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Government accounts

Introduction

South Africa's national government accounts are presented in Annexure B. The structure of the reporting tables is based on the recommendations in the most recent version of *Government Finance Statistics*[1] (GFS), 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.

The GFS presentation also differs in some respects from the presentation in Chapter 2 of the *Budget Review*, which is based on the SNA.

This annexure describes the 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 an 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, depreciation and accrued 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 timing of the resultant cash flow, but rather with the change of ownership or when economic value is created, transformed or extinguished. For example, in accrual accounting debt repayment should be recorded when the debt expires, whether or not this coincides with an actual repayment that gives rise to a cash flow.

The recommendation to use accrual accounting for government financial statements was first made in the 2001 GFS. Government has declared its intention, over time, to follow this recommendation but in the near future the practice to present government data on cash basis will continue. This implies that the transaction is recorded when the cash flow occurs and hence does not match the timing of 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 financial 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 actual 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 national budget system allows for a complementary period for each transaction. This

[1] International Monetary Fund, 2001, 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.

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 Service 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).

The new economic reporting format

The new economic reporting format (ERF) was introduced in the 2004 Budget. This new format, which is based on international best practice, replaced the old "standard item" classification. The ERF was developed using the GFS format as a basis, but adapted for the peculiarities of the South African environment. The introduction of this new budget format was supported by the introduction of a new standard chart of accounts (SCOA), which is fully aligned to the ERF and provides for posting level details of the budget within the financial systems.

In the economic format, as well as in the chart, each item label reflects the actual content of the item and is identified by this descriptive label. In addition, item labels such as "other" or "miscellaneous" have studiously been avoided, as their content is unclear and lacks transparency. This has ensured that all classifications are consistent across all national and provincial departments, improving the quality of information provided to legislatures and assisting in the policy-making process.

To assist departments with the use of the new format, and to protect the integrity of the chart, the National Treasury initiated a number of change management initiatives. These include the design and implementation of a detailed training programme, the setup of a classification committee and a call centre to support implementation. The aim of these initiatives is to improve consistency in the application of the new classification rules and to recommend appropriate amendments to the chart of accounts and the financial system. The classification committee regularly issues classification circulars that provide feedback to practitioners on amendments made to the chart of accounts. These circulars ensure that consistency is maintained as changes are made to the chart.

The structure of the ERF is discussed in detail in the annexure to the *2006 Estimates of National Expenditure*, issued by the National Treasury, and is summarised in brief in the next section.

Structure of the government account

The 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, which 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 in assets and liabilities*. *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 party making the transfer does not receive anything of similar value directly in return. These 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. *Interest, dividends and rent on land* includes all revenue associated with ownership of financial assets and land.

Financial transactions in assets and liabilities 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 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 largest spending items by department. For example, in an education department school books could be listed, while in a health department medicines might appear. 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 (interest on loans and bonds) and use of land (rent). It is distinguished from the repayment of borrowed money, which is classified under *financing*.
- *Financial transactions in assets and liabilities*: 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 subdivided 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 could be interpreted as exaggerating the actual contribution to capital formation made by government. 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 and its spending on new infrastructure, including improvements/extensions to existing infrastructure. Capital assets are divided into five categories:

- Buildings and other fixed structures
- Machinery and equipment
- Cultivated assets
- Software and other intangible assets
- 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 is the Department of Public Works 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*, which are included as part of receipts and payments. The financing items represent transactions in items on the balance sheet. 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 by transaction category (loan, deposit, bond, etc.).

Functional classification

The GFS recommends that each government payment should be classified in two ways, namely according to its functional and economic characteristics. 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's 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, and so on.

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.

Expenditure in a particular budget vote may cover more than one function; for example, spending in the health vote may include spending on education for medical training.

Introduction of consolidated accounts

The presentation format of the consolidated government accounts includes the accounts of national and provincial government, and the social security funds. In the 2006 *Budget Review* the coverage has been extended to include some of the entities of central government, currently classified as extra-budgetary agencies, as well as some important public sector entities involved in infrastructure financing and development.

This presentation is broadly in line with the GFS requirement that the accounts of general government be presented on a consolidated basis. In the consolidation process all relevant spheres of government are included and all intergovernmental transactions are eliminated. This is done to ensure that only the interaction of the general government units with non-governmental units is recorded. The resultant accounts reflect more accurately the financial position of the whole of general government and the impact of its activity on the economy at large.

To present a true consolidated general government account, the accounts of both national and provincial departments must be consolidated with their associated public entities. The accounts of the social security funds and local authorities are then added to give the consolidated general government account.

As a final step, all government business enterprises should be included and consolidated with the general government units. This would result in the consolidated public sector account.

The following dimensions are considered during the consolidation process:

- *Coverage,* referring to the choice of entities to be included in the consolidation. Firstly, entities belonging to the general government sector should be consolidated. To this consolidation should be added all business enterprises, but privately owned entities should always be excluded. The consolidation of the general government sector includes all entities that are mainly controlled and financed by government and provide goods and services at non-market prices. The public sector includes all state-owned entities and local authority trading accounts providing goods and services at market-related prices.
- *Elimination of inter-entity transactions*. In the consolidation process all intra-entity transactions must be eliminated. For this to be accurate, all such transactions must be easily identifiable. However, in the accounting systems of government and many of its agencies not all intra-entity transactions are identified. In many instances where goods and services are procured from other government units, elimination is impossible as such transactions cannot be separated from other transactions in this category. However, all transactions involving transfers from one government unit to another can be identified and have been eliminated from the consolidation.
- *Basis of accounting.* Entity accounts can only be consolidated if such accounts are compiled using the same basis of accounting. In South Africa, the national and provincial governments are on cash basis of accounting, while local authorities and public entities use the accrual basis of accounting. To provide data for consolidation, the accounts of the public entities have been adjusted to cash accounts.

In the 2006 *Budget Review* some central government entities and business enterprises have been consolidated. Due to the large number of entities at the national level, as well as difficulties experienced with the transformation to cash accounts for some of the smaller entities, only a selection of entities have been included in the consolidation. The selection was based on the entity’s contribution to infrastructure development and skills improvement in the economy. In the consolidation process transfers and other identifiable goods and services were netted out, with the rest of the transactions being aggregated.

The consolidation seeks to include the bulk of the associate entities based on their total contribution to expenditure levels, resulting in an estimated 76 per cent coverage of spending of general government entities. In future budgets the National Treasury will endeavour to include more entities to provide the full picture of spending by the public sector. The consolidation in this budget includes all the entities listed in Table D.1.

Table D.1 List of public entities included in consolidation

Department	PFMA Schedule	Public Entity
Department of Home Affairs	1	Independent Electoral Commission
National Treasury	3a	South African Revenue Service
Department of Public Service and Administration	3a	State Information Technology Agency
Department of Arts and Culture	3a	Freedom Park Trust
Department of Health	3a	South African Medical Research Council
	3a	National Health Laboratory Service
Department of Labour	3a	Sector Education and Training Authorities (22 included in consolidation)
		National Skills Fund
	3a	National Productivity Institute
Department of Social Development	3a	South African Social Security Agency
Department of Defence	2	Armaments Corporation of South Africa
Department of Agriculture	3a	Agricultural Research Council
Department of Communications	2	South African Post Office Limited
Department of Environmental Affairs and Tourism	3a	South African National Parks
	3a	Marine Living Resources Fund
	3a	South African Weather Service
	3a	SA National Biodiversity Institute
	3a	Greater St. Lucia Wetland Park Authority
	3a	South African Tourism Board
Department of Housing	3a	National Home Builders Registration Council
Department of Minerals and Energy	3a	Council for Geoscience
	3b	Council for Mineral Technology
Department of Science and Technology	3a	Human Sciences Research Council
	3b	Council for Scientific and Industrial Research
	3a	National Research Foundation
Department of Trade and Industry	3b	SA Bureau of Standards
Department of Transport	3a	South African National Roads Agency
	2	Airports Company of South Africa
Department of Water Affairs and Forestry	3b	Waterboards (15 included in consolidation)
	3a	Water Research Commission
	2	Trans-Caledon Tunnel Authority
		Water Services Trading Account

National budget data versus GFS recommendations

As mentioned above, compilation of national budget data published in Annexure B is based on GFS guidelines. GFS principles are used for the classification of all transactions at detailed 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 Reserve Bank, which strictly adheres to GFS recommendations.

The differences between the National Treasury format and that of the Reserve Bank 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 detailed 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 comparison.

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 (transfer) 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 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 SNA 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 GDP, gross national income (GNI), savings, capital formation and other key economic variables. National accounts 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 values of compensation of employees and goods and services in the government account differ from compensation of employees and goods and services 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 2. 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 Table D.2 below:

Table D.2 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* are 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 a framework to derive values for them.	These variables are not explicitly shown in the government account, but the account can be used as a 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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