



Reforming the Chart of Accounts in the Caribbean

July 2010

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My Objectives

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- To enhance understanding of how to classify financial stocks and flows
 - To examine GFS 2001 and its importance in forming a CoAs
 - To focus participants on the importance of consolidation in the government budget process

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Workshop Outline – Topics

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1. Chart of Accounts – Background
 2. Introduction to GFS 2001
 3. Design of Schematic for the CoAs
 4. Issues for the Caribbean



Topic 1

Charts of Accounts - Background

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What is a Chart of Accounts?

- A systematic way to classify all financial stocks and flows
- A mechanism through which financial information is captured, processed and reported on
- To put it simply, a filing system for financial data



IFAC – Defining COAs

“A 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.”

IFAC – Defining COAs - Example

The asset classifications available within the COAs allows assets to be classified by type, term (current or non-current), responsibility centre, location, etc. The COAs also includes codes for recording transactions against budgetary approvals.

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What does it do?

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- Defines the characteristics of the financial information – this provides the COA elements or segments (Eg Organisation/Economic)
 - Defines the financial information (reports) that are required by **all users** – this helps determine the structure of each element or segment

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What should a COAs do?

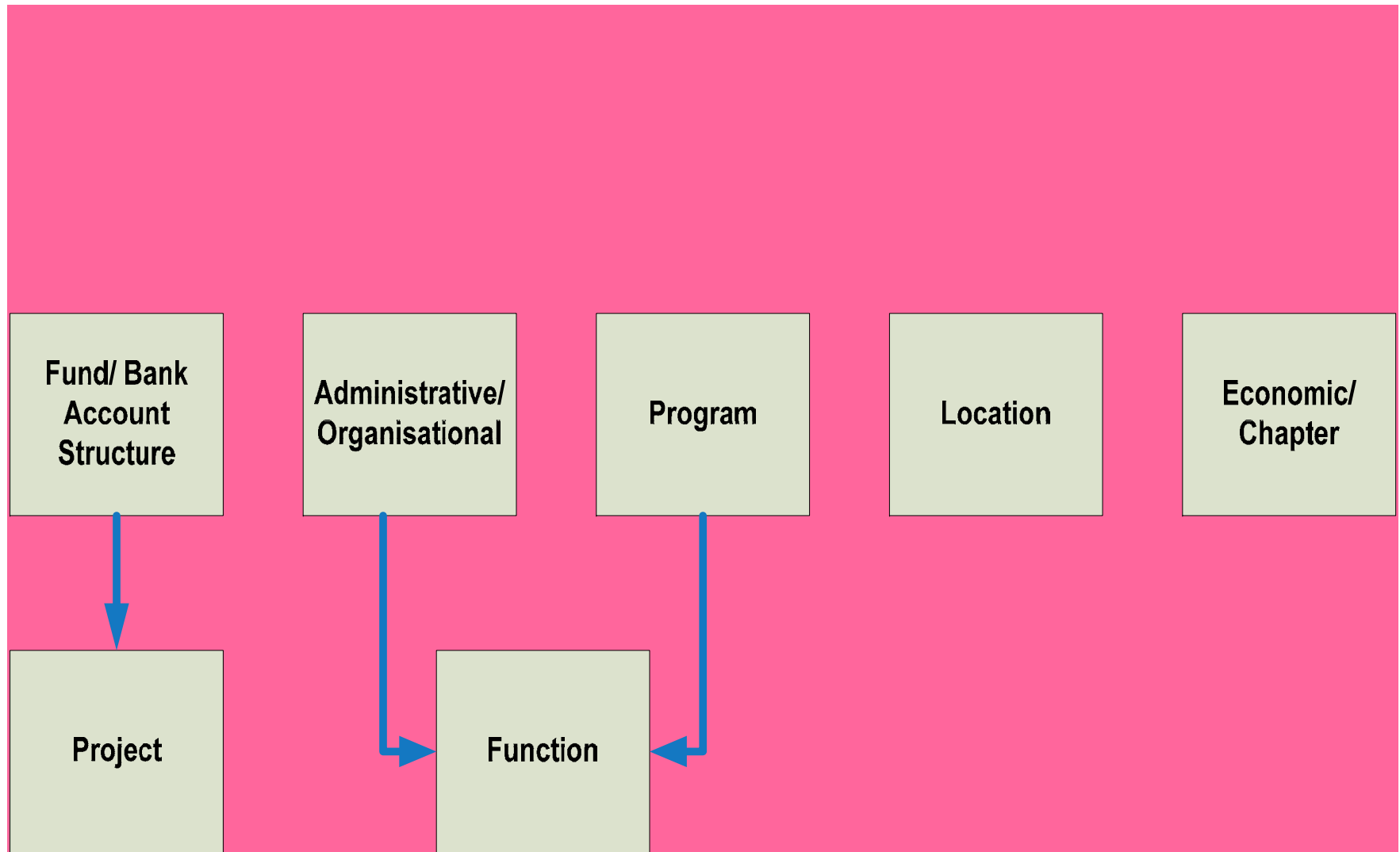
- Allow the capture of high level expenditure/revenue information for appropriation control
- Allow the capture of detailed expenditure/revenue information for management/internal control and audit purposes
- Provide a framework for recording and reporting on other financial stocks and flows such as assets and liabilities
- Facilitate the production of predefined reports for a variety of user requirements
- Facilitate the production of user defined reports as required
- Allow international comparison
- Facilitate the production of consolidated and detailed reporting
- Support strategic planning and results-based analysis

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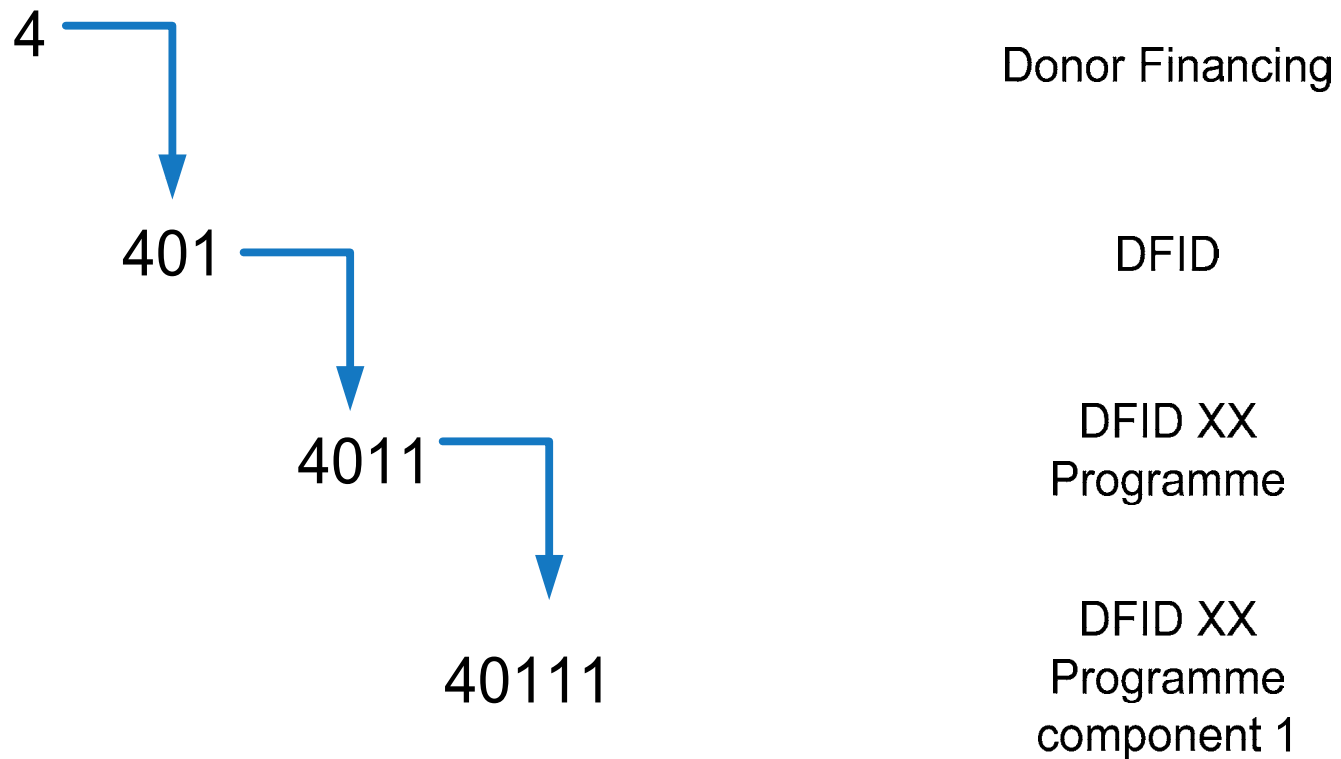
Key questions in building a COAs (or in identifying elements in COAs?)

- What is the money collected for?
- Where does the money come from?
- What is the nature of the spending?
- Who collects and spends the money?
- Where is the money spent?
- What reports are required by all users?

An example of elements of a COAs



Building a COAs element – Parent/child relationships





Topic 2

A Brief Introduction to GFS 2001

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What is GFS (Government Financial Statistics)?

- A statistical classification system for coding of financial information designed for the public sector by the IMF
 - GFS 1986 – cash based
 - GFS 2001 – Accrual
 - It includes the Classification of the Functions of Government (COFOG)

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Why is GFS important?

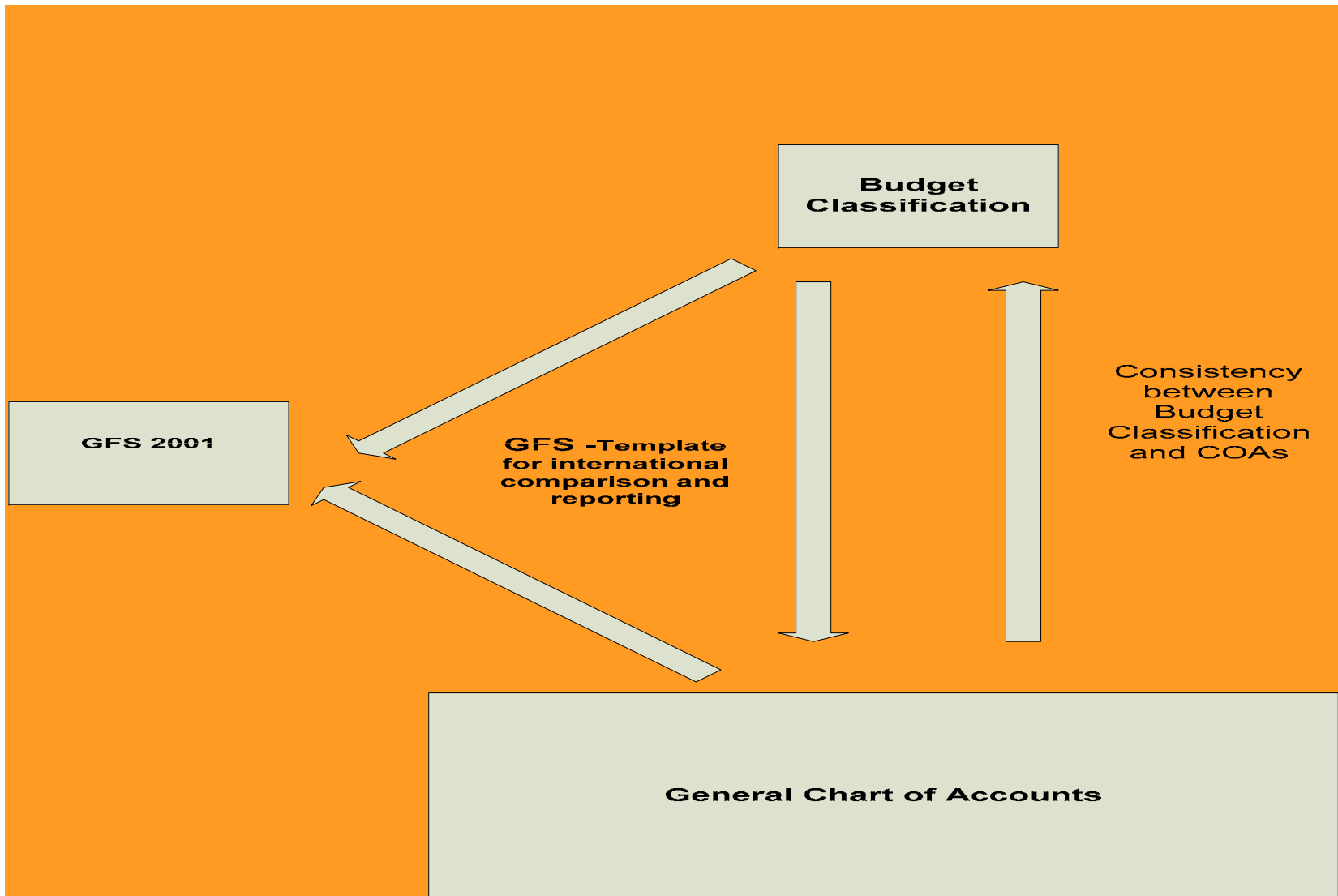
- It provides a mechanism to create uniformity in public sector finances
- It can assist developing countries to properly classify the CoAs
- It is a trigger for reform as it supports all cash, modified accrual and full accrual accounting


What GFS is not

GFS is not a panacea to all problems in this area

- It does not necessarily support reporting requirements for all decision makers
- It is not a good budget classification system – it is inputs-based and too detailed
- It is too aggregate for the purposes of expenditure and revenue tracking for management/internal control in line ministries and departments

Possible relationship between GFS and government financial requirements



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A closer look at the key components of GFS 2001 and the existing CoAs in Grenada

1. The Five economic elements of GFS 2001 and relationship to the Budget
2. COFOG
3. The existing CoAs in the Caribbean

Below the Line Accounts

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- Discussion regarding the difference between Caribbean Countries and GFS 2001
 - Problems with BTL accounts



Topic 3

Designing the schematic for the Chart of Accounts

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What is next in developing the CoAs?

- Decide on the direction and priorities for treasury/budget reform in relation to the CoAs
- Undertake gap analysis – what we have now verses where we want to go
- Identify the discrete activities which are required to get where we want to go
- Ensure we understand the interrelationship between the CoAs and other public sector reforms
- Sequence the activities to provide for a platform approach – platform 1

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Where we want to get to

Example:

- To have an automated government accounting system which is the statutory reporting system for government budget execution. The system should support the reporting and control requirements of all users in relation to cash (and in the longer term accrual) accounting. This should focus on both current and emerging needs.

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Who are the users?

Examples:

- Parliament
- Government
- MoF
- Director of Audit
- Ministries and Departments
- Spending Units/Institutions
- Donors

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What do we need?

A comprehensive and single COAs for (central) government reporting that should

- be compatible with (map to) GFS 2001 and COFOG (however this does not mean it is an accrual structure) to ensure uniformity internationally
- support an integrated budget and general classification
- provide the general structure for emerging reporting requirements including modified accrual reporting formats
- create a single format for the budget classification and execution for the recurrent and development budgets
- support development partner reporting
- support results based reporting
- allow sufficient detail to provide budget institutions (and Treasury on behalf of government) reports on execution in different economic categories (for both expenditure and revenue). This should also reflect the needs of the extra budgetary funds and local governments.


However it should not focus on satisfying the detailed interests of all parties

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Existing CoAs/budget classification

- Define the existing segments?
- What is missing in terms of reporting?

An Example for the CoAs in the Caribbean

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- A decorative graphic on the left side of the slide consists of two overlapping semi-circular shapes. The top one is a dark teal color, and the bottom one is a lighter teal color, both with a slight gradient.
- Programmes are actually second level organisational structures – Are there any alignment issues between programmes and actual organisational structures?
 - Some projects are asset categories
 - Indirect personnel is generally goods and services
 - High level classification system in general – difficult to meet management requirement needs
 - GFS 1986 mapping – not as detailed as GFS 2001

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Consolidation issues - What is meant by consolidation?

- Consolidation of bank accounts
- Consolidation of cash management
- Consolidation of funds
- Consolidation of recurrent and capital/recurrent budgets
- Consolidation of reporting

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What is a Treasury Single Account?

- It is a mechanism for cash management – having all cash contained in a single account simplifies liquidity management and reconciliation
- It does not always mean only one physical bank account – sometimes it will involve sub-accounts or even sweeping of bank balances from/to revenue or payment accounts
- It allows the segregation of funds for control purposes

Treasury Single Account – Consolidation of Cash in the CoAs

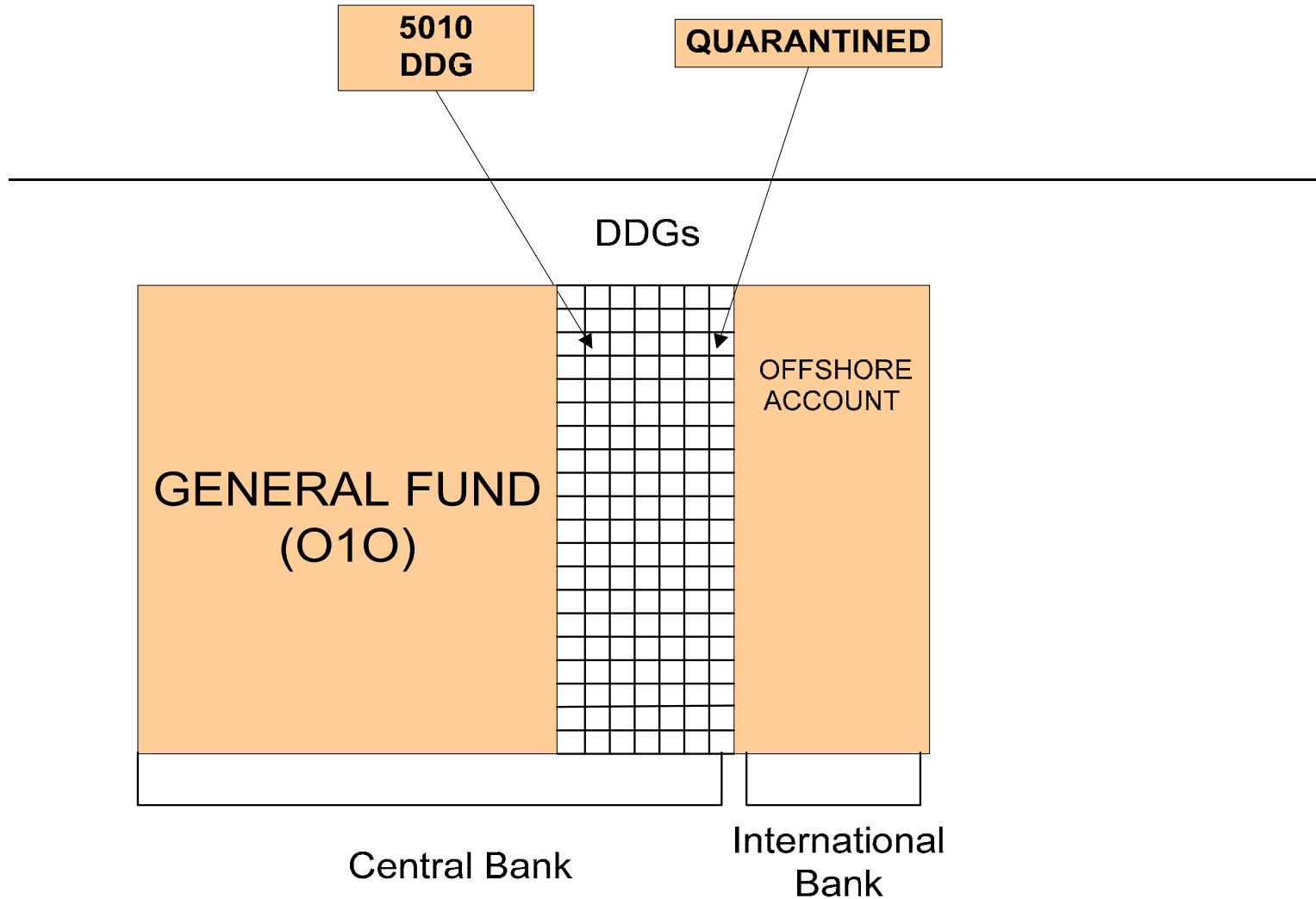
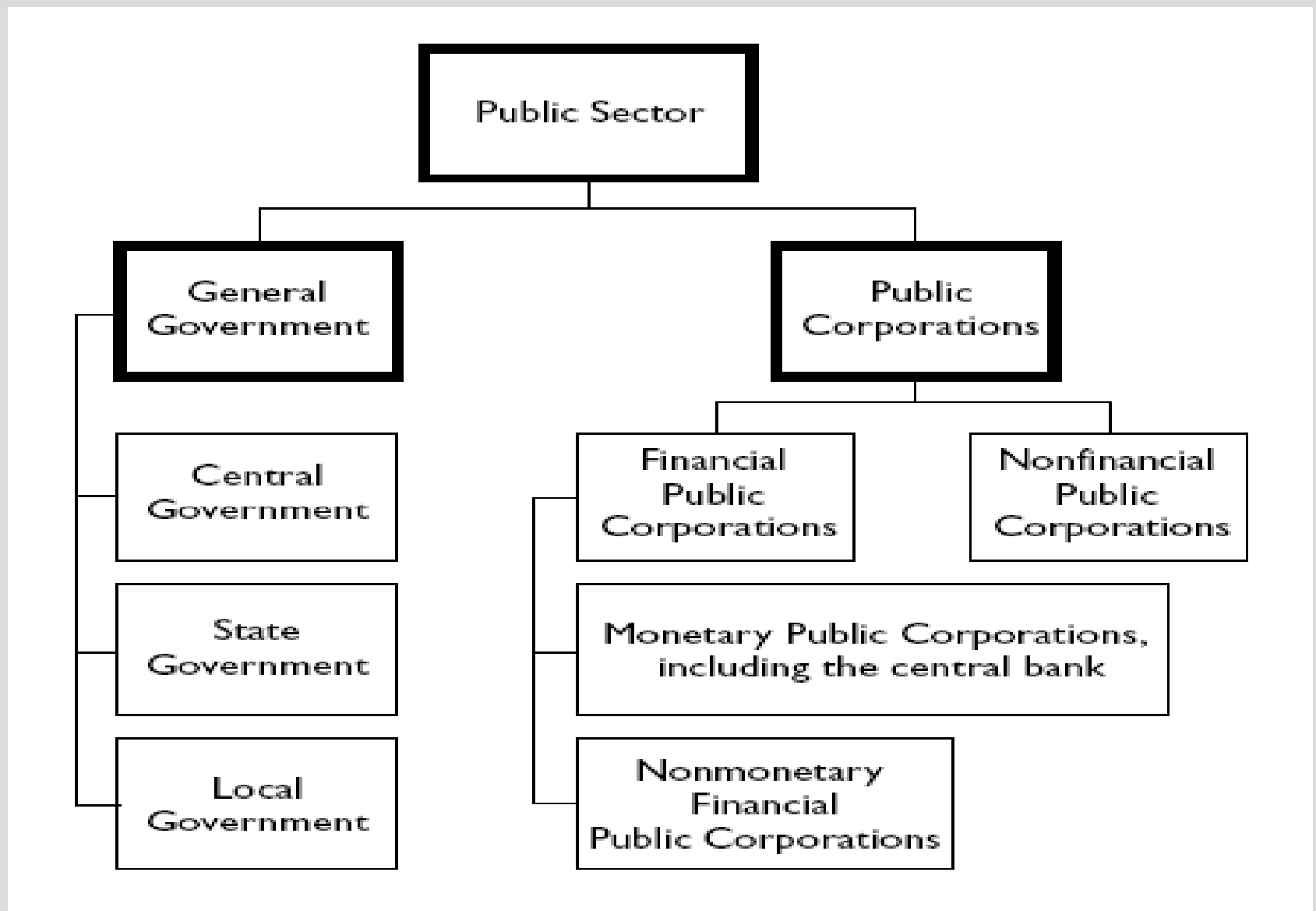
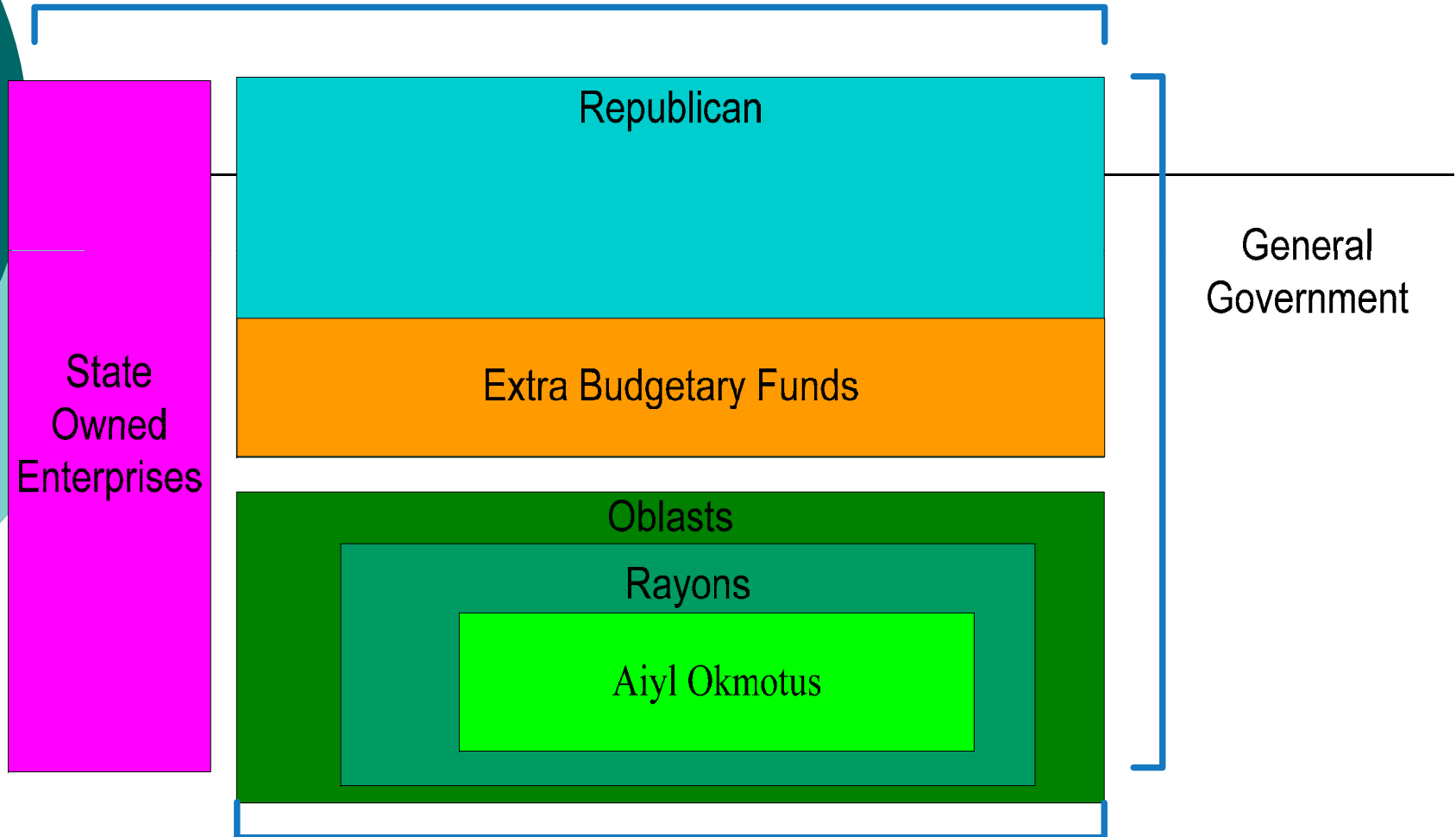


Figure 2.2: The Public Sector



Consolidated Government



State
Owned
Enterprises

Republican

Extra Budgetary Funds

Oblasts

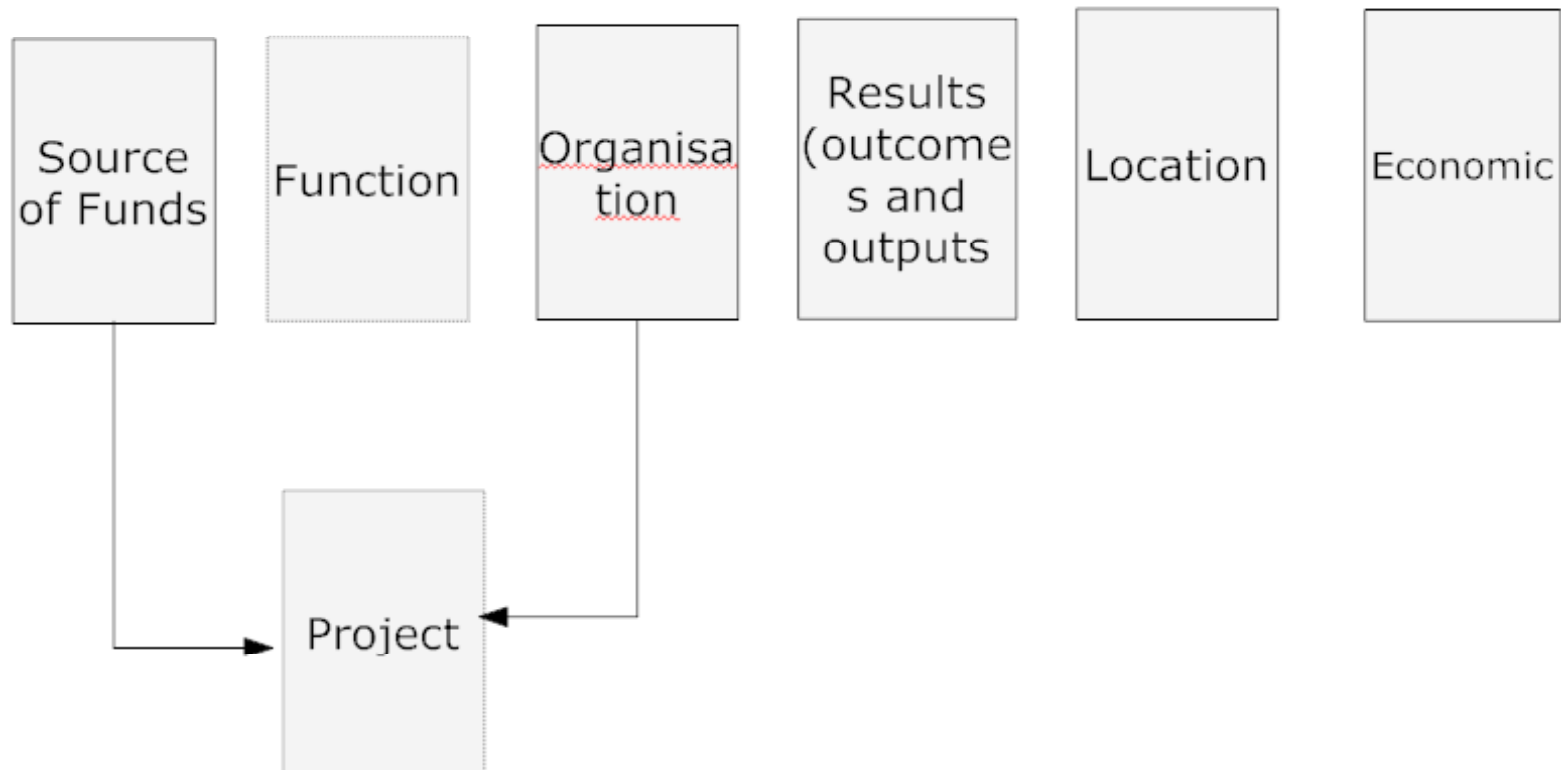
Rayons

Aiyl Okmotus

General
Government

Regional
Government

Integrating the development budget



Building an element/segment hierarchy

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Economic Class (1)

**Expenses
(2)**

Category (1)

**Goods and Services
(22)**

Strategic Planning

Item (2)

**Utilities
(2210)**

Financial Reporting

Sub-Item (1)

**Electricity
(22101)**

**Management
Reporting**

GFS 2001 Mapping - Implementation

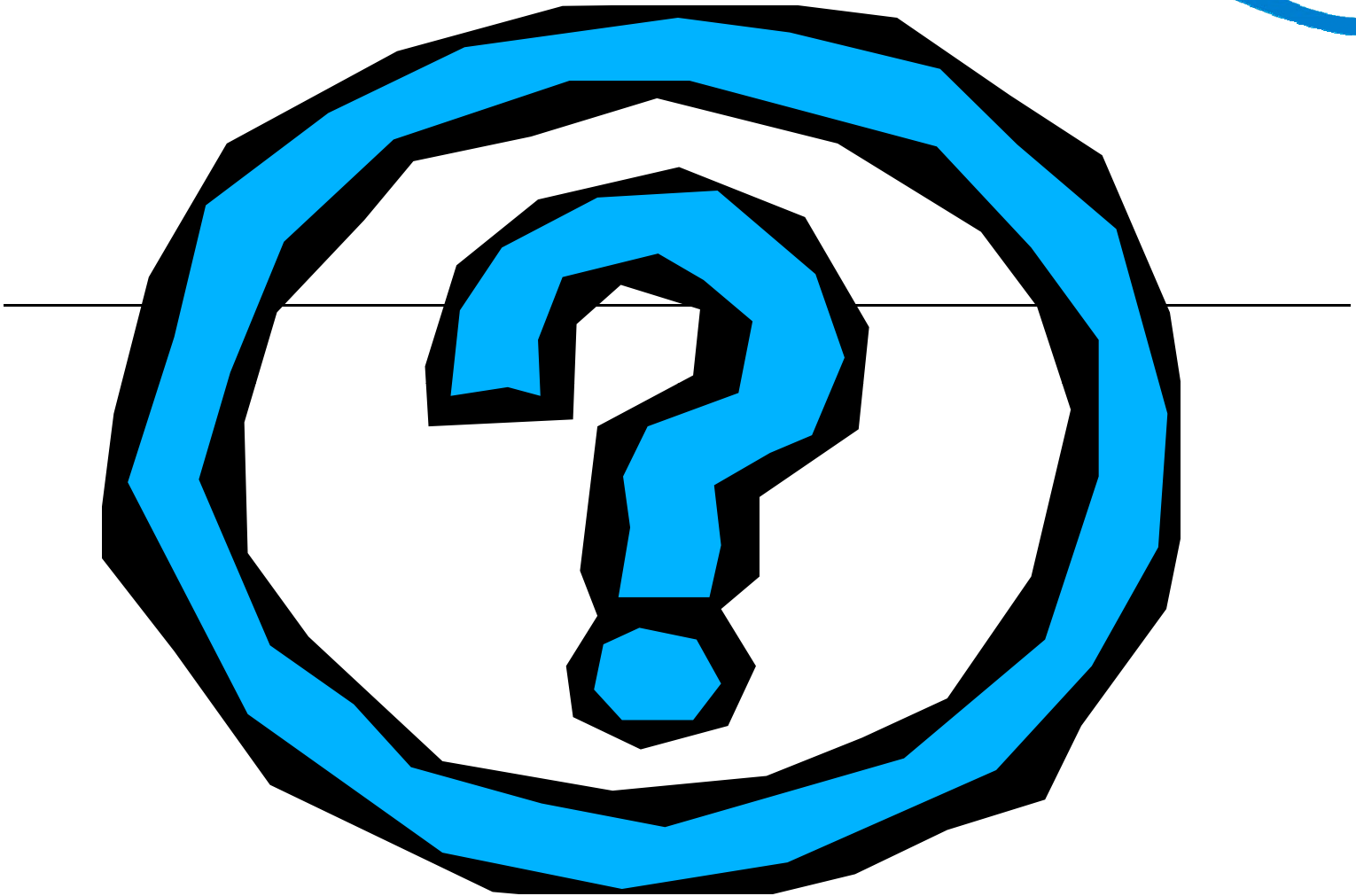



- Revenues 12 Feb 2010
 - Revision of Revenues with CARTAC 19 Feb
 - Expenditures 5 March
-
- Revision CARTAC 12 March
 - Non-financial Assets 26 March
 - Revision 9 April
 - Financial Assets and Liabilities 23 April
 - Revision with CARTAC 30 April
 - Meeting to Discuss implications of Mapping for changes to CoAs
 - Design new Economic classification (if required end of May)
 - Design other segments of the CoAs (end of June)
 - Consultation with key stakeholders (End of august)
 - Finalisation of CoAs (end of September)
 - Systems Changes and testing (End of November)
 - Training on new CoAs for users (Dec and Jan)
 - 1 Jan – new CoAs in SS
 - Bank Accounts/ add in functions/ backward mapping/ explanations

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Summary of today's presentation

- Redesigning a CoAs should focus on comprehensiveness to allow consolidated reporting
- Ensure the CoAs meets the needs of all users – not just the MoF
- GFS and COFOG should be integrated into the CoAs design



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**International Public Sector
Accounting Standards on a Cash
Basis (with some background on
Accrual Accounting)**

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What is the difference between cash and accrual accounting?

- Cash recognises transactions only when a payment is made or money is received in cash
- Accrual recognises all financial transactions at the time they occur, irrespective of whether a cash inflow or outflow occurs

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Some differences between the public and private sector

- Profit motive verses public good
- Going concern
- Annual appropriations
- Government has the right to raise taxes

Cash verses accrual



Cash

Modified
Cash/
Accrual

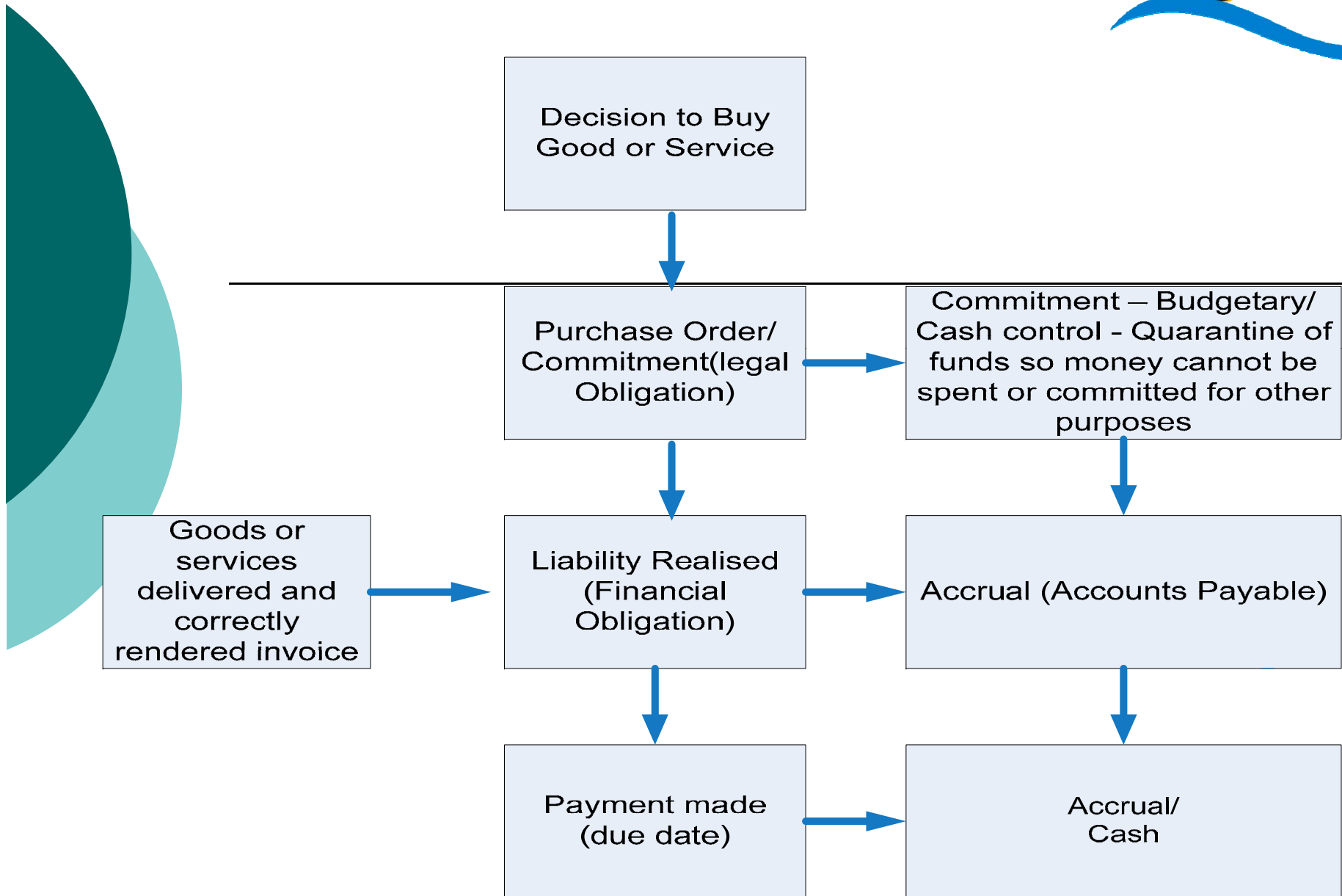
Accrual

Accrual
Reporting

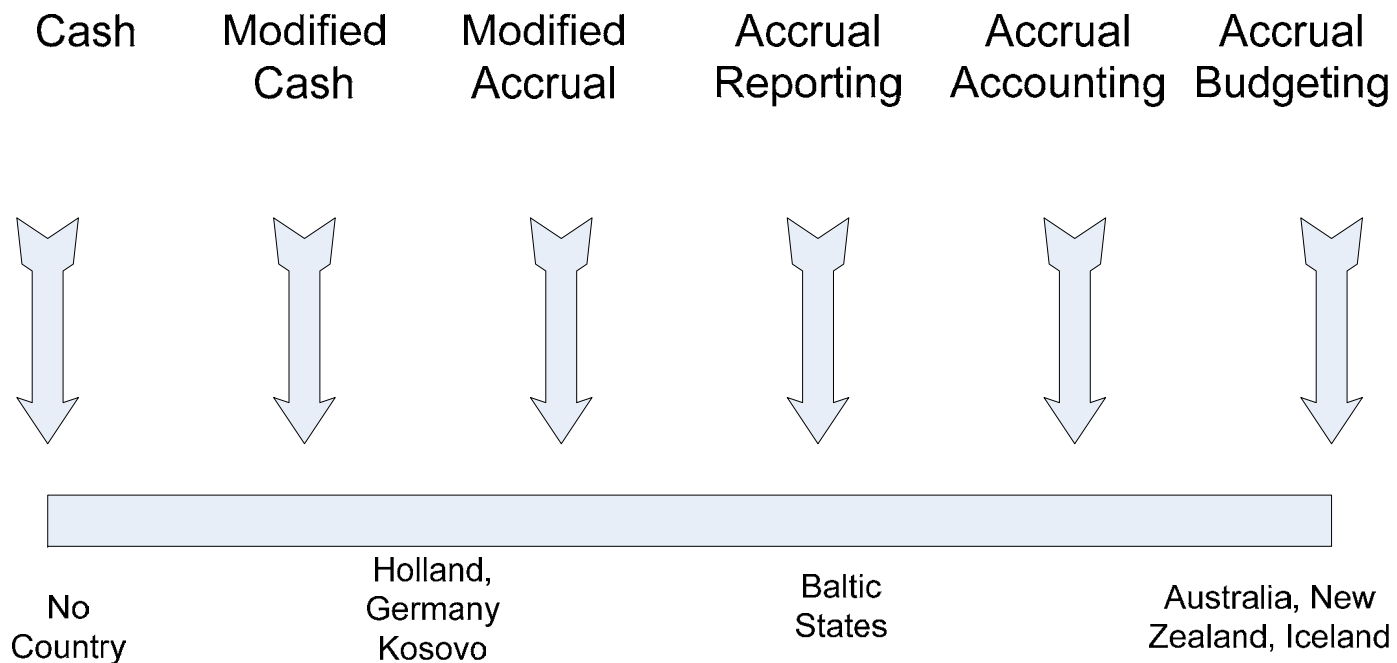
Accrual
Accounting

Accrual
Budgeting

Expenditures



Continuum of public sector accounting in government – international experience



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Specific issues for developing countries

- Getting cash right first!
- Legal framework
- Reporting and systems
- Cost of implementation
- Accompanying reform
- Depreciation of assets
- Recognition of revenues

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What are IPSAS?

- International set of accounting standards on financial reporting for the public sector
- Largely accord with IFRS – convergence. IPSAS also focus on where the requirements of the public sector depart from the private sector

Countries are encouraged to adopt IPSAS. Where they have domestic requirements which depart from IPSAS, these should be dealt with either with a supplementary standard or in the notes to the financial statements

Key message here is that countries have a sovereign right to report as they wish – however, adherence to standards is recommended and departure should be justified

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IPSAS cont...

- IPSAS are comprehensive in terms of recognition issues for financial reporting
- As such they can be complex
- This poses issues for developing countries in particular

IPSAS can be complex

A constructive obligation is an obligation that derives from an entity's actions where:

- (a) By an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
- b) As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A contingent asset is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the entity.

A contingent liability is:

- a) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the entity;

IPSAS – does this mean full accrual?

-
- Nay/Ne -Bosnia/Serbia (unless you are Greek)
 - No -English
 - Nyet -Russian
 - Nein -German
 - Nu -Romanian
 - Ochi -Greek
 - Jo -Albanian
 - Ei -Estonian
 - Non -French
 - Nem -Hungarian

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IPSAs and GFS

- Both support cash and accrual accounting
- IPSAS are international standards for financial reporting
- GFS is an international standard for statistical reporting
- They have a different focus but are overlapping

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Cash based IPSAS

- Focuses on cashflow reporting
- The structure is consistent with GFS 2001 reporting requirements
- Encourages supplementary reporting of assets and liabilities
- Countries can choose to migrate to accrual at a pace that suits their reform agenda

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Issues for Implementing IPSAS (IFAC)

The main constraints facing developing countries, in terms of changes to the basis of accounting used by government entities, are likely to be the existing capability of entities in terms of accounting systems and qualified staff, and the resources available within or outside government to develop that capability. Such resource restrictions mean that developing countries may be more inclined to consider step-by-step implementation paths.

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What is needed to implement IPSAS – cash, accrual or modified (IFAC)

- a clear mandate;
- political commitment;
- the commitment of central entities and key officials;
- adequate resources (human and financial);
- an effective project management and coordination structure;
- adequate technological capacity and information systems; and
- the use of legislation to provide formal authority and signal commitment to the changes.

To accrual or not to accrual; that is the question.



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In Conclusion:

- Accrual accounting will provide clear financial information for decision making – however, consider first adopting the cash based IPSAS
- Each country needs to decide on its pathway and exactly how it will implement accrual to maximise results
- A graduated implementation to allow budget institutions to adapt progressively is the best recipe for success (Diamond)

In Conclusion (Cont):

- Accrual is more complicated than cash, which requires higher skills and increases costs
- Do not over-estimate line ministry capacity – this process will require a significant investment in training including the creation of a dedicated accounting policy unit with the skills to deliver and develop educational materials

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Cash Based IPSAS

- Two parts – Part one mandatory cash disclosures; Part Two encouraged additional disclosures
- From 2009 must report against the budget in the financial statements
- *An entity shall present an explanation of whether changes between the original and final budget are a consequence of reallocations within the budget, or of other factors...*

Cash Basis of Accounting

1.2.2 The cash basis of accounting recognizes transactions and events only when cash (including cash equivalents) is received or paid by the entity. Financial statements prepared under the cash basis provide readers with information about the sources of cash raised during the period, the purposes for which cash was used and the cash balances at the reporting date. The measurement focus in the financial statements is balances of cash and changes therein. Notes to the financial statements may provide additional information about liabilities, such as payables and borrowings, and some non-cash assets, such as receivables, investments and property, plant and equipment.

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An entity should prepare and present general purpose financial statements which include the following components:

(a) a statement of cash receipts and payments which:

(i) recognizes all cash receipts, cash payments and cash balances controlled by the entity; and

~~(ii) separately identifies payments made by third parties on behalf of the entity in accordance with paragraph 1.3.24 of this Standard;~~

(b) accounting policies and explanatory notes; and

(c) when the entity makes publicly available its approved budget, a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the statement of cash receipts and payments in accordance with paragraph 1.9.8 of

this Standard.

1.3.5 When an entity elects to disclose information prepared on a different basis from the cash basis of accounting as defined in this Standard or otherwise

required by paragraphs 1.3.4(a) or 1.3.4(c), such information should be disclosed in the notes to the financial statements.


Structure of the Notes

1.3.30 The notes to the financial statements of an entity should:

(a) present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and other events; and

(b) provide additional information which is not presented on the face of the financial statements but is necessary for a fair presentation of the entity's cash receipts, cash payments and cash balances.

1.3.31 Notes to the financial statements should be presented in a systematic manner. Each item on the face of the statement of cash receipts and payments and other financial statements should be cross referenced to any related information in the notes.

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Cash is controlled by an entity when the entity can use the cash for the achievement of its own objectives or otherwise benefit from the cash and ~~exclude or regulate the access of others to that~~ benefit. Cash collected by, or appropriated or granted to, an entity which the entity can use to fund its operating objectives, acquire capital assets or repay its debt is controlled by the entity. Amounts deposited in the bank account of an entity are controlled by that

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Exchange Rate Differences

An entity should disclose the amount of exchange differences included as reconciling items between opening and closing cash balances for the period.

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Kosovo Financial Statements

- Why Kosovo – Using Cash Basis IPSAS since 2004
- Well structured – consolidation of financial information in FMIS –including all external financing
- Quarterly reporting in same format as annual statements
Overtime, introduce additional notes to disclose accruals
- <http://www.mef-rks.org/en>
- Consider eventually adopting accrual reporting while maintaining cash management (Bermuda)

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Summary of today's presentation

- In the Caribbean adopt Cash Based IPSAS as a first step
- Focus first on the primary statements
- Overtime, introduce additional notes to disclose accruals
- Consider eventually adopting accrual reporting while maintaining cash management (Bermuda)

