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Government accounts

Introduction

South Africa's national government accounts are presented in Annexure B. The structure of the reporting tables have been revised and is based on the recommendations in the most recent version of *Government Finance Statistics*[1] (GFS), which was published in 2001. It is also in line with the recommendations in the *System of National Accounts*[2] (SNA), published in 1993. However, to take into account the specific nature of the South African environment, certain modifications to the structure of the account and the labelling of the receipt and payment items have been made, relative to GFS recommendations.

It also deserves mention that the GFS presentation differs in some respects from the presentation in Chapter Two of the Budget Review, which is based on the SNA.

This annexure describes the new structure of the government account for South Africa and it explains deviations between GFS recommendations and the way government statistics within the national accounts are compiled and presented. It also contains a section describing the salient characteristics of the part of the SNA system that deals with government statistics.

Recording basis

Both the SNA and the 2001 GFS recommend that items should be recorded on accrual basis, implying that all government transactions, even those that do not give rise to cash flows, should be included in the government account. Examples of transactions that do not give rise to cash flows are changes in inventories and capitalised interest. Another consequence of accrual accounting is that the time of recording should coincide with the underlying economic event. This means that the entry does not necessarily coincide with the cash flow, but rather with the change of ownership. For example, in accrual accounting the time debt repayment should be recorded is at the time the debt expires irrespectively of whether or not this coincides with an actual repayment, which give rise to a cash flow.

The recommendation to use accrual accounting for government financial statements was first made in the 2001 GFS. The South African Government has declared its intention to, over time, follow this recommendation but in the near future the practice to present government data on cash basis will continue. This implies that the time of recording reflects the time the cash flow takes place, not the underlying economic event. However, in some instances modified cash principles are applied. This includes the recording of expenditure at the time of recording the transaction in the cashbook (i.e. at the time the transaction is processed in the system and the cheque is issued) and accruing interest on some types of government debt (i.e. on zero coupon bonds).

In strict cash accounting, the time of recording should coincide with the cash flow. However, in South Africa, entries for the national budget data are made in the time period in which transactions have been captured on the financial systems. For auditing and budgeting control purposes, the

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[1] International Monetary Fund, 1986, *Government Financial Statistics*. Washington, D.C.: IMF.

[2] United Nations, 1993, *System of National Accounts 1993*. Brussels/Luxembourg, New York, Paris, Washington, D.C.: Inter-Secretariat Working Group on National Accounts.

national budget system allows for a complementary period for each transaction. This is a period after the financial year-end during which books remain open so that all transactions relating to that specific year can be finalised. These transactions may be summarised as follows:

- Tax payments made during the financial year but not recorded by the South African Revenue Services until after the end of the financial year
- Late requests for funds by government departments to settle obligations relating to the specific financial year
- Surrenders of unspent funds by government departments, i.e. funds requested by the departments but not used
- Corrections to revenue, expenditure or financing transactions that were, for example, erroneously classified
- Adjustments to the expenditure data, for auditing and Parliamentary purposes, to show only authorised expenditure for the particular financial year (i.e. excluding all unauthorised spending).

Development of a new economic reporting format

In the 2004 Budget, a new economic reporting format is introduced, replacing the old "standard item" classification with a more appropriate classification in line with international best practice. The aim of this reform is to provide better quality information to legislatures to assist in the policy-making process and to reinforce Parliament's oversight role.

This reform was necessary due to the fact that many inconsistencies in the application of existing classification standards were identified. For example, disposable baby nappies were sometimes classified as capital expenditure and major school rebuilding projects as current expenditure. This was mainly due to classification rules being inconsistently applied and limited control over their application. It was clear that the existing classification regime was outdated and improperly used and the new format aims at addressing these inconsistencies.

In the design of the new format, the National Treasury endeavoured to ensure that each item label reflects the actual content of the item. In addition, item labels such as "other" or "miscellaneous" have studiously been avoided, as their content is unclear and lack transparency. Moreover, the term "grant" is not used even though it is generally accepted in the GFS. This is because in the context of the South African Constitution the meaning of "grant" differs from that in the GFS.

The development and structure of the new Economic Reporting Format is discussed in detail in the *2004 Estimates of National Expenditure*, issued by the National Treasury, and is summarised in brief in the next section.

Structure of the government account

The new South African reporting format organises the multitude of government transactions into three broad categories: receipts, payments and financing. The budget deficit or surplus is calculated as receipts less payments. By definition, it is equal to total financing but with the opposite sign.

Receipts

Government receipts are divided into *taxes*, *sales*, *transfers*, *fines*, *interest, dividends and rent on land* as well as *financial transactions*. *Taxes* are classified according to the type of activity on which they are levied, including income, profits, consumption of domestic goods and services, and international trade. *Sales* are disaggregated into sales of capital assets and other sales. *Transfers* are unrequited receipts; i.e. the other party does not obtain anything in return. They are classified according to unit, for example, other government units, private corporations, households, etc. *Fines* consist of all compulsory receipts imposed by a court or quasi-judicial body. The item, *interest, dividends and rent on land*, includes all revenue associated with ownership of financial assets and land.

The item *financial transactions* covers two financial transactions only. The first is repayments of loans and advances previously extended to employees and public corporations for policy purposes. The rationale for recording this financial transaction as revenue is that it is fundamentally different from other financial transactions, which are market oriented and thus appear as *financing* items. The second is associated with stale cheques from previous accounting periods. The temporary increase in revenue before a new cheque is issued is recorded as a receipt. The reason for recording it in this way is because the system does not allow that expenditure for the current period is reduced due to a cancellation of a payment from a previous accounting period. Remaining financial transactions, for example borrowing and repayment of loans on market basis, are not included under this category but under *financing*.

Payments

Payments are divided into three broad categories, namely *current payments, transfers and subsidies* and *payments for capital assets*.

Current payments

Current payments provides for funds directly spent by the department. Detail is provided on the following items:

- *Compensation of employees*: This payments category includes all personnel-related expenditure, i.e. all payments to government employees, both salaries and social contributions. Social contributions represent the amounts paid by government for pensions or social security into a social security scheme on behalf of its employees. An example would be payments into the Unemployment Insurance Fund.
- *Goods and services*: This item refers to all government payments in exchange for goods and services, but excluding capital assets and goods used by government for construction of and improvements to capital assets. This item would, in most instances be the second largest spending item for departments. The specific details of purchases of each department are provided, giving an indication of the four largest spending items by department. For example, in an education department schoolbooks could be listed, while in a health department medicines might be listed. This allows the classification to be adapted for the particular data needs of each department, thereby facilitating oversight and policy analysis.
- *Interest and rent on land*: This item is defined as payment for the use of borrowed money and is distinguished from the repayment of borrowed money, which is classified under *financing*.
- *Financial transactions*: This item consists mainly of lending to employees and public corporations for policy purposes. The reason for expensing this payment rather than treating it as *financing* is that, unlike other financial transactions, the purpose of the transaction is not market-oriented.

Transfers and subsidies

The second part of the payments table provides for funds that are transferred to other institutions, businesses and individuals, and therefore does not constitute final expenditure by the department.

This item therefore includes all unrequited, non-repayable payments by government; i.e. payments for which no goods or services are received in return.

The category *transfers and subsidies* is sub-divided into the various targeted recipients or beneficiaries receiving funding from government, for example other levels of general government, households, non-profit institutions and public corporations. This allows for the separation of all transfers from expenditure controlled directly by departments.

Transfers and subsidies includes current as well as capital transfers. In the past, capital expenditure included capital transfers. This led to ambiguity, because these numbers provided an incorrect picture of the contribution to capital formation made by departments. By including capital transfers with other transfers, a much clearer picture is provided of government spending on capital.

Payments for capital assets

In economic terms, it is important to identify capital expenditure as a separate item, because this shows Government's contribution to capital formation, as well as the Government's spending on new infrastructure. Capital assets are divided into five categories:

- Buildings and other fixed structures;
- Machinery and equipment;
- Cultivated assets;
- Software and other intangible assets; and
- Land and sub-soil assets.

Payments for capital assets covers purchases of new assets, as well as extensions and improvements to existing assets. This includes own-account construction; that is, when government units engage in capital projects on own account. An example thereof is the Public Works Department constructing a new road. In this case, certain payment categories are *capitalised*. The relevant payment categories capitalised are:

- Compensation of employees; and
- Goods and services.

These two payment categories are not capitalised unless payments are *directly associated* with a *capital project*. A capital project is defined as a project executed by the government unit to construct a new asset or upgrade/improve/extend an existing capital asset. However, payments on *current projects*, namely maintenance and repair of existing capital assets, are not capitalised.

Financing

The broad classification category, *financing*, encompasses all financial transactions other than *financial transactions in assets and liabilities* included as part of *receipts* and *payments,* which represent balance sheet transactions not usually recorded as part of *receipts* and *payments* in cash accountting. Items recorded under *financing* reflect the sources of funds obtained to cover a government deficit or the use of funds available from a government surplus. The most important items under *financing* are government borrowing, repayments of the principal component of loans incurred in previous periods, and transactions in government deposits and cash balances.

At the highest level, a distinction is made according to residence of the other party to the transaction; i.e. between financing originating from domestic and foreign sources. These two components are then disaggregated, first by resident or non-resident unit (households, public corporation, etc.), and, subsequently, by transaction category (loan, deposit, etc.).

Functional classification

The GFS recommends that each government payment should be classified in two ways, namely according to its functional and economic characteristics, and the new reporting format is in compliance with this recommendation. The items in the economic classification have been described above, under the heading *payments*. The main function of the economic classification is to categorise transactions according to type of object or input, for example, compensation of employees, interest payment, etc. This is crucial, as data must be classified this way for calculation of the surplus or deficit, as well as government contribution to the economy in the form of output, value added and final consumption.

The functional classification is complementary to the economic classification. It serves to distinguish transactions by policy purpose or type of outlay. This is also referred to as expense by output. Its main purpose is to facilitate understanding of how funds available to government have been spent. Examples would be health, education, administration, judicial services, etc.

The broad categories in the functional classification are listed below:

- General government services refer to those indispensable activities performed by the state, the benefits of which cannot be allocated to specific groups, businesses or individuals. These include fiscal management, general personnel management, and conduct of external affairs, public order and safety.
- Protection services include all services that ensure the safety and security of communities, namely defence, police, justice and prisons.
- Social services are supplied directly to the community, households or individuals, and include education, health care, social security and welfare, housing, community development and recreational and cultural activities.
- Economic services cover government expenditure associated with the regulation and more efficient operation of the business sector. This category incorporates government objectives such as economic development, the redressing of regional imbalances and employment creation. Economic services provided to industries include trade promotion, geological surveys and the inspection and regulation of particular industries.

It deserves mention that expenditure in a particular budget vote may cover more than one function; for example, spending in the health vote may include spending on education (medical training), and on medical functions.

National budget data versus GFS recommendations

As mentioned above, compilation of national budget data published in Annexure B of this *Review* is based on GFS guidelines. GFS principles are used for the classification of all transactions at the detail level, however, there are important differences in the final presentation of the data. This explains why the presentation of the government accounts in this publication differs from that published in the *Quarterly Bulletin* of the South African Reserve Bank (SARB), which strictly adheres to GFS recommendations.

The differences between the National Treasury format and that of the SARB is mainly in the structure of the account presented compared to that of the GFS, as well as the use of different labelling for some items. However, due to the fact that the same basis of classification is used at the detail level, it is possible to convert the South African government tables into a GFS table with a very high degree of accuracy. This is useful for purposes of international comparisons.

The most important structural difference is that the receipt and payments tables include both current and capital transactions in the South African reporting format. This is in variance to the

GFS presentation of the government account where current and capital transactions are presented in separate sub-accounts.

Differences in item labelling includes the following:

- The South African presentation does not include any unclear terms such as *other* and *miscellaneous.*
- The term *grant* is not used in South Africa. In the GFS, the term *grant* includes all funds flowing from one level of government to another level. However, in the South African context, the majority of funds flowing to other levels of government are not appropriated as *grants* but are identified as direct charges on the National Revenue Fund and are therefore included under transfers.
- More detail is provided on the various transfer categories in the South African presentation. This is to enhance transparency and facilitate the monitoring process, especially on the payment side.
- Finally, in the South African presentation, certain items are labelled more clearly than in the GFS version. For example, instead of using the term *sales of goods and services* for sales of goods and services produced by government, the label used in the South African presentation is simply *sales of goods and services produced by a department.* The intention is to enhance transparency and facilitate understanding of the various transaction categories.

National budget data versus the national accounts presentation

The system of national accounts is a coherent, consistent and integrated set of macroeconomic accounts, balance sheets and tables based on a set of internationally agreed concepts, definitions, classifications and accounting rules. It provides a comprehensive accounting framework within which economic data can be compiled and presented in a format designed for economic analysis, decision-taking and policy-making. The national accounts are compiled for a succession of periods, thus providing a continuous flow of information for monitoring, analysis and evaluation of economic performance.

The SNA provides a framework for calculating gross domestic product (GDP), gross national income (GNI), savings, capital formation and other key economic variables. SNA data pertain to all resident units in a given economy, which is divided into five sectors. The government is one of these five sectors.

In the national accounts, entries are made to reflect the perspective of all resident economic units, whereas the government account reflects the government perspective only. This inevitably leads to some differences in the accounting frameworks for the national accounts and the government account. For example, own-account construction is recorded as *payments for capital assets* in the government account with a counter-entry to reflect the use of financial assets or incurrence of a financial liability to finance the transaction. In the national accounts, on the other hand, the recording of the transaction is not complete until entries have also been made to reflect the production of a capital asset and the input in the production process of the asset. The productive activity is shown as output in the national accounts. The input is compensation of employees and the goods and services used in the production process. The values for output and compensation of employees/goods and services can be derived from the government account for national accounts purposes, but are not directly shown in the financial statements of government. This implies that the value of compensation of employees in the government account differs from that shown as compensation of employees payable by government in the national accounts.

Indeed the government account is different in many ways from the national accounts framework, which provides the foundation for the statistics presented in Chapter Two of this document. In addition, as discussed above, the government accounts used in South Africa differs from the government account drawn up in the GFS. The most important differences are highlighted in the table below:

Table D1 Differences between South African reporting format and government statistics in the 1993 SNA and 2001 GFS

	Budget data	GFS	SNA
Basis of reporting	Mainly cash basis; i.e. mainly cash transactions are included in the account. Thus, estimates for consumption of fixed capital and remuneration-in-kind are not included in the account. In addition, the time of recording reflects the cash flow. For example, *goods and services* are recorded when they are purchased.	Accrual basis; i.e. including all non-cash transactions, for example remuneration in kind and consumption of fixed capital, In addition, the time of recording reflects the underlying economic event, not the cash flow. For example, *goods and services* is recorded when they are used in the production process, not when they are purchased.	Accrual.
Compensation of employees	Does not include compensation of employees paid out to government employees who are engaged in government own-account construction in association with a capital project.	Does not include compensation of employees payable to government employees who are engaged in government own-account construction in association with a capital project.	Includes compensation of employees payable to government employees, who are engaged in government own-account construction in association with a capital project.
Goods and services	Does not include purchases of goods and services used in connection with a capital project within the context of government own-account construction.	Does not include the value of goods and services used in connection with a capital project within the context of government own-account construction.	Includes the value of goods and services used in connection with a capital project within the context of government own-account construction.
Sales by government	This item is explicitly shown in the government account.	This item is explicitly shown in the government account.	This item is not shown anywhere in the national accounts. Instead it is used to estimate final consumption by government.
Output, final consumption, savings, disposable income	These variables are not explicitly shown in the government account, but the account can be used as framework to derive values for them.	These variables are not explicitly shown in the government account, but the account can be used as framework to derive values for them.	These variables are explicitly shown in the accounts. Estimates for these variables have been made from data in the government account.

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