *European System of Integrated Economic Accounts* of 1971.

Traditional reporting and analysis of government finances were not complex and were based on simple cash accounting systems. The main focus was placed on a single balancing item – the overall deficit/surplus – calculated by considering all non-repayable cash inflows as 'revenue and grants' and all non-repayable cash outflows as 'expenditure'. Some repayable items pertaining to policy lending were included in the balancing item as 'net lending'. In the traditional approach the financing of this balance was the primary focus of analysts, and it can therefore be stated that liquidity considerations stood central in policy evaluation. This approach proved to be insufficient in providing information on the long-term sustainability of fiscal policies. It did not provide information needed for a realistic assessment of the effectiveness of policy decisions, and it ignored a large portion of the future obligations of the government. In addition, all future payment obligations of other units of the economy towards government were ignored.

The global dissatisfaction with cash accounting was aggravated by its focus on cash flows at the time of acquisition of capital goods and lack of attention to the subsequent management of and services arising from such goods. Similarly, the traditional cash accounting systems ignored all transactions in kind, which resulted in serious miscalculations of the true economic value transferred to and from governments.

It can rightfully be stated that the growing complexity of the economic and financial environment in which governments operate necessitated a more complex and integrated approach to the compilation and analysis of government operations.

The integrated approach to the compilation of economic statistics was to a large extent led by the work done which culminated in the publication of the *System of National Accounts 1993*. The revisions of statistical guidelines such as the fifth edition of the *Balance of Payments Manual*, the *Monetary and Financial Statistics Manual* and the *GFSM 2001* followed in due course and were harmonised as far as possible with the *SNA 1993*.

Major changes introduced by the *GFSM 2001*

The methodology for the compilation and presentation of data on government operations as presented in the *GFSM 2001* differs significantly from that presented in the *GFS 1986*. These changes can broadly be summarised as follows:

- Coverage

The main focus of the coverage of the *GFSM 2001* system is the *general government sector*, including all the *institutional units* that perform the functions of government as their *primary activity*. The functions of government are considered to be providing goods and services to the

whole of the community on a non-market basis, to redistribute income and wealth by means of transfer payments and to fund these activities primarily by raising taxes and other compulsory transfers. An entity is defined as an *institutional unit* when it can own assets, incur liabilities and enter into economic activities in its own right. In addition, an entity can only be considered to be an institutional unit if a complete set of accounts, including a complete balance sheet for the entity, exists or can reasonably be constructed. This approach differs from that of the *GFS 1986*, which followed a *functional* approach – all activities resulting from executing the functions of government were included in the statistics irrespective of the institution performing the function.

The *GFSM 2001* also encourages extension of coverage to the *public sector*. The public sector is derived by consolidating the financial results of the general government with that of the public non-financial corporations and public financial corporations in the analysis of government finances. Close relationships usually exist between public corporations and the governments that own and/or control them. This analysis is particularly important due to the potential fiscal impact on the resources of governments that these entities, producing for the market at market-related prices, could cause.

- Basis of recording

The *GFSM 2001* adheres to the *accrual basis* of recording flows. All economic flows are therefore recorded at the time when economic value is created, transformed, exchanged, transferred, or extinguished. The accrual basis also recognises all monetary and non-monetary flows of economic value. By contrast, the *GFS 1986* recommended a basis of recording as close to the cash flow stage as possible. Transactions in kind were also not included in the framework but were only recognised as a memorandum item if data on it existed.

- Valuation

In order to reflect true economic value, all flows, assets, liabilities and net worth are valued at prices that these goods, services, assets, or liabilities could be exchanged for cash. This approach in the *GFSM 2001* results in valuation at market value or as close to market value as possible. The *GFS 1986* measured flows according to the value of cash flows and contractual liabilities according to the value government is obligated to pay on maturity of the debt.

- Analytical framework

A new analytical framework as contained in the *GFSM 2001* introduces several new or revised definitions, classifications and balancing items to

enhance the analytical usefulness of the statistics and to redirect attention to various policy considerations, compared with the single balancing measure contained in the *GFS 1986*. The *GFSM 2001* proposes a comprehensive integrated system, which records all transactions and other economic flows. The system also contains all the information to reconcile these flows with the changes in the stock of assets, liabilities and net worth as presented on the balance sheets at the end of two consecutive periods.

The structure of the integrated framework as presented in the *GFSM 2001* comprises primarily four interrelated statements:

- Statement of government operations;
- Statement of other economic flows;
- Balance sheet; and
- Statement of sources and uses of cash

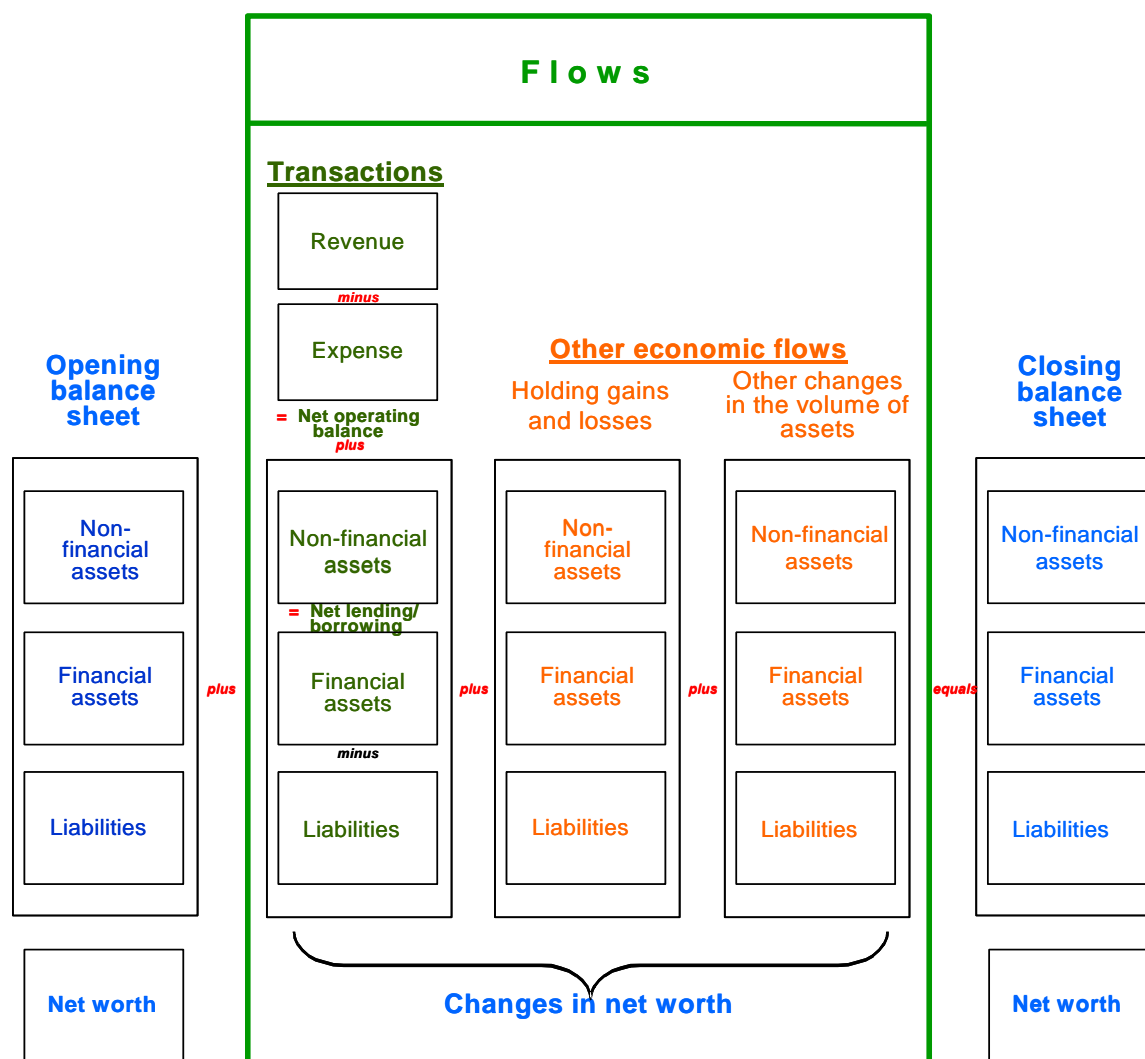
All information previously recorded according to the cash basis of accounting is retained and presented in a reorganised format in the *Statement of sources and uses of cash* – still serving the analysis of liquidity management. In addition, the other statements serve to provide an integrated presentation of the economic operations and position of government.

As indicated in the graphical presentation, the system integrates stocks and flows in a double-entry system, which ensures an integral balance in the

system at all times. The integrated approach ensures that changes to the stock of net worth, financial and non-financial assets, and liabilities of government, as presented in the opening balance sheet, are explained by flows during the same reporting period, to derive the closing balance sheet values of the stocks. These flows represent the creation, transformation, exchange, transfer, or extinction of economic values. In addition, the *GFSM 2001* classifies all flows as either a *transaction* or an *other economic flow* where:

- *transactions* are defined as flows resulting from interaction between two economic units by mutual agreement and include flows due to exchanges and transfers; and
- *other economic flows* are defined as changes in the volume or value of stocks of assets and liabilities not resulting from transactions.

Integrated analytical framework of *GFSM 2001*



Migration from *GFS 1986* to *GFSM 2001*

The IMF rightfully noted that the full implementation of the recommendations as contained in the *GFSM 2001* would be a complex and arduous process. Implementation of the revised statistical framework is also to a large extent dependent on major accounting reforms in a country – taking into consideration the capacity constraints existing in individual countries. It was therefore suggested that each country should develop its own migration path

within its means. Such a migration path comprises different phases of implementation over time. These phases start with awareness of the revised framework and should translate into political conviction to change, adopting the broad analytical framework and classification system, and eventually adopting accrual accounting and implementing the complete integrated system.

In South Africa the release of the Public Finance Management Act, Act 1 of 1999 (as amended) to a large extent already laid the foundation for a number of these reforms. The Act gives effect to section 216 of the Constitution of the Republic of South Africa, which requires that the National Treasury should introduce generally recognised accounting practices. To this effect the Minister of Finance, by regulation in terms of section 91, established the Accounting Standards Board. This Board was established with the purpose of setting standards of generally recognised accounting practice to be adhered to by South African government entities. These accounting standards are expected to adhere to international best practice in respect of public-sector accounting and would provide the basis for compiling data according to the *GFSM 2001* framework.

The IMF published a supplement to the *GFS Yearbook* of 2002, containing government finance statistics in the revised analytical framework for a number of countries. Working with GFS compilers, the IMF published the accrual accounting data for a number of countries but, in addition, the historic cash accounting data of a number of countries, including South Africa, were

converted to illustrate the use of the new analytical framework. As from the 2003 edition of the *GFS Yearbook* all the government finance statistics will only be published in the new format.

As a step in the migration path, the government finance statistics, as previously presented in the *Quarterly Bulletin of the South African Reserve Bank*, were revised in the September 2003 issue. These revisions reflect the conversion of the cash data to the analytical framework of the *Statement of sources and uses of cash*.

Conclusion

Financial reforms in the public sector will impact on the availability and quality of data used in macroeconomic analysis. In the quest for financing developments in Africa, economic data of a high quality are often prerequisites for financial assistance. Improvements in the availability and quality of data will most certainly be one of the major challenges African governments will have to cope with. Similarly policy makers, analysts and researchers will have to take care in using information during the transition period. The greatest challenge for analysts and researchers arising from these reforms is the harmonising of accounting reforms and economic analysis, while ensuring that comparability of research results is maintained.

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