A note on the revision of the Government Finance Statistics framework

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Introduction

The South African authorities recognise the importance of the timely availability of high-quality macroeconomic data. In view of the important role of government finance statistics in the assessment of the stability and sustainability of macroeconomic policies, South Africa has devoted considerable resources to ensuring that best practice is adhered to in the compilation of statistics. The quest for best practice was informed by recent initiatives of the International Monetary Fund (IMF) in developing methodologies for the compilation of statistics. The *Government Finance Statistics Manual 2001 (GFSM 2001)*, released by the IMF, was one of a series of manuals that was thoroughly revised to set a standard for the compilation and presentation of statistics. The revision was done following the identification of deficiencies in the reporting framework of traditional government reporting systems as portrayed in the IMF's *Manual on Government Finance Statistics 1986 (GFS 1986)*. *GFSM 2001* aims at providing improved flows of information that can be used to optimally guide policy decisions, and was released in December 2001 after extensive consultation.

1 The views expressed are those of the author and do not necessarily reflect the views of the South African Reserve Bank. Technical information is based on the Government Finance Statistics Manual 2001 *of the International Monetary Fund.*

The aim of this note is to briefly describe
- the background to the revision of the manual;
- major changes introduced by the new manual;
- the structure and accounts of the revised analytical framework of the *GFSM 2001*;
- the migration path needed to convert from the *GFS 1986* framework to the revised framework; and
- the adjustments made to the *Quarterly Bulletin* tables (Tables S71 – S79) as a first step in the migration process.

Background to the revised manual

In its time, *GFS 1986* provided valuable guidance regarding the compilation of government finance statistics. The compilers of this manual had drawn from other publications such as the *System of National Accounts* of 1968, the United Nations' *Classification of the Functions of Government* of 1980 and the *European System of Integrated Economic Accounts* of 1971.

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

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

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

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

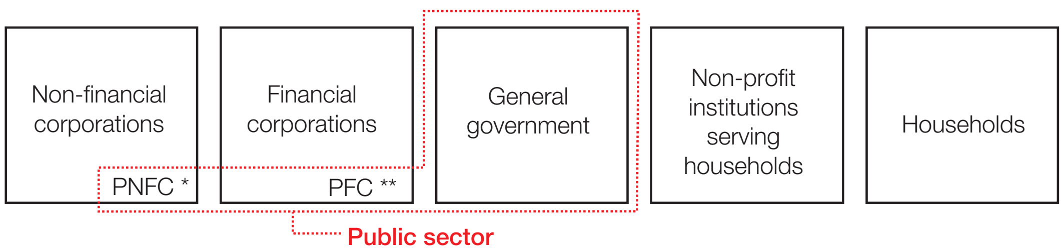
Major changes introduced by *GFSM 2001*

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

Coverage

The main focus of the coverage of the *GFSM 2001* system is the *general government sector*, including all the *institutional units* that perform the functions of government as their *primary activity*. The functions of government are considered to be providing goods and services to the whole of the community on a non-market basis, to redistribute income and wealth by means of transfer payments and to fund these activities primarily by raising taxes and other compulsory transfers. An entity is defined as an *institutional unit* when it can own assets, incur liabilities and enter into economic activities in its own right. In addition, an entity can only be considered to be an institutional unit if a complete set of accounts, including a complete balance sheet for the entity, exists or can reasonably be constructed. This approach differs from that of the *GFS 1986*, which followed a *functional* approach – all activities resulting from the execution of the functions of government were included in the statistics, irrespective of the institution performing the function.

Table 1: Coverage of *GFSM 2001*



* Public non-financial corporations
** Public financial corporations

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

Basis of recording

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

Valuation

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

Balance sheets

The *GFSM 2001* introduces the compilation of a full balance sheet for all units of government operating at all levels of the public sector. It records government's position with regard to all stocks of non-financial assets, financial assets and liabilities, and net worth. The *GFS 1986* recorded only stocks of certain contractual debt liabilities.

Integrated system

The *GFSM 2001* proposes a comprehensive integrated system which records all transactions and other economic flows. The system also contains all the information to reconcile these flows with the changes in the stock of assets, liabilities and net worth as presented on the balance sheets at the end of two consecutive periods.

Analytical framework

The new analytical framework as contained in *GFSM 2001* introduces several new or revised definitions, classifications and balancing items to enhance the analytical usefulness of the statistics and to redirect attention to various policy considerations, compared with the single balancing measure contained in *GFS 1986*.

The analytical framework of *GFSM 2001*

The system created by the *GFSM 2001* provides an analytical framework that caters for the data needs of a wide range of users. These users include compilers of macroeconomic information, analysts of government's performance, policymakers and government financial managers and auditors. It not only allows for the assessment of financial and economic performance, but also of fiscal soundness and long-term sustainability.

The structure of the integrated framework as presented in *GFSM 2001* comprises primarily four interrelated statements:
- *Statement of government operations;*
- *Statement of other economic flows;*
- *Balance sheet;* and
- *Statement of sources and uses of cash.*

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

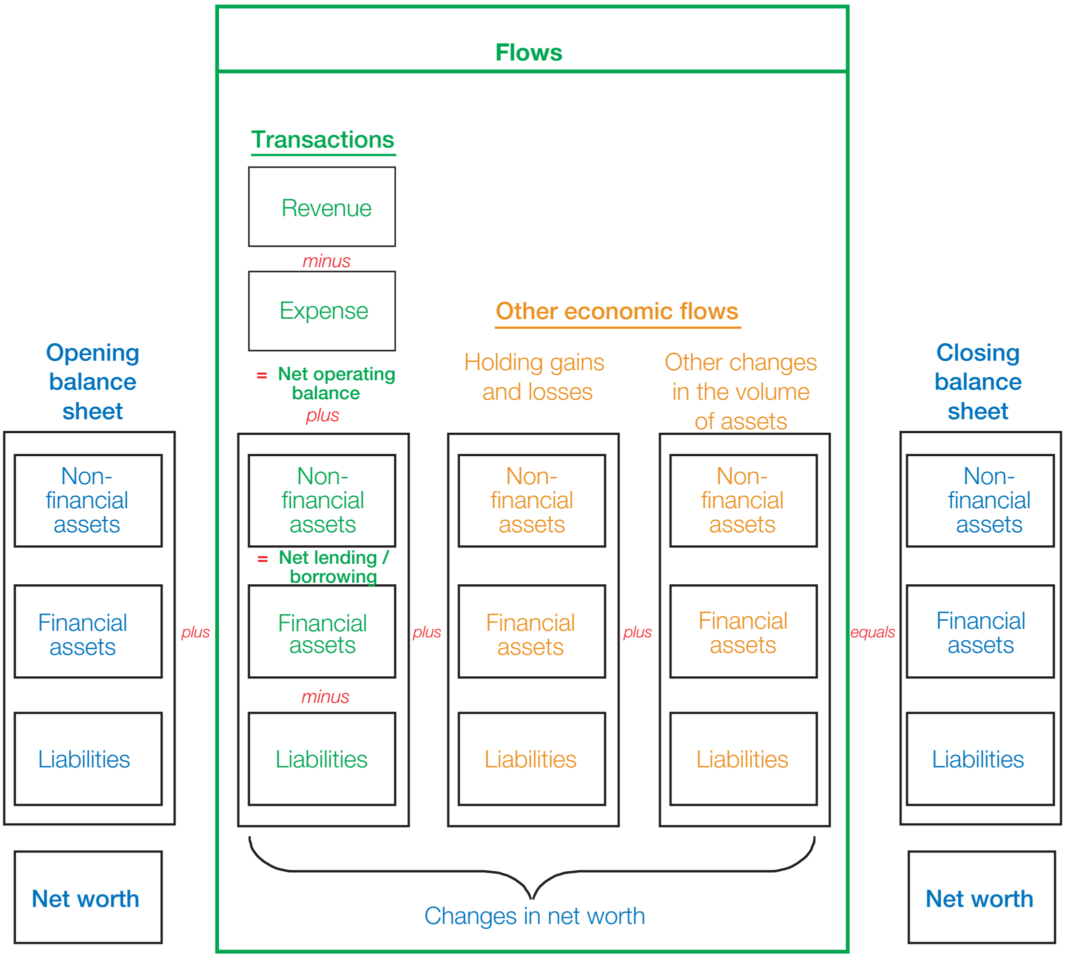
As indicated in Table 2, the system integrates stocks and flows in a double-entry system, which ensures an integral balance in the system at all times. The integrated approach ensures that changes to the stock of net worth, financial and non-financial assets, and liabilities of government, as presented in the opening balance sheet, are explained by flows during the reporting period, to derive the closing balance sheet values of the stocks. These flows represent the creation, transformation, exchange, transfer, or extinction of economic values. In addition, the *GFSM 2001* classifies all flows as either a *transaction* or an *other economic flow* where:
- *transactions* are defined as flows resulting from interaction between two economic units by mutual agreement and include flows due to exchanges and transfers; and
- *other economic flows* are defined as changes in the volume or value of stocks of assets and liabilities not resulting from transactions.

As indicated earlier, the structure of the integrated framework as presented in *GFSM 2001* consists of four integrated statements. The concepts and balancing items underlying each of these statements differ in order to serve a variety of purposes.

Statement of government operations

This statement summarises all the *transactions* (as defined earlier) of government and largely gives an indication of the impact of fiscal policies on the economy. The statement is organised to firstly calculate the *net operating balance* of government. As indicated in Table 2, this balance is calculated by subtracting expense from revenue. The concepts introduced by the *GFSM 2001* analytical framework for *revenue* and *expense* comprise all transactions increasing or decreasing net worth, respectively. As such, the *net operating balance* represents the change in net worth due to transactions. The *GFSM 2001* classification system also introduces sub-categories of revenue and expense according to the economic nature underlying the transactions.

Table 2: Integrated analytical framework of *GFSM 2001*



Revenue is broadly classified according to four main types of revenue, with provision made for further sub-classifications. The broad categories of revenue comprise the following:

Taxes are defined as compulsory transfers levied by general government institutional units. Taxes also include fees levied for services that are clearly out of proportion to the costs of providing the services, but exclude compulsory transfers in respect of social security contributions, fines and penalties.

Social contributions are defined as all receipts of contributions to general government social security schemes and employer social insurance schemes, other than retirement benefit schemes.

Grants are defined as all non-compulsory transfers received from foreign governments, international organisations and other general government units.

Other revenue is defined as all revenue other than taxes, social contributions and grants and comprises primarily:
- property income such as interest, dividends and rent;
- the sales of goods and services;

- fines, penalties and forfeits;
- voluntary transfers other than grants; and
- miscellaneous and unidentified revenue.

The *GFSM 2001* also classifies expense in eight categories and provides for further sub-classifications. The broad categories of expense comprise the following:

Compensation of employees, defined as the remuneration in cash and in kind paid to employees in exchange for work done.

Use of goods and services, defined as the value of goods purchased by governments to be used in the production process or goods acquired for resale, less the net change in inventory of those goods.

Consumption of fixed capital defined as the decline in the value of the stock of fixed assets during an accounting period as the result of physical deterioration, normal obsolescence and normal accidental damage.

Interest, defined as the expense incurred by a debtor for the use of another unit's funds.

Subsidies, defined as current transfers that government units pay to market enterprises in support of the price of their products or in support of their production processes.

Grants, defined as non-compulsory current and capital transfers in cash and in kind to foreign governments, international organisations and other general government units.

Social benefits, defined as current transfers to households to provide for needs arising from events such as sickness, unemployment, retirement, etc.

Other expense, defined as all expense transactions not classified elsewhere and comprising primarily of
- property expense other than interest;
- rent of non-produced assets; and
- miscellaneous other expenses related to transfers, other than grants and social benefit payments.

The second balancing item calculated in the *Statement of government operations* is *net lending/borrowing* – calculated by adding the net acquisition of non-financial assets to the net operating balance. The transactions resulting in the acquisition or disposal of non-financial assets do not affect net worth but change the composition of assets or liabilities. These transactions often lead to exchanges of a financial asset, such as cash for a non-financial asset such as a vehicle. Alternatively, an asset can be exchanged for a liability when acquired on credit – also not affecting net worth of government. The *GFSM 2001* analytical framework distinguishes mainly between produced assets comprising fixed assets, inventories and valuables, and non-produced assets such as land. In order to serve economic analysis these categories of assets are further sub-divided to reflect their exact nature.

Net lending/borrowing as a measure of government's performance gives an indication of the financial resources that government places at the disposal of other units of the economy (government lending) or of the financial resources created by the rest of the economy that government utilises (government borrowing). Activities of government pertaining to the acquisition or disposal of financial assets and liabilities are recorded in the last part of the *Statement of government operations.*

Statement of other economic flows

The *Statement of other economic flows* records all *other economic flows*, which are defined as changes in the volume or value of stocks of assets and liabilities not resulting from transactions. Other economic flows can broadly be disaggregated into two categories. The first category pertains to all changes in the monetary value of stocks of assets and liabilities and is referred to as *holding gains and losses.* Changes in the value of assets and liabilities denominated in foreign currency resulting from exchange rate movements and adjustments to the value of securities due to interest rate movements, can be cited as examples of this type of flows. The second category of flows recorded in this statement is the result of changes in the volume of assets due to the occurrence of various events. The *GFSM 2001* refers to this type of flows as *other changes in the volume of assets.* Events resulting in recording this type of flows are quite often beyond the control of the owner, or occur naturally. Three broad categories of events are recognised in the system:

- the recognition or derecognition of an existing entity as an asset;
- changes in the quantity or quality of assets such as new discoveries;
- extinction due to disasters, or natural depletion; and
- changes due to the reclassification of assets.

Balance sheet

The *Balance sheet* introduced by the *GFSM 2001* presents the stocks of assets and liabilities at a specific point in time and could be regarded as the result of all flows recorded in periods prior to the date of the balance sheet. The value of all non-financial and financial assets owned on the balance sheet date are disclosed, as well as the value of all liabilities of the reporting unit, representing financial claims of other units against the reporting unit. The balancing item calculated from the value of total assets of government less the liabilities of government is the net worth of government as on the reporting date. For analytical purposes the use of the balance sheet as an indicator of the financial position of governments is supplemented by the usefulness of information on the changes in the balance sheet over time. This information forms the basis of the assessment of the sustainability of governments' operations.

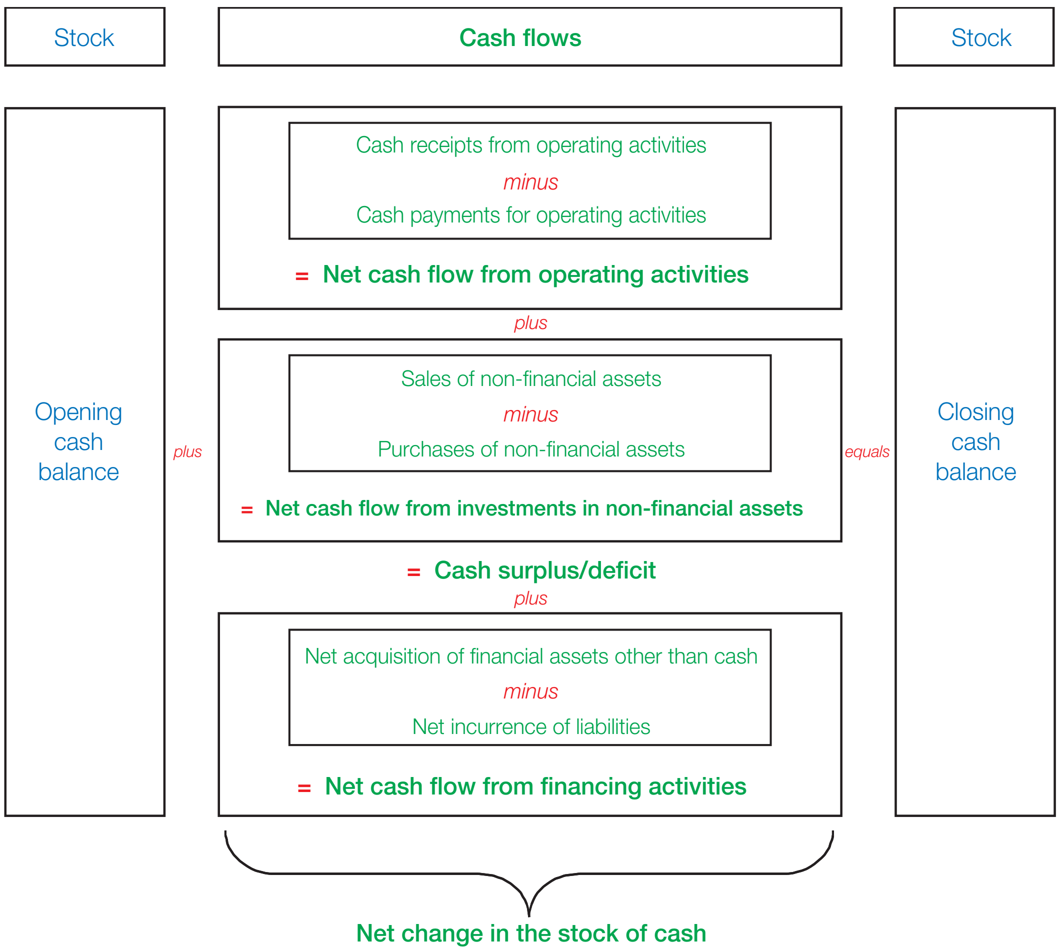
Statement of sources and uses of cash

Cash is one of the financial assets reported on the balance sheet of the integrated analytical framework of the *GFSM 2001*. Owing to the importance of assessing the liquidity of government units, this statement presents the structure according to which the changes in the stock of cash can be recorded. Cash as defined in the *Statement of sources and uses of cash* refers to cash on hand, deposits of a highly liquid nature and overdrafts considered to be entered into for cash management purposes.

The *Statement of sources and uses of cash* records all transactions of the government unit on a cash basis, which means that transactions are captured when cash is received or when cash payments are made. The statement therefore also relates to historic data on government finances that were traditionally compiled on a cash basis in the *GFS 1986* framework. The analytical usefulness of the *Statement of sources and uses of cash* is further increased when a comparison between this statement and the *Statement of government operations* is made. Such a comparison could clearly indicate potential cash inflows and outflows (or the lack thereof) which could indicate a need for policy changes.

Transactions recorded in the *Statement of sources and uses of cash* can be disaggregated according to the same economic classifications than those followed in the *Statement of government operations*. To this effect the cash receipts from operating activities are recorded as taxes, social contributions, grants or other revenue. Similarly, cash payments follow the classification of expense transactions. However, non-cash transactions such as consumption of fixed capital, imputed transactions and transactions in kind are not recorded in this statement. As indicated in Table 3, the *Statement of sources and uses of cash* introduced the balancing items *cash surplus/deficit* calculated as the sum of the net cash flow from operating activities and the net cash flow from investing in non-financial assets. The cash surplus/deficit is financed through cash flows from financing activities derived from the net result of all transactions in financial assets and liabilities. The net change in the stock of cash can therefore be explained by the total of the cash surplus/deficit and the net flow from financing activities.

Table 3: Statement of sources and uses of cash



Migration from *GFS 1986 to GFSM 2001*

The IMF rightfully noted that the full implementation of the recommendations as contained in *GFSM 2001* would be a complex and arduous process. Implementation of the revised statistical framework is also to a large extent dependent on major accounting reforms in a country – taking into consideration the capacity constraints existing in individual countries. It was therefore suggested that each country should develop its own migration path within its means. Such a migration path comprises different phases of implementation over time. These phases start with awareness of the revised framework and should translate into political conviction to change, adopting the broad analytical framework and classification system, and eventually adopting accrual accounting and implementing the complete integrated system.

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

The IMF published a supplement to the *GFS Yearbook* of 2002, containing government finance statistics in the revised analytical framework for a number of countries. Working with GFS compilers, the IMF published the accrual accounting data for a number of countries, but in addition, the historic cash accounting data of a number of countries, including South Africa, were converted to illustrate the use of the new analytical framework. As from the 2003 edition of the *GFS Yearbook* all the government finance statistics will only be published in the new format.

Adjustments made to the *Quarterly Bulletin* tables (Tables S71 – S79)

As a step in the migration towards publishing government finance statistics according to the revised *GFSM 2001* framework, the Government Finance Statistics, as previously presented in Tables S71 – S79 of the *Quarterly Bulletin*, were revised to reflect the conversion of the cash data to the analytical framework of the *Statement of sources and uses of cash*. These changes were specifically effected in this edition of the *Bulletin* to coincide with the start of reporting data for the new fiscal year 2003/04. Although historic data are in some instances insufficient to fully complete these new tables, broad conversion guidelines and assumptions were followed in the conversion process, as indicated in Table 4.

It should also be noted that separately identifiable data on the payments of social benefits are currently not available for all levels of government. These payments are included in the other expense categories if not shown separately.

In addition to the above-mentioned conversions, financial data on the result of the activities of the non-financial public corporations are also now presented in the same format than that of the general government. Previously, these data were sourced from less comprehensive surveys conducted by the Reserve Bank. Data for the fiscal years

2000/01 and 2001/02 were sourced directly from the published financial statements of these corporations. Past trends in their financial data were used to estimate quarterly data for this period. Data for periods prior to the analysis of the financial statements were retained and it should be noted that this could constitute a break in the time series.

Table 4: Summary of major changes effected in Tables S-71 to S-79

GFS 1986	Amendments to derive *GFS 2001*
Tax revenue	Disaggregated to reflect *taxes* and *social contributions* separately
Non-tax revenue	Recorded as *other receipts*
Capital revenue	Recorded as cash flow from investment activities – *sales of non-financial assets*
Grants	Continue to be recorded as grants
Goods and services	Disaggregated to record *compensation of employees* and *purchases of goods and services* separately
Interest	Continue to be recorded as *interest*
Subsidies and current transfers...	Disaggregated to record subsidies, grants, social benefit payments and other expenses separately. In addition capital transfers were added to the respective categories, as relevant
Acquisition of capital assets	Recorded as cash flow from investment activities – *purchases of non-financial assets*
Capital transfers	Capital transfers were disaggregated to be included in: - grants if the transfer was made to another government or international organisation; or - social benefit if the transfer was made to the household sector; or - other expenses if the transfer was irregular in nature and used to recapitalise an entity or if debt was forgiven
Net lending	Recorded as part of cash flows from financing activities
Domestic and foreign financing	Disaggregated to record the incurrence or redemption of *liabilities*, the acquisition or disposal of *financial assets*, and the change in *cash and cash equivalents* separately

Local government data were revised to include the gross revenue and expense of trading accounts of local governments in accordance with the recommendations of *GFSM 2001*. Previously, only the net result of these trading activities was recorded as a source of non-tax revenue when a surplus was recorded or as a subsidy when a deficit was recorded. Following the institutional approach of *GFSM 2001*, the gross result of these market establishments is included in the statistics for local government due to the fact that they do not operate as a separate institutional unit.

Table S-79 reports the non-financial public-sector borrowing requirement (PSBR). However, it should be noted that this estimate of the non-financial PSBR differs from the estimates previously reported due to the revised reporting formats of Tables S-71 to S-78. The non-financial PSBR is now calculated as the inverse of the cash surplus/deficits of all levels of government, which differs due to the net lending amount previously included in the calculation of the deficit/surplus and the revised results of the analysis of the public corporations.

Conclusion

As with the financial results of companies in the private sector, a thorough analysis of the government's accounts requires more than just an abbreviated cash flow statement. South Africa is moving towards an integrated presentation of stocks and flows of the public sector's activities. The more comprehensive disaggregation shown in Tables S-71 to S-79 of this *Quarterly Bulletin* is an important step forward in ensuring adherence to best practice in the dissemination of government finance statistics.