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TOWARDS A NEW BUDGETING AND ACCOUNTING SYSTEM IN THE PUBLIC SECTOR

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Towards a New Budgeting and Accounting-System in the Public Sector

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1. Introduction

Public management reform is an ongoing and international phenomenon. Successful public management reform is a mixture of opportunity, strategy, and tactics (Schick, 2002, p. 8). Opportunities are country-specific conditions that facilitate some reforms and retard others. Strategies are policies and actions that set goals for government and for tasks to be undertaken in implementing wanted change. Tactics are the methods used to mobilize support for and overcome obstacles to reform. In this paper we focus on certain dimensions of the strategy of public sector reform.

Since countries differ at the level of individual reforms, there is no single model of reform. Nonetheless, reform strategies have many points in common emphasizing the international character of public management reform. Cross-national comparisons of the reform process have underlined some components of the relevant policies. Generally, OECD countries aimed at improving the public sector's performance and redefining its role in the economy. More in particular, these reforms include (OECD, 1995, pp. 25-28):

- A greater focus on outputs and results.
- A greater value for money.
- Enhanced flexibility by changing the nature of central steering and control.
- Various forms of devolution of authority.
- Strengthened accountability and control, since accountability for actions is the counterpart of greater autonomy.
- Establishment of a client- and service-oriented public sector that is more outward looking than inward looking.
- Reinforced capacities of developing strategy and policy.
- The introduction of competition and other market elements to reduce the burden governments place on the private sector in terms of tax imposition and compliance and administrative costs.
- Establishing different relationships with other levels of government.

This paper focuses on several of these common points of public sector reform while paying special attention to experience in Germany and the Netherlands. Changes in public sector financial management in Germany have been relatively slow and careful. They were first pursued by local governments and later by states (Länder) and the federal government. Most financial management reform attempts have centered on developing output structures for budget purposes and on cost accounting. More and more jurisdictions intend to introduce a comprehensive and integrated financial management system consisting of output- and accrual-based budgeting, accrual based financial accounting and cost and performance accounting. Existing problems relate mainly to the output structure of the budget, the definition of performance indicators, and measuring non-financial performance (Lüder, 2002).

In the Netherlands strengthening accountability has a long history (Van der Hoek, 1994). From the mid-1980s a process of reinforcing accountability in the central government sector was set in motion. Under pressure of Parliament the government of the Netherlands developed major reform plans. One of the results was an integrated commitment-cash accounting system. In the early 1990s, further reforms were developed in the form of agencies as units subject to special rules including accrual accounting. In 2002, 24 agencies had been formed (Ministry of Finance, 2003, p. 32). Obviously, the Dutch government valued the experiences of the agencies. In the Budget Memorandum 2001 it announced to introduce, at least in principle, a system of accrual accounting in the entire central government sector (Ministry of Finance, 2000, p. 84). Generally, national accounting standards do not play a prominent part in government accounting. In the Netherlands, however, central government has
adopted the 1995 European System of Accounts (ESA)\(^1\) as a starting point, in particular for the treatment of expenditure on investments (capital expenditures).

Governments in a growing number of countries have already shifted or are planning to shift from cash-based to some form of accrual accounting. New Zealand, Australia, Canada, and the USA implemented accrual accounting in the 1990s. In Europe, Sweden and the UK followed suit, while other countries - including Germany and the Netherlands - are shifting or are planning to shift to an accrual basis. Half of OECD member countries use some form of accrual accounting in their financial reporting, although only a few use accruals in their budget process. Extending accruals to budgeting is controversial (Matheson, 2002, p. 44). Originally, accrual accounting was developed for private enterprises, which are income-generating households. A comparison of revenues and cost yields the financial result (profit or loss). In a commercial environment this is a measure to judge efficiency. Government, however, is essentially an income-spending household. It raises tax revenues that it spends on public outlays. Relevant is not so much the financial result, but rather the social outcome of public expenditure, while the public budget needs authorization by the legislature. Generally, legislatures grant authorization through appropriations enabling the government to spend money for specific purposes. Moreover, cash budgets are still very important for macroeconomic analyses. The most important reason for the shift towards accrual accounting is that it is expected to lead to more insight in the costs of government resulting in higher cost awareness with bureaucrats, which in turn leads to a more efficient government (Algemene Rekenkamer, 2002b).

The remainder of this paper is organized as follows. Section 2 addresses the different international standards. Section 3 deals with different budgeting and reporting systems in the public sector. Section 4 addresses the German experience with a new budgeting and accounting system for the public sector, while section 5 pertains to the Dutch experience with budgeting and accounting systems in the public sector. Section 6 summarizes the main findings.

2. International standards

Governments follow widely diverse financial reporting practices making international comparisons problematic. At central government level there are two accounting systems serving different purposes:

   Individual government organizations draw up budgets and financial reports for managing these organizations.

   National accounts present statistical, macroeconomic financial data on the national economy.

Different accounting standards have been developed for both types of accounting.

Government Accounting

The Public Sector Committee (PSC) of the International Federation of Accountants (IFAC) has drawn up International Public Sector Accounting Standards (IPSAS)\(^2\) that are based on international accounting standards. The IPSAS are the authoritative requirements established by the PSC to improve the quality of financial reporting in the public sector around the world. Several international organizations (the EU, NATO, and the OECD) and South Africa have explicitly adopted the IPSAS, while it can be expected that a growing number of countries will do so too. So far, the IPSAS only pertain to financial accounts, but the PSC intends to also address budgeting in future.

The International Organisation of Supreme Audit Institutions (INTOSAI) discerns in its 1995 Accounting Standards Framework four financial reporting systems: 1) full cash; 2) modified cash; 3) modified accrual; 4) full accrual. In statement 4 of paragraph 36 it states that performance reports and departmental reports should be based on full accrual. General-purpose financial statements should be based on either full accrual or modified accrual depending on a particular government's circumstances.

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1 This system has replaced the European System of Integrated Economic Accounts published in 1970. The ESA's classification system is to be found at http://europa.eu.int/comm/eurostat/ramon/esa_1995/esa_en.html.

2 More details can be found at http://www.ifac.org.
The INTOSAI Accounting Standards and the IPSAS are largely comparable; both are based on the international accounting standards (Algemene Rekenkamer, 2003b, p. 57).

**National Accounting**

The ESA is mandatory for EU member states from 1996. It is consistent with the 1993 System of National Accounts (SNA) that has been developed under the common responsibility of the United Nations (UN), the International Monetary Fund (IMF), the European Commission, the Organisation for Economic Co-operation and Development (OECD), and the World Bank. The ESA is not restricted to annual national accounting, but also applies to quarterly accounts and regional accounts. The ESA framework consists of two main sets of tables:

- **Sector accounts**
  They provide, by institutional sector, a systematic description of the different stages of the economic process: production, generation of income, distribution of income, redistribution of income, use of income and financial and non-financial accumulation. The sector accounts also include balance sheets to describe the stocks of assets, liabilities and net worth at the beginning and the end of the accounting period.

- **Input-output framework and the accounts by industry**
  They describe in more detail the production process (cost structure, income generated and employment) and the flows of goods and services (output, imports, exports, final consumption, intermediate consumption and capital formation by product group).

The ESA encompasses concepts of population and employment. These concepts are relevant for both the sector accounts and the input-output framework.

The ESA is not only used for drawing up national accounts, but also as a calculation base for the Stability and Growth Pact of the Economic and Monetary Union (EMU) and for accession countries. Since the Stability and Growth Pact also makes demands on public budgets it ostensibly links national accounts and public budgets and public financial statements. However, the sector government in national accounting is not yet based on certified financial statements. Rather, they are taken from non-certified data that is specifically collected as statistical data for national accounts. The ESA is not designed for financial accounts; it only applies to national and regional accounts of each EU member state.

**Conclusion**

SNA and ESA are the leading standards for national accounting, but they are not designed for government budgets and financial reports. The IPSAS are the leading standards for government accounting. The Dutch government's intention to apply the ESA to its budgets and financial reports implies that the contents of these documents will fail to meet current requirements. Examples of ESA non-current requirements are:

- The grouping of main financial reviews.
- The headings of items in these reviews.
- The criteria for capitalization.
- The valuation of assets at market value.
- The non-allowance of provisions.

Given the increasing importance of international harmonization of financial reporting it seems reasonable to expect that the role of the IPSAS will gain significance in budgeting and financial reporting in the public sector. Currently, however, it is unclear whether the two leading international standards IPSAS and ESA will be harmonized and if so, how.

**3. Budgeting and reporting systems**

There is a distinction between budgeting and financial reporting (Matheson, 2002). Budgets are future-oriented financial plans for allocating resources among alternative uses. Financial reports retrospectively describe the results of an organization's financial transactions and events in terms of its financial position and performance. In the private sector budgets are targets rather than plans, while budgets reflect what the organization hopes to achieve rather than what it actually brings about. Companies
and other private organizations are not obliged to draw up a budget even though they usually do. However, they rarely publish their budgets. For governments it is not only mandatory to draw up budgets, but also to publish them. Governments must allocate resources both within the public sector and between the public sector and the rest of the economy. Australia, New Zealand, and Sweden use accruals both in financial reporting and in the budget. Canada, France, and the UK have plans for more extensive use of accruals in the near future, while the European Union decided in 2002 to implement accruals from 2005 (Matheson, 2002, p. 44; Algemene Rekenkamer, 2003b, p. 47).

As to budgeting, appropriations can be based on different systems. Most widespread are cash-based appropriations giving the government rights to make cash payments over a limited period of time. Commitment-based appropriations give the government authority to make commitments and make cash payments according to these commitments without a predetermined time limit. Accrual-based appropriations cover the full costs of the operations of the government and increases in liabilities or decreases in assets. This kind of appropriations requires special mechanisms for controlling cash. Notably, accrual accounting does not require the abolition of cash-based appropriations. Some critics point out that an accrual budgeting system cannot be the system for a government for two reasons. First, budgetary laws often require the legislature to authorize cash payments. Second, an accrual system is tailored to income formation: it matches revenues and cost. In the public sector, however, it is impossible to match tax revenues with production cost (Mol, 2001, p. 75).

There is a wide spectrum of accounting bases ranging from cash to full accrual. Cash-based accounting measures the flow of cash resources and recognizes transactions and events only when cash is received or paid. Accrual accounting recognizes stocks and flows. Stocks refer to the holdings of assets and liabilities. Assets can be financial (such as cash), physical (such as property), or intangible (such as copyrights). The difference between the total value of assets and the total value of liabilities is the net worth. Flows reflect the creation, transformation, exchange or transfer of economic value and, thus, either an increase or a decrease in net worth. Revenues increase net worth, whereas expenses decrease net worth. In practice, many countries’ systems are a mixture of both extremes. Insofar accrual accounting systems are used, they differ across countries.

Usually, the implementation of some accrual-based system is linked to wider financial management reforms including performance management requiring information on costs (Algemene Rekenkamer, 2003b). Those countries that shifted to an accrual-based system have to a large extent common goals:

- Complementing performance management.
- Facilitating better financial management.
- Improving understanding of program costs.
- Expanding and improving information for resource allocation.
- Improving financial reporting.
- Facilitating improved asset and cash management.

Differences exist, however, as to the way countries have designed and implemented the new system. First, some countries value fixed assets at their historic cost, other countries value them at their historic cost less accumulated depreciation and yet other countries revalue their fixed assets periodically.3 Second, some countries apply a charge for the use of capital, whereas other countries do not apply any capital charge. Third, countries account differently for the consumption of fixed assets by applying either a linear depreciation method or a free one.

4. A New Budgeting and Accounting System in Germany

A new Budgeting and Accounting System (BAS) for the public sector in Germany will be developed and implemented first at the local government level (Modellprojekt Doppischer Kommunalhaushalt in NRW, 2002), which will serve as a testing ground. In order to achieve a highly integrated BAS in the public sector, the model then will serve as the foundation for the development of a similar BAS at the

3 The IPSAS requires items to be valued at historic cost (the cost as at the date an item is acquired). However, where an asset is acquired at no or nominal cost, the IPSAS determine its cost as its fair value (the amount for which an asset could be exchanged or a liability settled).
state and federal levels of governments. First results already are in hand and were achieved mainly through utilization of suitable ERP-Software.

Previously, BAS at any level in the public sector was characterized by cash budgeting and cash-based accounting systems. These concepts proved inadequate with regard to efficiency and effectiveness in budget management. Therefore, the following guidelines for the creation of a new BAS can be posited:

- Integration and presentation of the complete resources available and used in order to meet public demand and fulfill public services, not merely the financial cash flow. It is due to this suggestion that the model is titled “From the total cash resources concept towards the total economic resources concept”.
- Recording and presentation of the complete assets of a jurisdiction, specifically including the fixed assets. This has not been the case in the past, so that a first-time recording and evaluation of all fixed asset items will require an immense effort.
- Incorporation of goals, objectives and performance measurement with internal and external assessment, outputs, and outcomes into budget management.
- Development of prerequisites for flexibility in budget management of agencies, which also will support incentive structures for staff members to increase efficient and effective use of budget resources.
- Use of a uniform style of accounting for all agencies in a jurisdiction based on double-entry bookkeeping, as used in private organizations, i.e. accrual-based accounting instead of cash-based accounting.

Characteristics
The guidelines formulated above are not only applicable in Germany. They are rather the foundation for a number of reforms carried out in Europe. Thus they can be implemented in the form of slightly varying models in any country under the condition that the specific social, cultural, political, administrative, economical, and constitutional characteristics of that country are taken into consideration in this process.

The following paragraph delineates the German BAS - the New Local Government’s Finance Management - and its main characteristic features:
1. Chart of Accounts
2. Budget organization and content of the budget
3. Attention to depreciation and valuation of fixed assets
4. Rules of budget balancing including regulations for borrowing and credits
5. Components of financial reporting
6. Integration of the annual budget into comprehensive strategic planning
7. Supplementation of financial accounting by robust cost accounting systems

Sub 1
The framework of accounts as the basis for budgeting and accounting can be categorized in the following account classes:

Class | Designation
--- | ---
0: | Fixed Assets:
    | land, buildings, equipment etc.
1: | Financial Assets:
    | investments, stocks, securities etc.
2: | Current Assets:
    | inventories, accounts receivable, down payments for assets under construction etc.
3: | Equity and Reserves:
    | reserve for pending claims or for impending losses or future capital outlay etc.
4: | Liabilities:
    | accounts payable, borrowings and credits, capital leases payable etc.
5: | Operating Revenues:
    | taxes, grants, fees, charges for sales and services (external), charges for services (from internal activity allocation), interest revenue, donations etc.
6: Operating Expenses:
   payroll, costs of sales and services (internal), cost of services (for internal activity allocation),
   interest expense, depreciation etc.

7: Cash received:
   cash received from customers, from citizens or from other jurisdictions, from sales of fixed assets
   or investments, from given loans, from borrowings and credits etc.

8: Cash paid:
   cash paid to employees, to suppliers or to other jurisdictions, cash paid for purchase of fixed
   assets, for investments, amortization payments etc.

9: Cost Accounting:
   specific accounts for secondary cost elements. This account class will be used only for inte-
   grating the cost accounting with the financial accounting.

This framework of accounts is essentially comparable to the one used in private organizations. This
fact will facilitate the legal consolidation of enterprises, agencies, boards, and commissions within a
jurisdiction.

Accounts of classes 0-4, the real accounts, are closed into the balance sheet. Accounts of
classes 5-8 are the basis for planning and budgeting. Budgetary accounts, i.e. in the American fund
accounting, used to post budgetary processes such as appropriations, estimated revenues, encum-
brances, and allotments will not be included in this model. These processes will be shown with the
specific object that they refer to, for example in cost centers, fixed assets items, etc.

Sub 2
The annual budget consists of two plans:

a. The accrual-based income plan (see Appendix A), which accounts for the revenues (class 5 of the
   Chart of Accounts) and the expenses (class 6 of the Chart of Accounts). The income plan is
equivalent to the profit and loss statement of private organizations. Therefore, the rules for the in-
tegration of revenues and expenses into the budget are parallel to commercial and fiscal law for
private organizations.
This plan thus will illustrate the utilization of resources used for ongoing activities split down to
the single unit of a jurisdiction within one year; due to this set up, the use of resources will be
shown even if there is no cash flow (cash paid/cash received); for example, depreciation, reserves
for pending claims etc. Therefore, this plan is equal to an operating budget and will function as a
total economic resources concept.

b. The cash-based plan of cash items (see Appendix B), which registers cash receipts (class 7 of the
   Chart of Accounts) and cash payments (class 8 of the Chart of Accounts) based on the separate
   operating units.
Cash receipts consist of the cash items of the ongoing activities in the jurisdiction, which are
shown as revenues in the income plan, and cash items, which are connected to capital projects and
financial management, for example cash received from sales of fixed assets and from borrowings
and credits.
The amounts paid category consists of cash items which are used for ongoing activities in a juris-
diction (they are shown as expenses in the income plan) and cash items connected with public in-
vestment and its financing, for example cash paid for purchase of fixed assets and for debt service
(amortization and interest).
This category of cash accounts (classes 7 and 8) will not appear in the accounting of private or-
ganizations. In the public sector, these accounts maintain solvency and cash flow. These items ap-
pear in the income plan and in the plan of cash items on a time line, which is shown below (FY =
Fiscal Year):

<table>
<thead>
<tr>
<th></th>
<th>Actual</th>
<th>Budget</th>
<th>Adopted</th>
<th>Projected</th>
<th>Projected</th>
<th>Projected</th>
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<tbody>
<tr>
<td>FY t-2</td>
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<td>FY t</td>
<td>FY t+1</td>
<td>FY t+2</td>
</tr>
<tr>
<td>FY t-1</td>
<td></td>
<td></td>
<td></td>
<td>FY t</td>
<td>FY t+1</td>
<td>FY t+2</td>
</tr>
<tr>
<td>FY t</td>
<td></td>
<td></td>
<td></td>
<td>FY t+1</td>
<td>FY t+2</td>
<td>FY t+3</td>
</tr>
</tbody>
</table>

As a result, medium-term financial planning is integrated into the annual budget. With every an-
nual budget, the medium-term financial planning is extended by another year.
The income plan and the plan of cash items are part of the annual budget and as such they can be decomposed into smaller parts, i.e. the products of the single jurisdictions; in this process a balance between the organizational units will be established, i.e. between the agencies in a jurisdiction and their products.

The basis for this process is a statewide product plan so that comparability and, consequently, benchmarking between all local jurisdictions of a state is guaranteed. The items shown in the annual budget can be managed flexibly, so that authorized expenditures, which were not made during a given fiscal year, can be transferred into the next fiscal year. Furthermore, authorized expenditures, which were not used for a specified item, also can be transferred to the product budget. This flexibility aims at eliminating inefficient management, which was a problem in the old BAS.

Sub 3
The depreciable fixed assets of a jurisdiction serve as the basis for calculating the depreciation. That means that there is as a rule no depreciation for land.

Depreciation charges appear in the income plan as expenses. This is aimed at balancing the total consumption of fixed assets with the operating revenues, so that there is no need for credits and borrowing in order to maintain the substance of the fixed assets.

The amount of the depreciation is dependent on the valuation of the fixed assets. The fixed assets will be valued at their historical cost, regardless of their being disposable or non-disposable fixed assets. Cost, for the purpose of valuation, not only includes the purchase price or cost of construction, but also any other charges necessary to bring the asset to operation, i.e. transportation charges, land-preparation cost, etc.

At the first inventory of the fixed assets, if the historical cost is unknown, there will be careful estimation based on the date for opening the balance sheet. At the same time, the anticipated useful life of the asset will be determined.

Sub 4
The rule of the budget balance applies to the whole budget, the income plan as well as the plan of cash items.

The minimal requirement for the income plan is a zero balance, i.e. total revenues = total expenses. This also applies to the plan of cash items; one has to distinguish between the cash items from operating administrative tasks and the cash items from investments and their financing. The difference between the total cash receipt for ongoing administrative tasks and the total amount paid out for ongoing administrative tasks has to be at least as high as the amortization for credits and borrowings as planned in the budget. This parameter guarantees that credits and borrowings will be financed by the surplus and not by additional credits and borrowings.

There is another financial restriction within the plan of cash items which stipulates that the total amount of the planned credits and borrowings can not be higher than the amount of the expenditures for capital projects; financing ongoing administrative activities by means of credits is therefore not possible.

There is no direct link between the credits and the single capital project expenditures, i.e. credits are not directed towards financing a specific object. As a result, the sum of all credits is used to finance the sum of all capital projects (rule of total coverage). That also implies that there is no link between the duration of credits and the duration of use of the single fixed assets.

Sub 5
Transactions in budget management and closing out the budget at the end of a fiscal year are undertaken according to the rules of double-entry bookkeeping. This is then the basis for financial reporting.

The structure of financial reporting follows the structure of the budget and its two components, income plan and plan of cash items. Therefore, there appears an income statement for the complete income plan and for every single product of the plan of cash items, and a cash flow statement for the complete plan of cash items and for every single product of it. Information on performance will be shown with reference to the product statements, i.e. a relationship is established between the goals, objectives, performance, output, and outcome.
Next to these statements, which are established on the basis of the classes 5-8 in the Chart of Accounts, a balance sheet will be assembled. This balance sheet will not use products as the unit of analysis, as do the statements, but it is a balance sheet in which all products of a jurisdiction are included. The balance sheet conforms in structure to the one used in private businesses.

Thus, products cannot be shown as separate funds as the term fund usually is defined as an independent fiscal and accounting entity with a self-balancing set of accounts. This is clearly not the case here.

**Sub 6**

The goals and objectives in a budget are established for one year, which makes it necessary to extract this information from the medium and long-term system of goals and objectives of a jurisdiction. The annual budget therefore has to be integrated into comprehensive strategic planning, i.e. the budget will be the annual plan element of the strategic plan.

The development or implementation of integrated strategic plans and budgets as sketched above has not been fully realized in the German public sector. At present, only first efforts in this development are discernable.

On the local level, a strategic plan will include all policy areas of a city; on the state level however, every agency has to develop its own strategic plan. In order to ensure that this will happen in a universal configuration, a nationwide strategic planning template has to be enforced. An example is the Texas Strategic Planning Template, which comprises the following nine “tiers”:

1. State-wide vision, mission, philosophy
2. State-wide goals and benchmarks
3. Agency mission
4. Agency philosophy
5. External/internal assessment
6. Agency goals
7. Objectives and outcome measures
8. Strategies and output, efficiency, explanatory measures
9. Action plans

The stages 6-8 of these “tiers” will be incorporated into the annual budget.

The main obstacle to introducing a planning and budgeting system in this format in the German public sector has been politics. Elected officials show little willingness to focus on medium and long term planning in addition to dealing with day-to-day concerns. The planning necessary for a strategic plan thus requires new modes of thinking. At the same time, it presupposes a will to plan for the long-term future and thus provides a great amount of ammunition for the opposition.

**Sub 7**

While the budget is linked to a larger framework through strategic planning, financial accounting has to be linked to smaller structures by means of a robust cost accounting system. Current ERP software packages offer the customer a comfortable union between financial and cost accounting. Cost accounting is indispensable for functional controlling and monitoring of the efficiency of the administration.

The implementation of cost accounting has reached most areas of the German public sector (Gornas, 1992). Thus, many jurisdictions show the revenue and expense transactions not only on the nominal accounts of the financial accounting system but also in various controlling elements in cost accounting.

Cost centers, profit centers, and internal orders are used as controlling elements. Agencies are grouped together in cost centers internally, which show the areas of responsibility of the agency. Internal orders are used for certain temporary purposes and projects.

The internal services and orders between the cost centers are made transparent in secondary costs by means of internal cost allocation, direct activity allocation, and settlement relations. These elements are not only booked with the actual cost, they also are used for cost planning and as a basis for the budget.

The system of activity-based costing (ABC), i.e. ABC in conjunction with cost center accounting, and its implementation has not had far-reaching effects as of now. In that system resource costs
are assigned to activities. The activities then will be assigned to products and processes. ABC is an important instrument for performance improvement and activity-based accounting.

**Information Technology**

The successful implementation of a newly created BAS requires the use of capable and appropriate hard- and software-systems. In the hardware sector, the Client-Server-Model should be taken into consideration. Enterprise Resource Planning (ERP)-systems would be a good choice from the current software options (Miranda, 1999). ERP-systems show a number of characteristics, which are the prerequisite for efficient and effective BAS implementation, for example the far-reaching integration of all the modules belonging to the ERP-systems (especially logistics- and financials-modules).

This characteristic becomes apparent in the manner of account assignment of the transactions. It requires the account assignment in the initial stages of the process. That means that in purchase processes, the account assignment for the goods to be purchased has to be established in the purchase requisition of the logistics-module. If the product is purchased for immediate use, the department requesting it has to include the following information with the purchase requisition:

1. Budget item number or expense account number in conjunction with a controlling element, which shows the product structure of the two plans forming the budget.
2. The cost center, internal order, or work breakdown structure element of a project which is the amount assigned.

If a capital item is to be purchased, the purchase requisition has to include the budget account, together with the record number from the asset accounting in which the capital project will be capitalized.

The buyer, who processes the purchase requisitions, is in charge of the account assignment in the purchase order. After the delivery of the ordered goods, the bill will show the invoice verification of the account assignment and any other data from the purchase order and the goods receipt. Staff in accounts payable, who book the bill in the financial-modules, can refer back to the account assignment, which was first established in the purchase of the goods.

The account assignment at the beginning of the purchase process is of immense importance to budget management. With the input of the budget account, a check occurs in the first stages of the process to verify that sufficient budget appropriations or budget allotments are left in the specific account. If that is the case and the purchase order is delivered, the budget account will be encumbered with the amount of the purchase. These encumbrances will be removed when the final bill is booked.

This manner of integrated account assignment then implies that account assignments of different modules are assigned to one process. One distinguishes between main account assignments and additional account assignments. Thus, a deliverance bill will be booked to an expense account as a debit and to the specific supplier account as a credit. The main account assignment is required for the general ledger accounting. Additionally, this booking process can be repeated with the internal order number after the product has been used.

Next to this main feature of modular integration, a common and relational database for both financial and non-financial application, which is accessible in real time, is a feature of the ERP software. In addition to this operational database, a second database can be installed for monitoring and controlling purposes. This business information warehouse (BIW) is connected to the operational database, so that the operational data can be transmitted to the BIW in an integrated and aggregated form. This is the path the German Ministry of Defense has chosen to follow. Information needed for monitoring and controlling the operations are supplied by the BIW and not the operational database. It has to be acknowledged that this solution involves considerable additional expenditure and that data provided in the BIW is not always up to date, because the transfer of data into the BIW does not take place in real time, but only occurs at certain time intervals.

A functional view with regard to fulfilling tasks dominates in the agencies within a jurisdiction, i.e. a single task usually is the focal point whereas the fact that all tasks are embedded in agency-wide processes often is overlooked. However, ERP software is based on a process view. This enables the agencies of a jurisdiction to adopt best business practices and redesign existing processes as they implement ERP software.

The workflow capabilities of the ERP software provide potential for a more efficient and economic organization. For example, if the check on sufficient budget appropriations in the purchase
process turns out negative, the workflow automatically will request additional resources for the responsible department without any intervention by staff.

Members of agencies often criticize that in the traditional legacy financial systems one cannot determine who changed records and when. ERP software therefore provides audit trail capabilities. Audit trails provide the ability to review all of the history of changes to a record in the operational database.

An additional problem with financial systems historically is that one cannot conclude what amounts are combined in an account that is shown on the screen. The drill-down capabilities of the ERP software provide the opportunity to view all posting documents that comprise an amount in an account online.

The ERP-systems as standard software originally were designed to meet the demands of the private sector. Therefore, if applied in the public sector, special attention has to be paid to two points. First, in the process of developing a BAS-concept one has to keep close to the suggested functionalities in regard to the accounting instead of seeking new modes of application. Second, it has to be acknowledged that there are few approaches provided for the budget preparation process, which is of course of far greater importance in the public sector than it is in the private sector; this is then a point at which individual solutions have to be sought.

There are in general two alternatives for implementing an ERP software system:
1. Parts of the old system still will be in use. In the background, the old system will be interlocked with the new system.
2. The new BAS substitutes the old BAS completely after a certain date.

Sub 1
In this solution, the budget will continue to be used in its old structure but it will be accrual-based instead of cash-based. Booking of revenues and expenses happens as follows:

- A staff member records a warrant for payment on the screen and books the warrant to the budget item number as well as to the account number of the provider or the customer.
- The system connects this booking to the Chart of Accounts in the new BAS based on the budget item number. In the Chart of Accounts the separate budget items are assigned to the new expense or revenue accounts. It is possible that one budget item is assigned to multiple accounts. The staff member then has to decide which revenue or expense accounts to use for the purchase in question.
- The system checks if the assigned expense or revenue account is shown as a cost element in cost accounting. In this case, the staff member has to do an additional account assignment for the controlling element from the cost accounting (cost center number or internal order number, etc.).
- The system then books the process to:
  - the account of the budget item,
  - the supplier account (accounts payable) or the customer account (accounts receivable),
  - the assigned expense or revenue account in the general ledger, and
  - the assigned controlling element in cost accounting.
- The system creates electronic documents for the booking
  - a document for budget management posting,
  - a document for general ledger posting, and
  - a document for controlling element posting.

Through this process, the prior financial accounting system, the so-called Kamleralistik, and the new accounting system, double-entry bookkeeping, can be employed at the same time. The software package incorporating IS-PS of SAP R/3 guarantees that financial reporting can be done according to the rules of the old BAS as well as the new BAS.

This can prove valuable if a jurisdiction has not completely switched to the new BAS, and if only some agencies in a jurisdiction use the new system. The German Ministry of Defense employs this process, because this ministry still is a component of the federal budget and the prior financial accounting system. So far, the ministry is the only one that employs the new BAS at least partially.
When this alternative is used, the budget will be done on the basis of the new BAS exclusively with double-entry bookkeeping. The main account assignment for the budget consists of expense or revenue accounts from the Chart of Accounts and a controlling-element, corresponding to the product, with which the expenses or revenues are associated. The main account assignment includes the recording of the customer or delivery number. For the additional account assignment a cost center, an internal order, etc. from the cost accounting module can be used.

This alternative requires the staff to commit completely to the new BAS, and thus will be connected with training efforts for staff. It is mainly local jurisdictions that have chosen this alternative in implementing the new BAS in Germany.

One last aspect with view to the use of ERP software should be stressed in the end: this software is the indispensable backbone of digital government. Without ERP software there cannot be an effective e-government or e-procurement.

5. Budgeting and Accounting in the Central Government Sector of the Netherlands

An accrual accounting system is widely used in the public sector of the Netherlands. Local, provincial and single-purpose governments and some autonomous bodies already apply this system for a long time. For local and provincial governments accrual accounting is mandatory for both budgeting and financial reporting. Central government mainly uses a mixed cash/commitments system, but in 1994 the Dutch government introduced the possibility for certain central government organizations to obtain the status of agency. Agencies had to apply an accrual accounting system.

In 1997, the government published a note entitled From expenditure to cost weighing advantages and drawbacks of an accrual accounting system (Ministry of Finance, 1997). Accounting on an accrual basis was considered to have additional merits. However, the economic and political conditions did not permit to make a comprehensive move to a new accounting system. Standardization of public spending on the basis of costs implies that cash expenditure can vary. Though costs may be equal to cash spending, this is not true in the case of investments. A cash based system recognizes investment at the date of spending, whereas an accrual-based system spreads the costs of investments over time (in the form of depreciation of assets). Given the 1997 deficit it seemed possible that fluctuations in cash expenditure could result in a deficit exceeding the EMU accession criterion of 3% of GDP, which later on became one of the requirements of the EMU’s Stability and Growth Pact. By the early 2000s, however, the deficit had been considerably reduced, thereby mitigating the risk of exceeding the EMU’s public deficit criterion.

In 1999, the Dutch government announced the introduction of policy accounting in a document entitled From Policy Budget to Accounting for Policy (Ministry of Finance, 1999). This process is usually referred to as VBTB after the document’s acronym in Dutch. Effective from 2001, the government made an accrual accounting system possible - though conditionally - for other central government organizations than agencies. As a result, a growing part of the public sector applied an accrual accounting system, whereas the rest of the central government sector applied a cash/commitment system. The fact that the central government sector applied two different accounting systems was confusing and, therefore, it has been criticized. In 2000, the Dutch government announced that within several years an accrual based accounting system would be implemented in the whole central government sector. The government considered the move to an accrual basis an important step toward a more result-oriented government, since the policy budget links means, instruments, and performance (Ministry of Finance, 2000, p. 84).

Obviously, the VBTB-system implies a switch from financial accounting to policy accounting witness the fact that the system focuses on the following three budgeting questions:

- What do we want to achieve?
- What will we do to achieve it?
- How much can it cost?

In particular the third question calls for an accrual accounting system, since it focuses on the cost of policy implementation. A cash/commitments system does not produce full information about the cost of policy implementation if certain expenditures yield benefits over a number of years, such as in-
vestment expenditure. An accrual-based system does produce this information and can therefore contribute to a more result-oriented management.

The reform has also changed the viewpoint of the financial report. Departmental accounts now seek to make the achievement of policy goals more visible and transparent by focusing on the following three accounting questions:

- What did we achieve?
- Did we do what we thought we would do?
- Did it cost what we thought it would cost?

Thus, the VBTB system is based on a measurable formulation of policy objectives, preferably in terms of social effects. The budget starts with general goals, which are subsequently operationalized in terms of products and services or, if this is not possible, in terms of activities. It goes without saying that the implementation of the new-style budgets is a learning process that can only gradually proceed. This process started in 1999 with the publication of the VBTB-document (Ministry of Finance, 1999), whereas the government aims at completing this process in several years. As a result, the budget for 2006 should be a full-fledged VBTB-budget.

The Budget Memorandum 2001 (Ministry of Finance, 2000) included additional\(^4\) policy intensifications, which are in fact additional appropriations. The Dutch General Accounting Office (GAO)\(^5\) looked at the transparency of the budgeting and accounting information (Algemene Rekenkamer (2002a). They identified 203 additional policy intensifications in the departmental budgets for 2001. GAO tried to identify for each intensification a general objective as well as an operationalized goal (see Box 1 for an example). Based on budgets it appears in 20% of the cases impossible to identify a general objective in the budget, whereas in 30% of the cases it is not possible to identify a concomitant operationalized goal. Based on accounts the result is poorer. In over 40% of the intensifications the accounts do not refer to a general objective, while in nearly 40% they do not refer to an operationalized goal. As to the means it is in 90% of the cases possible to ascertain the amount involved. The departmental accounts, however, often do not include these amounts separately, but rather as part of a larger amount. As a result, in 70% of the cases departmental accounts do not offer insight into the spending of the additional budgetary means. As to the instruments, in 75% of the cases budgets pay attention to the instruments to be used, but accounts do so to a much lesser extent. As to performance it is possible to ascertain the budgeted performance in nearly 50% of the intensifications. However, only 20% of the accounts make mention of the realized performance.

Box 1. Example of a policy intensification, Ministry of Agriculture

<table>
<thead>
<tr>
<th>Art. 12.02</th>
<th>Budget 2001</th>
<th>Account 2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>General objective</td>
<td>Sustainable agriculture 10%</td>
<td>Same</td>
</tr>
<tr>
<td>Measure</td>
<td>of farm land used for biological cultivation in 2001</td>
<td>Same</td>
</tr>
<tr>
<td>Operationalized goal</td>
<td>Switch to biological cultivation</td>
<td>Same</td>
</tr>
<tr>
<td>Realization</td>
<td>4,720 hectare in 2001</td>
<td>2,979 hectare and a number of commitments concluded in early 2002</td>
</tr>
</tbody>
</table>

Following the general elections of 2002 a new cabinet was formed on the basis of a new coalition agreement. However, this cabinet was already overthrown after 87 days. In early 2003, GAO published a study of the coalition agreement of 2002 similar to that of the additional intensifications\(^4\) Additional relative to the coalition agreement of the cabinet that was formed in 1998. However, the definition of policy intensifications is not unambiguous and can vary in different budgetary documents, in particular the (general) Budget Memorandum and the (specific) amplifications in departmental budgets.

\(^5\) The Dutch acronym is AR (Algemene Rekenkamer). For reference purposes we use the Dutch name, for other purposes we use the English acronym GAO.
agreed upon by the previous coalition government (Algemene Rekenkamer, 2003a). Again, the study was based on the premise that it can only be determined whether or not an objective has been realized if goals, performance and budgets have clearly been defined beforehand. GAO looked at 107 of the 299 general policy plans, all 24 policy intensifications, 27 of the policy extensifications, and the way the cabinet gave concrete form to central government wide goals with regard to efficiency, volume, subsidies, and hiring of external personnel. They concluded that 79% of the policy intensifications gave sufficient or good answers to the three budgeting questions. In addition, 73% of the policy extensifications show to a sufficient or good extent the effects and performance aimed at. However, a smaller fraction of the general policy plans (56%) appeared to been elaborated sufficiently or good. Finally, only 9% of the central government wide goals appear to have been elaborated sufficiently.

A few months later GAO looked at the progress of the VBTB-process on the basis of plans for improvements that had been announced in the departmental budgets for 2002 (Algemene Rekenkamer, 2003c). Figure 1 shows the results. Of the total number of improvement plans 40% appears to have been realized after one year, whereas 20% appears to have been presented again as plans in the budget for 2003. Unclear is why 21% of the plans were not presented again though they have not yet been realized. Of the 223 plans related to the 2003 budget 123 have been realized (55%). In addition, 80 of the 289 plans that had been scheduled for implementation after 2003 appears to have already been realized in 2003.

![Figure 1. Improvement plans in 2002 budgets](image_url)


GAO also looked at how departments addressed the budgeting questions in their budgets. The first budgeting question is: "What do we want to achieve?" It appears that nearly ¾ of the budget articles fail to address this question adequately. Only 29% offer a sufficient or good insight in what the minis-

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6 Extensifications are the opposite of intensifications and can be defined as slim-downs referring to a decline of projected spending levels (Van der Hoek, 1994, p. 288).

7 The following qualifications have been used:
try aims to achieve, 47% provide a limited insight, and 24% do not offer any insight at all. The second budgeting question is: "What will we do to achieve it?" Generally, departments answer this question better than the first budgeting question regarding the expected achievements. Over half (56%) of the budget articles offer a sufficient or good insight into the activities the ministry plans to undertake and the instruments it plans to deploy, whereas 38% provide only a limited insight. The third budgeting question is: "How much can it cost?" Over ⅔ (69%) of the budget articles provide a sufficient or good insight in the cost of the activities the ministry plans to undertake and the instruments it plans to deploy. Further improvements are possible by specifying the relationships of expenditures and performance. Summarizing:

- It is insufficiently clear what the ministries want to achieve since many effect-indicators are lacking.
- It is insufficiently clear which performance the ministries want to achieve because many performance-indicators with target figures are lacking.
- It is insufficiently clear what relationship exists between goals and performance on the one hand and expenditures on the other hand.

Departmental budgets give some insight into the plans for improvements that should lead to achieving the goal of full-fledged VBTB-budgets in 2006. GAO found 437 improvement points. Figure 2 specifies the number of points to be improved and the number of plans to implement improvements. In 70% of the cases there is no improvement plan, while in 9% improvement plans are not formulated in concrete terms. Thus, in 79% of the cases there is no prospect of improvement for the 2006 budget. Departments did put forward improvement plans for 30% of the cases, but they did not phrase all of these plans in concrete terms. As a result, in only 21% of the cases there is a prospect of improvement for the 2006 budget. Given the results for the 2002 budget, however, it seems unlikely that this will be fully achieved. Therefore, it can be expected that less than 1/5 will actually be improved in the 2006 budget.

**Figure 2. Improvement plans in the 2003 budget**

<table>
<thead>
<tr>
<th>Number of improvement points: 436</th>
<th>Improvement plan: 131 (30%)</th>
<th>Formulated in concrete terms: 91 (21%)</th>
<th>Prospect of improvement for 2006 budget: 91 (21%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>No improvement plan: 305 (70%)</td>
<td>Not formulated in concrete terms: 40 (9%)</td>
<td>No prospect of improvement for 2006 budget: 345 (79%)</td>
<td></td>
</tr>
</tbody>
</table>

Source: Algemene Rekenkamer (2003c), p. 27.

Summarizing, the 2003 budget clearly shows that the budgeting questions are not yet fully addressed. Departmental budgets provide insufficient insight into policy effects that ministries aim at and activities they want to undertake. Moreover, the relationship between expenditures on the hand and goals, performance, and financial means on the other hand is insufficiently clear because expenditures are

- No insight: the objective is not or hardly defined in terms of effect-indicators.
- Limited insight: the objective is partly defined by one or several effect-indicators and/or target figures are absent.
- Sufficient insight: the objective is largely defined in terms of effect-indicators with target figures.
- Good insight: the objective is defined in clearly recognizable effect-indicators and target figures.
not elucidated in terms of performance data. An important reason for the shortcomings is that the objectives are not yet formulated in a measurable way in terms of effect-indicators and target figures (Algemene Rekenkamer, 2003d, p. 13). It seems unlikely that the objective of a full-fledged VBTB-budget in 2006 will be realized.

6. Summary

Among governments of industrialized countries a growing trend can be observed to shift from cash-based to accrual counting. Half of OECD member countries use some form of accrual accounting in their financial reporting, although only few also use accruals in their budgeting process. The 1993 System of National Accounts (SNA) and the European System of Accounts (ESA) are the leading standards for national accounting, but they are not designed for government budgets and financial reports. The International Public Sector Accounting Standards (IPSAS) are the authoritative requirements established by the Public Sector Committee (PSC) of the International Federation of Accountants (IFAC) to improve the quality of financial reporting in the public sector around the world. So far, the IPSAS only pertain to financial accounts, but the PSC intends to also address budgeting in future.

Budgets are future-oriented financial plans for allocating resources among alternative uses. Financial reports retrospectively describe the results of an organization’s financial transactions and events in terms of its financial position and performance. Cash-based appropriations giving the government rights to make cash payments over a limited period of time are most widespread in budgets. In accounting, however, there is a wide spectrum of bases ranging from cash to full accrual. Usually, the implementation of some accrual-based system is linked to wider financial management reforms including performance management requiring information on cost. Countries that shifted to an accrual-based system have to a large extent common goals, but show differences as to the way they have designed and implemented the new system.

A new Budgeting and Accounting System (BAS) for the public sector in Germany will be developed and implemented first at the local government level, which will serve as a testing ground. In order to achieve a highly integrated BAS in the public sector, the model then will serve as the foundation for the development of a similar BAS at the state and federal levels of governments. First results already are in hand and were achieved mainly though utilization of suitable ERP-software.

The Netherlands is somewhat further on its way to an accrual based budgeting and accounting system than Germany. Local, provincial and single-purpose governments already use it for a long time, while central government is implementing it both in budgeting and accounting. The implementation process should be finished by 2006. Though quite some progress has already been made it seems unlikely that this goal will be fully achieved in 2006. Currently, departmental budgets still provide insufficient insight into policy effects that ministries aim at and into activities that ministries want to undertake, whereas the relationship between expenditures and goals, performance, and means is insufficiently clear. An important reason for these shortcomings is that the policy objectives are not yet formulated in a measurable way in terms of effect-indicators and target figures.
## Appendix A:

<table>
<thead>
<tr>
<th><strong>Total Income Plan</strong></th>
<th>Actual (t-2)</th>
<th>Budget (t-1)</th>
<th>Adopted FY (t)</th>
<th>Projected (t+1)</th>
<th>Projected (t+2)</th>
<th>Projected (t+3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Taxes</td>
<td></td>
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<tr>
<td>2 + Revenues from grants and allowances</td>
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<tr>
<td>3 + Other transfer revenues</td>
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<tr>
<td>4 + Public-law based fees</td>
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<tr>
<td>5 + Private-law based fees</td>
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<tr>
<td>6 + Revenues from reimbursement of expenses and allocation of overheads</td>
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<tr>
<td>7 + Other regular revenues</td>
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<tr>
<td>8 + Capitalized services rendered for own account</td>
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<tr>
<td>9 +/- Changes of inventory</td>
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<tr>
<td>10 = Regular revenues from ongoing activities in the jurisdiction</td>
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<tr>
<td>11 - Salaries and wages</td>
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<tr>
<td>12 - Donations to retirement systems</td>
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<tr>
<td>13 - Cost of material and services</td>
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<tr>
<td>14 - Depreciation</td>
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<td>15 - Transfer expenses</td>
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<tr>
<td>16 - Other regular expenses</td>
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<tr>
<td>17 = Regular expenses from ongoing activities in the jurisdiction</td>
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<tr>
<td>18 = Income statement from ongoing activities in the jurisdiction (lines 10 and 17)</td>
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<tr>
<td>19 + Financial revenues</td>
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<td></td>
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<tr>
<td>20 - Interest and related expenses</td>
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<tr>
<td>21 = Financial income statement (lines 19 and 20)</td>
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<tr>
<td>22 = Regular income statement (lines 18 and 21)</td>
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<tr>
<td>23 + Non-recurrent revenues</td>
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<tr>
<td>24 - Non-recurrent expenses</td>
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<tr>
<td>25 = Extraordinary income statement (lines 23 and 24)</td>
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<tr>
<td>26 = Income statement of the year (lines 22 and 25)</td>
<td></td>
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<tr>
<td>27 - Amount net loss from previous years</td>
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<tr>
<td>28 = Balance after consideration of the net losses for previous years</td>
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<td></td>
</tr>
</tbody>
</table>
### Appendix B: Total Plan of Cash Items

|   | Cash receipts from Taxes | + Cash receipts from grants and allowances | + Other transfer cash receipts to the jurisdiction | + Cash receipts from public-law based fees | + Cash receipts from private-law based fees | + Cash receipts from reimbursement of expenses and allocation of overheads | + Other regular cash receipts from ongoing activities | + Interest and similar cash receipts (amortization of a loan etc.) | = Regular cash receipts to the jurisdiction for ongoing activities | - Payments for staff | - Payments to the retired | - Payments for material and services | - Interest and similar payments for a given loan | - Transfer payments | - Other regular payments for ongoing activities | = Payments from the jurisdiction for ongoing activities | = Cash flow from ongoing activities in the jurisdiction (lines 9 and 16) | + Cash receipts from grants, contribution and allowances for capital projects | + Cash receipts from sales of fixed assets | - Payments for capital projects | + Cash receipts from sales of investments | - Payments for investments | = Cash flow from capital projects and investment activities | = Financial fund surplus / -deficit (lines 17 and 23) | + Cash receipts from loans and borrowings for capital projects and investments | Amortization payments for loans and borrowings | + Advance on current account | - Amortization payment for current account | = Cash flow from financing activities | + Inventory change of financial funds before taking-up liquid reserves (lines 24 and 29) | + Cash receipts from liquid reserves | - Payments to liquid reserves | = Inventory change of financial funds after taking-up liquid reserves (lines 30 and 31 and 32) | + Opening inventory of financial funds | = Final balance of financial funds (lines 33 and 34) |
References


