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T08 ACCOUNTING FOR PUBLIC SECTOR AND COOPERATIVES

ACCOUNTING FOR PUBLIC SECTOR AND COOPERATIVES

STUDY TEXT

T08

Accounting Technician Level II

THE NATIONAL BOARD OF ACCOUNTANTS AND AUDITORS TANZANIA (NBAA)

T08

ACCOUNTING FOR PUBLIC SECTOR AND COOPERATIVE

STUDY TEXT

NBAA

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FOREWORD

The National Board of Accountants and Auditors in Tanzania is a professional body in Tanzania, established under the Auditors and Accountancy Registration Act No 33 of 1972 as amended by Act No 2 of 1995. The Board has been charged among other things, the responsibility to promote, develop and regulate the accounting profession in the country.

In fulfilling its role, NBAA has revised its national accountancy examination scheme and syllabi for students aspiring to sit for Accounting Technician and Professional Examinations. For effective implementation of these syllabi and improve examination results, the Board has prepared study materials for all subjects to assist both examination candidates and trainers in the course of learning and teaching respectively.

The study guides have been prepared in the form of text books with examples and questions to enable the user to have comprehensive understanding of the topics. The study guides cover the wide range of the topics in the syllabi and adequately cover the most comprehensive and complete knowledge base that is required by a leaner to pass the examinations.

These study guides for each subject from ATEC I to final Professional Level will ensure that learners understand all important concepts, know all the workload involved and provide practice they need to do before examinations. The guides have right amount of information with plain language -easy-to-understand, plenty of practice exercises and sample examination questions which are set in a competence based approach.

Competency based study guides have been developed aiming at developing a competent workforce. The guides emphasize on what the individual can do in a workplace after completing a period of training. The training programme therefore is directly related to the expectations of the employer.

These study guides which have been developed under competence based approach are characterized by the following features:-

1. Focus on outcome – The outcomes shown in every topic are relevant to employment industry

2. Greater workplace relevance – the guides emphasize on the importance of applying knowledge to the tasks to be performed at a workplace. This is different from traditional training where the concern has been expressed that theoretical or book knowledge is often emphasized at the expense of the ability to perform the job.

3. Assessments as judgments of competence – The assessment will take into consideration the knowledge, skills and attitudes acquired and the actual performance of the competency.

Study guides are also useful to trainers specifically those who are teaching in the review classes preparing leaners to sit for the professional examinations. They will make use of these study guides together with their additional learning materials from other sources in ensuring that the learners are getting sufficient knowledge and skills not only to enable them pass examinations but make them competent enough to perform effectively in their respectively workplace.

NBAA believes that these standard study guides are about assisting candidates to acquire skills and knowledge so they are able to perform a task to a specified standards. The outcomes to be achieved are clearly stated so that learners know exactly what they have to be able to do, and on the other hand trainers know what training is to be provided and organizations as well know the skills level acquired by their expected accountants.

The unique approach used in the development of these study guides will inspire the learners especially Board's examination candidates to acquire the knowledge and skills they need in their respective examinations and become competent professional accountants in the labor market thereafter.

Pius A. Maneno
Executive Director

STUDY TEXT CONTENTS

T08 – Accounting for Public Sector and Cooperative

Features of the book

'The book covers the entire syllabus split into various chapters (referred to as Study Guides in the book). Each chapter discusses the various Learning Outcomes as mentioned in the syllabus.

Contents of each Study Guide

'Get Through Intro': explains **why** the particular Study Guide is important through real life examples.

'Learning Outcomes': on completion of a Study Guide, students will be able to understand all the learning outcomes which are listed under this icon in the Study Guide.

The Learning Outcomes include:

'Definition': explains the meaning of important terminologies discussed in the learning Outcome.

'Example': makes easy complex concepts.

'Tip': helps to understand how to deal with complicated portions.

'Important': highlights important concepts, formats, Acts, sections, standards, etc.

'Summary': highlights the key points of the Learning Outcomes.

'Diagram': facilitates memory retention.

'Test Yourself': contains questions on the Learning Outcome. It enables students to check whether they have assimilated a particular Learning Outcome.

Self Examination Questions': exam standard questions relating to the learning outcomes given at the end of each Study Guide.

EXAMINATION STRUCTURE

The syllabus is assessed by a three hour paper based examination.

The examination will consist of

Three conventional question of 20 marks	60 marks
Twenty objective questions of 2 marks	40 marks
	100 marks

STUDY GUIDE A1: INTRODUCTION TO PUBLIC SECTOR ACCOUNTING

Get Through Intro

Globally, the public sector is characterized by their focus in service provision rather than profit orientation. Services offered by the public sector in Tanzania range from those offered by the central government, local government and independent departments and agencies. These services include health services, education services, infrastructure services, security services etc.

This Study Guide will introduce the basics of public sector accounting and the related concepts. Knowledge of this Study Guide is important as it will facilitate your understanding of the various concepts which are dealt with in this Study Text.

Learning Outcomes

a) Explain the meaning and identify organisations which constitute public sector.
b) Explain the role of government entities.
c) Explain the nature, scope and objectives of public sector accounting.
d) Explain the theoretical and practical arguments in favour of having public sector accounting.
e) Explain the distinguishing features of public sector accounting.
f) Compare between public sector accounting and commercial accounting.
g) Define accounting concepts and methods employed in public sector accounting.
h) Explain the concept of public sector financial reporting.
i) Identify users of public sector accounting information and their needs.
j) State how you would differentiate their needs from those under private sector.
k) Describe the nature, scope and sources of finance for quassi-governmental bodies.

1. Explain the meaning and identify organisations which constitute the public sector. [Learning Outcome a]

1.1 Public sector

Definition

The term public sector refers to national governments, regional governments (state, provincial, and territorial) including local governments (city, town) and related government entities

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The term public sector includes in its scope a combination of central government, local government, independent agencies and other government institutions entrusted for serving the community through provision of public goods and services. Examples of public sector include all government controlled agencies, boards, commissions and enterprises.

The public sector includes all organisations which are not privately owned and operated, but which are established and run by the government on behalf of the public.

Important

The simplest definition of public sector is: all organisations which are not privately owned and operated, but which are established, run, and financed by the government on behalf of the public.

1.2 Public sector organisations

The objective of the public sector organisation is to make available basic services and amenities to the public and these organisations do not run with a primary motive of making a profit.

Organisations which constitute the public sector include:

(i) Central government which comprises ministries, department or agencies
(ii) Local government which comprises cities, municipals, town councils, wards, villages etc.
(iii) Body corporate, statutory body or authority established by the government
(iv) Any company registered under the Companies Act, being a company in which the government or an agency of the government is in a position to control or influence the policy of the company.

Example

Muhimbili National Hospital is a national referral hospital offering health care services to Tanzanian citizens. This is an independent agency offering public health services to the community. The objective of this hospital is to make healthcare service available to the public at an affordable price.

Test Yourself 1

Which of the following is not a public sector organisation?

A Central government
B Local government
C Tanzania Broadcasting Corporation
D Community Based Organisation (CBOs)

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2. Explain the role of government entities.

[Learning Outcome b]

2.1 Role of government entities

Public sector entities are also referred to as government entities. Governments worldwide are characterised by provision of various services such as education, security, economic development, employment creation, judicial services etc. The magnitude of government involvement in providing goods and services differs from one country to the other depending on the economic ideology adopted, which may be socialism or capitalism.

The major roles of the government entities include:

(a) Collection of revenue

All public entities have a role to ensure that they collect revenue through taxes, levies, fees, duties, fines, commissions etc. to enable the government to build its financial ability to serve the society.

(b) Fair usage of resources

The government is concerned with social justice or equity in resource distribution to ensure that the society gets what was planned for. This is achieved through distribution of income, wealth and welfare in a way that is considered just and fair. The government entities play an important role in utilising scarce resources in the economy and making them available to the general public at a reasonable price. For example the government entities may be responsible for providing a transport system to the general public at a reasonable cost.

(c) Stabilisation of economy

Monetary and fiscal policies are normally used by the government to reduce the impact of inflation, unemployment, balance of payment challenges etc., thereby improving the society's welfare. These tools are also used to protect infant industries and promote production within the country; this may include tariffs, quotas and import duties. The government entities support the government in achieving the above objective by creating employment, improving the balance of payment situation and ensuring that the economy's trade and business is regulated in a proper manner.

(d) Allocation of resources

In a need to meet the interest of society for better services, the government always strives to allocate the scarce resources to meet expenditure on public services such as education, medical and health services, defence service, judicial services etc. The government may provide these services through private and public enterprises. Mostly the activities such as defence which are of a national importance are never privatised and are often regulated through public entities.

Test Yourself 2

Which one of the following is not a primary role of the government entities?

A Stabilisation of economy
B Allocation of resources
C Collection of revenue
D Maximisation of profits

3. Explain the nature, scope and objectives of public sector accounting.
Explain the theoretical and practical arguments in favour of having public sector accounting.

[Learning Outcomes c and d]

3.1 Scope and nature of public sector accounting

Definition

Public sector accounting is the process of recording, communicating, summarizing, analysing, and interpreting government financial statements and statistics in aggregate along with the details.

Public sector accounting currently is governed by accounting standards, which is not different from commercial accounting that is characterised by accounting assumptions and accounting concepts that guide the preparation of public sector financial statements. The difference originates from the service provision motives rather than a profit motive. Thus the nature and practice of generating revenue and expenditure vary.

3.2 Objectives of public sector accounting

The general objective of public sector accounting is to provide information useful for decision making, and to demonstrate the accountability of the public sector for resources entrusted to it, and specifically have the following objectives:

1. Providing information about the sources, allocation and use of financial resources

2. Providing information about how the entity financed its activities and met cash requirements

3. Ascertaining legitimacy of transactions and their compliance with government laws, regulations and statutes

4. Providing a basis of decision making to the government

5. Providing information that is useful in evaluating the entity's ability to finance its activities and to meet its liabilities and commitments

6. Providing information about the financial condition of the entity and the changes in it

7. Providing aggregate information useful in evaluating the entity's performance in terms of service costs, efficiency and accomplishments.

8. Enhancing the appraisal of the efficiency of management.

9. Highlighting various sources of revenue to the government and also the expenditure to be incurred.

10. Identifying sources of capital to fund projects

Example

The government of Tanzania is accountable for the provision of public services such as construction of roads, railways, airports, health services etc. to the citizens of Tanzania.

3.3 Arguments in favour of public sector accounting

There are a number of arguments in favour of public sector accounting both theoretical and practical. The following points discuss the importance of public sector accounting, which includes:

(a) The ability of public sector accounting to demonstrate the proprietary of transactions and their conformity with the law, established rules and regulations

(b) To measure current performance

(c) To provide useful information for the efficient control and effective management of government operations

(d) To facilitate audit exercise to be carried out

(e) To plan future operations

(f) To appraise those having authority, in efficiency and effectiveness.

Test Yourself 3

The main objective of a private enterprise is to maximise profit while that of a government is to:

A Decrease expenditure
B Cater for the welfare of the people, at the least cost
C Increase revenue
D Increase taxation

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4. Explain the distinguishing features of public sector accounting. Compare between public sector accounting and commercial accounting.

[Learning Outcomes e and f]

4.1 Distinguishing features of public sector accounting

While large corporations and many commercial private enterprises focus on maximising their shareholders' wealth, public sector entities exist to carry out the activities for which they have been formed. They include provision of services and facilities at cheap or reasonable cost to the general public. This is one of the most distinguishing features of public sector entities.

Public sector entities receive the funds required to carry out their activities smoothly through voluntary contributions from members, the government or from outside agencies, they may or may not carry out trading activities to supplement their income. Even if trading is carried out by public sector entities, the trading activity will be secondary to their main activity which is provision of service. As a result, public sector entities measure their performance by evaluating whether they provide value for money to the recipients of their services. The term value for money refers to how well the public sector entity makes use of the available resources by utilising the three Es: Economy, Efficiency and Effectiveness. The meanings of these terms are explained below:

Economy: buying goods and services at the best possible price so as to reduce costs.

Efficiency: utilising the inputs in the most resourceful manner so as to obtain the maximum output.

Effectiveness: meeting the right goals at the right time.

Public sector entities are not supposed to show a profit or under spend their budget. If they do under spend their budget, the allocation for the next year would be considerably reduced. As a result, instead of financial performance measures, the performance of public sector entities is measured by what they have achieved. They will have key performance measures illustrating the level of service achieved by spending public money.

Charities, on the other hand, have to provide the public with a detailed analysis of the funds they have collected and how they have made use of those funds in terms of their stated objectives. Some charities very specifically state what they set out to achieve, what they have achieved so far and what remains for them to be achieved. Mismanagement of funds by a charity is taken very seriously by the authorities and the public.

In summary, accounting for the public sector is concerned with accounting for provision of goods and services to the citizens while the accounting for the private sector is concerned with profit maximisation. Despite this major distinction, there are other similarities and differences as discussed here under.

4.2 Similarities between public sector accounting and private sector accounting

(a) Both systems prepare, maintain and retain the financial and related records.

(b) Both use books of accounts like cash books, journals, ledgers and vouchers.

(c) Both communicate financial information to enable decision making assessment

(d) Both systems have some common users e.g. employees, management, lenders, general public etc.

(e) Both use accrual basis or modified accrual basis of accounting

(f) Both use accounting standards, whether national or international standards such as TFRSs, IFRSs, IPSASs, ISAs etc.

(g) Both systems record transactions in a chronological order.

4.3 Difference between public sector accounting and private sector accounting

(a) The main objective of a government is to provide adequate welfare to the people at the reasonable costs while that of the private sector is to maximise profits. Therefore the accounting in private sector is more focussed towards calculation of yearly performance and position.

(b) In government accounting, financial transactions are recorded on cash basis while in private sector accounting is on an accrual basis.

Example

In government accounting, tangible and fixed assets such as buildings and motor vehicles are not shown in the statement of assets and liabilities under cash basis of accounting. They are written off immediately in the year of purchase. Private sector accounting reflects fixed assets in the statement of financial position, displaying the historical cost, accumulated depreciation and written down value of each.

(c) Government accounting does not record stocks and debtors in the statement of financial position (statement of assets and liabilities), unlike private sector accounting which displays those items, and others such as sales, cost of goods sold and carriage outward expenses (in the trading and profit and loss accounts).

(d) Private sector accounting is peculiar to commercial undertakings which have the maximisation of profit as their main objective. Government accounting focuses on the provision of adequate welfare to the people with probity, accountability, legality and wise spending in mind.

(e) Government accounting adopts cash basis of accounting, as against accrual basis used for private sector accounting.

(f) Government accounting mostly uses the budgetary approach, recording and classifying items of revenue and expenditure under various heads and sub-heads. On the other hand private sector accounting uses budgeting techniques as a potent control tool.

(g) The legal basis of government accounting is the Nation’s Constitution and Act of Parliament, unlike private sector accounting, which draws its existence and strength from the Companies Act.

(h) Unlike private sector, the financial statements of government are not issued in the annual general meeting. Government may hold public briefing on specific issues to communicate to stakeholders.

Test Yourself 4

Public sector entities are not owned and financed by the:

A Philanthropies
B Members of the National Assembly
C Local government
D Central government

5. Define accounting concepts and methods employed in public sector accounting. Explain the concept of public sector financial reporting.
[Learning Outcomes g and h]

5.1 Concept of public sector reporting

The concept of public sector reporting can be understood from the objectives of public sector reporting. The objectives of public sector reporting include:

(i) Demonstrating the proprietary of the transaction and their compliance in accordance with the rules and regulations framed by the government.

(ii) Providing information to manage various governmental entities in an efficient and effective manner.

(iii) Facilitating the audit of transaction and ensuring that the funds allocated to the entities have been utilised in a fair manner.

(iv) Planning out future activities on the basis of the reported data.

(v) Measuring the performance of various government departments

(vi) Provide appraisals and plan future budgets on the basis of the reported data.

Therefore in order to achieve the above objectives, financial reporting for public sector is very crucial.

5.2 Accounting concepts

Definition

Accounting concepts are rules of accounting that should be followed in preparation of all accounts and financial statements.

Some of the fundamental concepts common to both public sector and private sector accounting are:

(a) Accruals concept

The financial statements should be prepared on the basis of an accrual system of accounting. In the accruals system, items are recognised as assets, liabilities, incomes and expenses **on the date they satisfy the recognition criteria mentioned in their definitions.** The actual date of payment of cash is immaterial for the purpose of recognition.

The following example will further explain the accruals concept.

Example

Almond Inc. purchased goods on 5 December 20X6 but paid the supplier on 8 February 20X7. Here, Almond Inc. became the owner of the goods on 5 December 20X6 even though the payment was made later. Hence the purchase transaction should be recorded on 5 December 20X6.

Advantages of accruals

(i) It provides the financial position of the public entity by producing the assets and liabilities statement at the year end.

(ii) It provides a measure of the economic goods and services consumed during the period.

(iii) It facilitates the measure of capital

Disadvantages of accruals are:

(i) It introduces subjectivity in accounts.

(ii) Adjustments demand high administrative and accounting costs; these include cases where a specific person has to keep track of creditors, which is not the case in cash basis.

(b) Consistency concept

According to this concept, the policy once adopted in one accounting period should be consistently followed in the subsequent accounting periods.

Example

Until 20X5, MERERANI Plc. followed the reducing balance method (RBM) for charging depreciation on assets. However, in 20X6, the company calculated depreciation according to the straight line method (SLM). Here, MERERANI Plc. has not followed the principle of consistency.

(c) Going concern

The going concern concept assumes that an entity:

(i) will **continue** its operations **for at least the next 12 months**
(ii) does **not have any intention or need to close down its operations**

(d) Prudence concept

Revenue and profits are included in the statement of financial position only when they are realised (or there is reasonable 'certainty' of realizing them) but liabilities are included when there is reasonable 'possibility' of incurring them.

The concept of prudence implies that the profit should not be over-stated but all anticipated losses should be recognised. The implication of this is that all anticipated losses should be recognised and recorded immediately. But profits should be recognised and recorded in the books of account only when realised (this need not necessarily be in cash).

5.3 Other concepts employed in the public sector

There are some concepts which are specifically applicable to the public sector entities. These concepts have been discussed in detail below:

(a) Budgetary accounting

The objective of public sector accounting is to portray the stewardships of management on scarce resources entrusted to them by the public. To achieve this, an approved budget becomes the basis of the accounting system to ensure that the approved budget is implemented fully.

All financial activities of the government such as collection of revenue from different sources and expenditure are determined and controlled by laws. All plans and budgets of the public sector must be approved by the Parliament which is in accordance with laws and regulations. This becomes the basis of control and management of financial activities for the subsequent period.

(b) Cash basis of accounting

The cash basis measures cash flows at the time those flows actually take place. The cash basis accounting reports do not produce the statement of financial position of the government and therefore assets and liabilities are charged to income and expenditure. This basis of accounting will be discussed in detail in Study Guide A3.

The following are the advantages of cash based accounting:

(i) Easy to learn and carry out. It requires care, but no special accounting skills.

(ii) Well-adapted to the needs of budgetary control. Payment is definite. Strict budget control can be exercised by comparing sums authorized with those actually spent.

(iii) Easy to understand and verify.

(iv) A statutory requirement in many countries.

The following are disadvantages of cash based accounting:

(i) Does not give sufficient information to users on the cost of operating the public entity during the year.

(ii) Does not show the financial position of the public entity; does not prepare a statement of financial position that shows the assets and liabilities as at the year end.

(c) Modified accrual basis of accounting

In this system, only revenue is accrued when earned, while payments throughout are not continually accrued. However, at the year end, all unpaid invoices will be consolidated and accrued accordingly in the financial reports. This basis of accounting will be discussed in detail in Study Guide A3.

(d) Fund accounting

Fund is defined as a sum of money or other resources segregated for the purpose of carrying out specific activities or ascertaining certain objectives in accordance with the specific establishments such as Constitutions, Statute or Ordinance or by appropriate action by legislature or administrative branch of the government. The objectives of the funds include:

(i) ensuring compliance with budgetary spending limits

(ii) providing a basis of control for compliance with legal requirements

(iii) ensuring the financial position of the organisation's funds

(iv) showing the results of operations of the organisation's funds

Types of funds

The number and types of funds created depends on the nature and volume of activity and the degree of control desired. In this case, there are three classes of funds, namely:

1. Government funds

These are the funds that are accumulated by the government and used in spending of resources to provide the public with day-to-day basic services. These funds are different from the proprietary and fiduciary funds.

Government funds may further be subdivided into the following:

(i) General fund: this is the most significant fund maintained by central and local governments. This fund keeps a record of many of the central and local government's most important transactions and also serves as a residual fund account which will record revenues and expenditures not recorded in other types of funds.

Example

General fund expenditure includes payment made for general administration, public safety, routine maintenance and day-to-day operations of the government units.

(ii) Special revenue funds: these are ring-fenced funds where the proceeds of a specific source of revenue are accounted for and legally restricted to expenditure on specific purposes.

Example

The government has set aside funds to be spent for AIDS pandemic activities which are controlled by TACAIDS. Such funds are not allowed to be spent for any activities other than those intended for.

(iii) Capital project funds: these are funds that are to be used for the acquisition or construction of major capital facilities such as construction of roads, bridges, hospitals etc.

(iv) Debt service funds: these are funds that are to be used to account for the accumulation of resources and payments of government long term loans and interest accrued on those loans.

(v) Special assessment funds: these are funds used to account for financing of public improvement or service deemed to benefit the properties against which special assessment is levied.

2. Proprietary funds

Proprietary funds are used when the government unit handles its operations in a manner similar to that of the business enterprises. Activities that use appropriators fund accounting and reporting do charge fees for services and focuses on determining the operating income and changes in net assets.

Proprietary funds can be further subdivided into enterprise funds and internal service funds.

Example

Operations of TANESCO and DAWASCO are financed by consumers of electricity and water utility services through charges or service fees that partially cover the operating costs and capital costs.

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3. Fiduciary funds

These are funds used to account for assets held by the government in a trust or agency in a private organisation or other government organisation. This includes trust funds, agency funds, pension funds etc. that may be held in National Health Insurance fund, TASAF etc.

Test Yourself 5

The basis of accounting that records anticipated expenditure which has been finally authorized by the management is called____________.

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6. Identify users of public sector accounting information and their needs.
State how you would differentiate their needs from those under private sector.
[Learning Outcomes I and j]

6.1 Users of public sector accounting

Users of public sector are categorized into internal and external groups who have different interests in the public sector information.

(a) Internal users and their areas of interest

This group of users includes:

(i) Labour Union in public service: it will press for improved conditions of employment and security of tenure for their members.

(ii) Members of the executive arm of government such as the President, Ministers and Regional Commissioners etc.: their interest areas are to ensure probity and accountability through score keeping and performance control which are achieved through accounting information.

(iii) Top management members such as Permanent Secretaries of various Ministries and General Managers of Parastatals: they are the conduit of accounting information generation and transmission and serve as liaison officers between government, employees and the public.

(b) External users and their areas of interest

This group of users includes:

(i) Members of the legislature at both national and local government levels: information in the accounts of Governments is the major media through which politicians render stewardship to their constituencies and apprise them of the endeavors of governance.

(ii) Members of the Public: to demonstrate accountability and assist the people to appreciate or otherwise, the efforts of Governments.

(iii) Researchers and Financial Journalists: they are expected to develop new and better ideas of governance. Financial journalists publish accounting information to advise existing and potential investors.

(iv) Financial Institutions, such as commercial banks, World Bank and International Monetary Fund (IMF): accounting information assists them to evaluate the credit rating of a borrowing nation or Governments, apart from the ones reporting. Governments collaborate on ideas of investment and research. They require accounting information on the well-being or otherwise of each other.

(v) Suppliers and contractors: suppliers and contractors are eager to ascertain the ability of a government to pay for goods and services delivered. Only accounting information can be revealed.

6.2 Need for accounting information in public sector

The internal users require accounting information to assess whether actual expenditure is in accordance with the budget and whether the regulatory compliance has been followed. The external users require accounting information to ascertain the financial viability of the public sector entity. Also they are concerned with the efficiency and effectiveness with which the scare resources has been utilised by the management.

6.3 Information needs in the private sector

The accounting needs of the private sector public sector differ from public sector. We have already discussed needs of users in Paper T01, Study Guide 2. Let us summarise it here:

Sr. No	Users	Use of information on the financial statements
1	**Owners and shareholders** i.e. the providers of capital for running the operations of the entity. Includes shareholders	To assess whether the entity has utilised the capital efficiently. To ascertain the financial position of the entity i.e. information about the assets and liabilities of the company. To determine whether the financial condition and performance is improving / deteriorating over time. To determine the managements' efficiency in running the operations of the entity. To know the extent to which the available profits can be distributed to the shareholders. To assess the safety and growth of their investment. To assess the stewardship function of the management.
2	**Investors** i.e. the potential owners of the organisation	To assess the organisation as a profitable investment destination. To compare the financial statements of a number of companies from the same industry to make investment decisions.
3	**Employees**	Employees are interested in the company's financial position as their salaries are dependent on it. Employees use the financial statements to determine their future prospects for promotions, career development, etc.

Continued on the next page

4	**Providers of finance** to the company, which include: trade payables funding the operations of the company bank providing overdraft facility, long term finance, etc.	To know about the future profitability of the entity. To assess the entity's ability to generate sufficient cash flows to satisfy their debt repayments going forward. To determine the value of the assets that the company has pledged as security / collateral.
5	**Customers**	To know adequate availability of goods and services without disruption. To determine business continuity in near future.
6	**Trade relations** i.e. Suppliers and Vendors Customers	Suppliers want to know the financial stability of the entity, i.e. the ability of the company to pay for the goods and services supplied. Customers want to be assured about the continuity of operations and regular supply of goods and services.
7	**Government and their agencies**	To know the allocation of resources to take different policy decisions. To collate the information of all entities and compile national economic statistics e.g. GDP
8	**General public**	To conduct research for their studies. To know the environmental impact
9	**Management of the company** who are appointed by the owners to supervise the day-to-day activities of the company	To analyse the information relating to current and future financial position of the entity To determine the efficiency of the management in taking timely decisions throughout the year To determine the effectiveness of management's control and planning
10	**Financial analysts and advisers** i.e. (a) Stock Brokers (b) Credit Agencies (c) Journalists	To make predictions on the future financial conditions of the entity on the basis of the current financial statements To advise their clients (investors) on whether to invest in a particular organisation or not
11	**Tax Authorities**	To know the business profits To determine the amount of tax payable by the company, e.g. income tax or VAT liability from revenue and purchase figures

6.4 Comparison of information needs between public sector and the private sector

The above table shows how the accounting needs of the private sector are different from the public sector. To summarise, the public sector is more focussed towards governance and compliance, whereas private sector is more focussed towards liquidity and profitability.

Test Yourself 6

Which of the following is not an internal user of public sector accounting?

A Government employees
B Revenue collectors
C Trade unions
D Local and foreign investors

7. Describe the nature, scope and sources of finance for quasi-governmental bodies.
[Learning Outcome k]

7.1 Definitions

Definitions

'Parastatal organisation' means: a local authority of the United Republic, a body corporate established by or under any Act or Ordinance of the United Republic other than the Companies Act, and any company registered under the Companies Act where:

(a) in the case of a company limited by shares, not less than 50 percent of the issued share capital of the company is owned by the Government or an organisation which is a parastatal organisation under this definition; or

(b) in the case of a company limited by guarantee:

(i) the members of the company include the Government or an organisation which is a parastatal organisation under this definition; and

(ii) such members have undertaken to contribute not less than 50 percent of the amount to be contributed by members in the event of the company being wound up.

Income Tax Act

Quasi-governmental bodies are government-owned corporation, state-owned company, state-owned entity, state enterprise, publicly owned corporation, government business enterprise, commercial government agency, public sector undertaking or parastatal setup for the purpose of rendering services.

7.2 Scope of finance

Although public-owned entities are set to render social services to the public at the lowest possible costs and principally self-financing, the government makes funds available in the form of subventions. Money given to public owned entities is classified as emoluments, recurrent revenue or capital revenue. The entity may raise funds as per the mandate set in the basis of its formulation, which may be fees, levies, fines and other miscellaneous revenue that are within the law.

Quasi-governmental bodies help the central and local government in provision of services to the society. They also contribute to revenue generation by paying dividends to the government on profits generated by those entities.

Example

Power utility company is a state owned institution which provides electricity facilities on behalf of the government to Tanzanian citizens. The same illustration can be extended to Tanzania Telecommunications Company Ltd.

7.3 Sources of finance

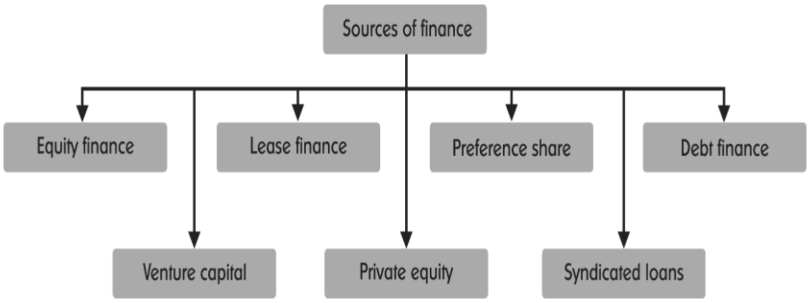
Sources of revenue for government bodies will be discussed in detail in Study Guide 7. The revenue generated is used to finance the needs of quasi-governmental / parastatal bodies. Apart from revenue other long term sources of finance are also available.

Long-term finance is used as a source for long-term assets such as:

1. non-current asset (i.e. fixed asset)
2. expansion of facilities
3. large-scale construction projects

There are different sources available for these long-term funds. The following are the major sources available to quasi-governmental bodies/parastatals:

Diagram 2: Sources of long-term finance



1. Equity finance

Equity finance is the money raised by issuing ordinary shares to investors**.** It may take different forms such as a rights issue, a placing, a tender or a public offer. Equity holders are the owners of the company. They are not, however, usually involved in the day-to-day running of the business. They control the company's affairs by selecting a board of directors (at the annual general meeting), which is responsible for the day-to-day running of the company. According to company law, certain decisions are to be made or ratified by shareholders, and not by the board.

Equity finance is available for an indefinite period. There is no fixed repayment date.

Example

Equity holders of Far Public Ltd are entitled to the entire retained profit or loss, as they bear the entire risk of a business. The distribution of the profits in the form of dividends, however, is proposed by the directors and ratified by the shareholders at the annual general meeting, striking a balance between pay-out of cash and reinvestment to grow the business. The dividend payment is discretionary.

2. Debt finance

Long-term debt finance is finance obtained through borrowing and has a fixed (or variable) interest payable on it. This interest is a tax-deductible expenditure. This is in contrast to equity finance which has no fixed interest or dividend attached to it. Interest on debt is payable whether adequate profits are available or not. This is unlike dividend which is purely discretionary.

Example

Ndege Public Ltd went into liquidation and debts were paid first before anything was paid to equity holders. The exact ranking for repayment of debt depended upon the kind of security the lenders held. What equity holders got after liquidation depended upon the assets left over after paying all the trade payables. In this way, debt carried a lower risk for investors as compared to equity owners of the company.

Debt finance, even when it is long-term, still has to be repaid on the stipulated dates. A company has to plan for these repayments.

Types of debt finance

(a) Loan stock and debentures

Loan stock or debentures have a par value that signifies a debt owed by a company to the loan stock holder. Loan stock or debentures can be bought or sold on the capital markets.

The market value may be different from the par value. This is because the market value depends upon market forces and interest rate expectations.

(b) Deep discount and zero coupon bonds

Deep discount bonds are bonds that are issued at a large or ‘deep’ discount to their par value and are redeemable at par or at a premium.

They carry a very low rate of interest. A zero coupon bond is an extreme form of deep discounted bond, issued at a very large discount to par value, with a zero% rate of interest and usually redeemable at par.

(c) Institutional debt and bank finance

Banks and financial institutions provide long-term loans. The interest rates may be fixed or flexible. Usually, the rate is tied to the bank’s base lending rate. A loan processing fee and/or an arrangement fee is charged at the time the loan is taken out by a company. A commitment charge is often charged for a loan that is sanctioned but not utilise

(d) Eurobonds

Eurobonds are bonds that are denominated in a currency different from that of the country in which they are issued. They are outside the control of the country in whose currency they are denominated.

Eurobonds have the following features:

They are usually sold in different countries at a time. These are suitable for large companies and governments.

The usual term of Eurobonds is 5 to 15 years. They are suitable for financing long-term investments.

Eurobonds are ‘bearer’ securities, which mean that their owners are unregistered. As the Eurobonds are unsecured, companies that issue them are internationally known and have excellent credit rating.

Usually the interest rates are lower, compared to the rates on domestic bonds. This is perhaps due to the fact that the Eurobond market is not as tightly regulated as the domestic bond markets.

(e) Convertible bonds and warrants

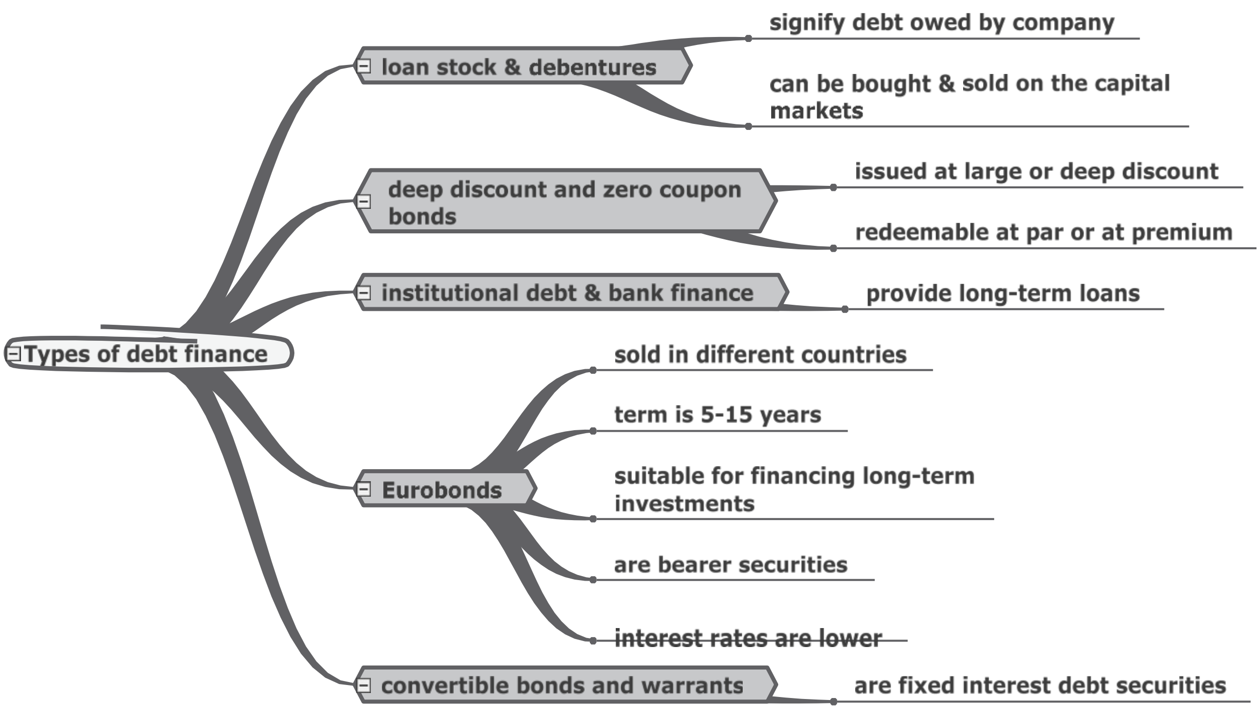
Convertible bonds are fixed interest debt securities which the holder can choose to convert into ordinary shares of the company.

This conversion takes place at a predetermined rate and on a predetermined date.

If conversion does not take place, the bond will run for full life and be redeemed on maturity.

A warrant is similar to an option and is the right to buy ordinary shares in a company up to a specified future date, at a fixed, predetermined price known as the exercise price

SUMMARY



3. Lease finance

Lease finance is another form of long-term financing. If a public entity wants to borrow in order to purchase an asset in its own name, it has to provide assets as a security for the borrowing. If it lacks good assets, it may not be able to borrow.

The title in the assets does not pass to the user in the case of leases. As a result, the asset can be repossessed by the lessor if there is a default from the lessee. In this way, the leased asset itself serves as a security. Hence it is possible to acquire assets on lease even where there are no good assets to offer as a security, other than the leased assets. This factor has made lease financing popular, especially with smaller entities.

4. Venture capital financing

Venture capital, as the name indicates, is the capital (usually equity, but may also be high-risk unsecured debt) which investors put into a relatively more risky business. The investors take the risk knowingly, with an expectation of higher returns and/or a stake in the ownership of a company. The risk may be due to the fact that the business is new, or the product is based on a new technology that has not yet been marketed, or the business is regarded as high risk for some other reason. Nowadays public private partnership is become very popular. This enables government to involve private players in improving the quality of services provided by the public entities.

Example

A polypropylene technology has been newly introduced in the African country. There are worldwide success stories. However, it has not been tested in that country, therefore, banks and financial institutions are not willing to finance projects involving this technology. The promoters approach a venture capital company in UK, VC Ltd. VC Ltd feels that there are prospects of good returns and the risk is worth taking and so it agrees to finance the project.

5. Private equity

Private equity funds are invested in equity shares of a company that is not traded on the stock exchange. Private equity investors not only invest in a company but sometimes also acquire or help in acquiring the company.

6. Syndicated loans

Syndicated loans are loans that are made available by more than one bank as the loan amount is large (and therefore perhaps more risky) and a single bank is reluctant to undertake the entire risk. This type of loan is suitable for large amounts of loan. The creation of a banking syndicate will be led by an 'arranging' bank. The arranging bank will find other banks that would be willing to lend funds to the company through the syndicate loan.

Advantages of syndication

(a) The loans provided can be of a considerably greater value than those that could be managed by a single bank without disturbing the balance of its lending portfolio or breaching its capital requirements under the Basle agreements.

(b) Banks in more than one currency jurisdictions can combine their resources to create lending packages that meet the requirements of a company requiring funds in several countries.

(c) The borrower can obtain funds faster and with lower transaction costs.

Disadvantages of syndication

(a) Due to overseas borrowing, the borrower is exposed to the risk of unfavorable change in the currency rates.

(b) If a bank involved in the syndicate loan becomes bankrupt then it might not be able to provide its share of the loan.

(c) The interest charged is sometimes above the spreads available in the bond market.

Test Yourself 7

Which of the following would be regarded as the objective of public sector accounting?

(i) Ascertaining the proprietary of transactions and their conformity with established rules, giving evidence of financial accountability and serving as the basis for planning, controlling, decision making and appraisal of performance
(ii) Evaluating the economy, efficiency and effectiveness with which resources are managed
(iii) Determining how capital expenditure is financed

A (i) only **B**
(ii) only **C**
(iii) only
D (i) (ii) and (iii)

Answers to Test Yourself

Answer to TY 1

The correct option is **D**.

Except Community Based Organisations, all other options are examples of public sector organisations.

Answer to TY 2

The correct option is **D**.

Government entities are basically formed for the welfare of general public and for making available the basic amenities at a reasonable price to the public. They also help in stabilisation of economy and use the scarce resources in a fair manner.

Answer to TY 3

The correct option is **B**.

Answer to TY 4

The correct option is **A.**

Answer to TY 5

Commitment Accounting

The basis of accounting that records anticipated expenditure which has been finally authorized by the management is called **commitment accounting.**

Answer to TY 6

The correct option is **D.**

Except local and foreign investors, all the other options are examples of internal users of public sector accounting.

Answer to TY 7

The correct option is **D.**

Self Examination Questions

Question 1

List any five objectives of public sector accounting.

Question 2

List the three categories of funds used in government accounting and explain them briefly.

Question 3

A basis under which a financial transaction is recorded only when cash is received or paid is known as:

A Modified cash basis
B Modified accrual basis
C Cash basis
D Accrual basis

Answers to Self Examination Questions

Answer to SEQ 1

The general objective of public sector accounting is to provide information useful for decision making, and to demonstrate the accountability of the public sector for resources entrusted to it, and specifically have the following objectives:

1. Providing information about the sources, allocation and use of financial resources
2. Providing information about how the entity financed its activities and met cash requirements
3. Ascertaining legitimacy of transactions and their compliance with government laws, regulations and statutes
4. Providing a basis of decision making to the government
5. Providing information that is useful in evaluating the entity's ability to finance its activities and to meet its liabilities and commitments
6. Providing information about the financial condition of the entity and the changes in it
7. Enhancing the appraisal of the efficiency of management.
8. Highlighting various sources of revenue to the government and also the expenditure to be incurred.

Answer to SEQ 2

The three categories of funds used in government accounting are as follows:

1. Government funds

Government funds are accumulated by the government and used in spending of resources to provide the public with day-to-day basic services. These funds are different from the proprietary and fiduciary funds.

2. Proprietary funds

Proprietary funds are used when the government unit handles its operations in a manner similar to that of the business enterprises. Activities that use appropriators fund accounting and reporting do charge fees for services and focuses on determining the operating income and changes in net assets.

Proprietary funds can be further subdivided into enterprise funds and internal service funds.

3. Fiduciary funds

These are funds used to account for assets held by the government in a trust or agency in a private organisation or other government organisation. This includes trust funds, agency funds, pension funds etc. that may be held in National Health Insurance fund, TASAF etc.

Answer to SEQ 3

The correct option is **C**.

Under cash basis of accounting, financial transaction is recorded only when cash is received or paid.

STUDY GUIDE A2: THE LEGAL FRAMEWORK GOVERNING THE FINANCIAL ACCOUNTING REPORTING IN THE PUBLIC SECTOR

Get Through Intro

Public sector accounting in government departments is a major function that incorporates the accounting and recording of the money received by the government and also the expenditure from the government funds in order to fulfil public duties. The government is the custodian of public money and hence various laws govern the accounting in public sector.

Public sector accounting governed by the various acts and statutes is done by various accounting officers appointed under the Public Finance Act and the Constitution of the United Republic of Tanzania. In the Study Guide, we will understand the nature, scope and objectives of public sector accounting and the legal framework. It will also elaborate on the various officers who account for and facilitate public sector accounting along with their specific roles and hierarchy.

This Study Guide is important from the exam point of view since it lays down the backbone of governmental accounting and teaches you the importance of statutes and laws while accounting for public money.

Learning Outcomes

a) Explain the nature and scope of public sector financial discipline.
b) Explain the legal framework governing the financial accounting and reporting.
c) Describe the main legislative requirements and standards governing the form and contents of public sector accounting.
d) Identify the central and local government financial management hierarchy components.
e) State the roles and responsibilities of central and local government officers as shown in government financial management hierarchy components.

1. Explain the nature and scope of public sector financial discipline.
Explain the legal framework governing the financial accounting and reporting.
[Learning Outcomes a and b]

1.1 Nature and scope of public sector financial discipline

The nature and scope of public sector financial discipline in public enterprises depends largely on the scope and objectives of setting them up.

Public finance is a study of how the public sector enterprises and bodies like the government (regional and national) raises finance in the form of taxes and borrowings from the public and incurs public expenditure with a view to achieving its social and economic objectives.

The main aim of public sector enterprises and bodies like the government: regional and national, includes building and maintaining public welfare structures and schemes. These are carried out by mainly employing public money collected through taxes. Hence the main aim of public sector financial discipline must be to ensure that the public money is safeguarded.

The nature and scope of public sector financial discipline should ideally include the following:

(a) To make sure that public money is used efficiently and effectively in accordance within statutory regulations for the benefit of public.
(b) To aid the function of stewardship. This includes preparing accounting records in a manner that ensures transparency and accountability towards the stakeholders which mainly includes the general public.
(c) To assist the reporting function and appraisal of management efficiency.
(d) To create financial information which will aid in policy formulation.
(e) To facilitate in proper audit of the accounts in order to add credibility to the proper use of public money.
(f) To provide a clear picture of the loans, liabilities and assets of the government and the ability to fulfil long term goals.
(g) Facilitate comparison of budgeted with actual in order to appraise the performance of the government on the use of public money.

Example

The town council of Rwanda needs to employ the public funds it has collected for the construction of public parks and sanitation facilities. The council will have to maintain proper accounts wherein the money collected in form of taxes is recorded and expenses on sanitation and parks are also recorded clearly. This will help the council to have proper records of revenue and expenses and also give an account to the auditors and public at large of the money used for welfare activities as promised.

(a) To ensure economic and financial stability in an economy. Economic stability is the absence of excessive fluctuations in the economy, whereas financial stability can be achieved by efficient allocation of resources by appropriate policy making. For example, an increase in direct taxes will reduce the money available with the people to purchase goods and services and will, in turn, help to reduce inflation. On the other hand, increase in public expenditure during depression helps to increase demand for goods and services, which is otherwise very low during periods of depression.

(b) To ensure optimum utilisation of scarce resources by adopting suitable monetary policies.

(c) To tackle unemployment - for example, the government sets up fiscal policies which increase employment opportunities.

(d) To provide infrastructure like railways, road-ways, improved transportation etc. This kind of capital expenditure, in turn ensures increase in capital formation, which brings about long-term benefits to the public in general.

1.2 Legal framework governing the public sector financial accounting and reporting

Financial reporting in public sector in Tanzania is governed by the Constitution, legislations, national accounting standards and the International Public Sector accounting standards (IPSAS).These standards have been issued by the IASB and are based on the IFRS for use by public sector.

The legal framework for public sector accounting mainly includes the following:

(a) The Constitution – the constitution mainly lays down the foundation for accounting, the books of account to be kept and the authorisation for revenue and expenditure of the federal, state and local governments.

(b) The Public Finance Act, 2004 - this act shall govern the entire operations carried out by the Treasury under the supervision and authority of the accountant general and the controller and auditor general.

(c) The Income Tax Act, 2006.

(d) The Public Procurement Act 2011 – It applies to the extent public finance is used for procurement.

(e) Various other state legislations and acts that support the purpose of protecting public interest and the stewardship function:

i. International Public Sector Accounting Standards (IPSAS)

International Public Sector Accounting Standards (IPSAS) are a set of accounting standards issued by the IPSAS Board (IPSAS Board) for use by public sector entities. IPSAS are broadly based on International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). In this regards public sector entities include national governments, regional governments, local government and related government entities such as agencies boards, commission and enterprise.

While the IPSAS are IAS / IFRS changed to meet the requirements of public sector entities, the IPSAS state that where there is no currently applicable IPSAS, the IAS / IFRS should be looked to for guidance on disclosure on accounting events.

Tip

The Government has adopted both national and international accounting standards for the purpose of facilitating comparability of financial statements prepared, and is accountable to users and the donor community.

ii. Code of ethics for public servants in Tanzania

In order for the public service to be efficient and respected, public servants must behave and conduct themselves in a manner as stipulated below

(a) Respect all human rights and be courteous;
(b) Perform diligently and in a disciplined manner;
(c) Promote team work;
(d) Pursue excellence in service;
(e) Exercise responsibility and good stewardship;
(f) Promote transparency and accountability;
(g) Discharge duties with integrity, and
(h) Maintain political neutrality.

Test Yourself 1

Public sector accounting deals with the accounting of public money. While doing so the purpose of the accounting should be

(i) To make sure that the stewardship function is fulfilled
(ii) To ensure that the auditing of public accounts is assisted
(iii) To ensure that public money is safeguarded and saved properly.

Which of the above statements are correct?

A (i) and (iii)
B (i) and (ii) **C**
(i), (ii),(iii) **D**
(ii) and (iii)

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2. Describe the main legislative requirements and standards governing the form and contents of public sector accounting.

[Learning Outcome c]

The United Republic of Tanzania has developed various acts and statutes that govern the form and contents of public sector accounting. The financial discipline includes the practices adopted by the Government such as rules and regulations which must be adhered to in order to enhance revenue collections and expenditure. The rules and regulations are grouped into laws passed by the National Assembly, financial orders and Treasury accounting circulars, standing orders, staff circulars and internal circulars.

(a) Laws passed by the national assembly

Accounting operation in the public sector is governed by laws passed by the National Assembly; thus no individual or authority has the capacity to contravene the requirement of the laws. Government accounting has to comply with only those laws and with provisions relating to or affecting the collection and expenditure of public funds. Some of these include the Constitution of United Republic of Tanzania of 1977(RE), the Public Finance Act of 2001 RE 2004, the Pension Act, the Severance Act, the Appropriation Act, the Finance Act, the Public Procurement Act etc.

(b) The Public Finance Act

The Public Finance Act, the related legislations and by laws passed from time to time and the Appropriation act are the main legislatives that govern the form and contents of the public sector accounts. The Public Finance Act lays down the foundation of who will prepare the accounts and the frequency of preparation of the accounts to be submitted to the National assembly. The Public Finance Act is one such act that has been passed to provide for effective management, control and regulation of public money collection and use. It lays down various rules for accounting the money collected and recording expenses made under authority of parliament. It basically governs the operations of treasury under the accountant general and the controller and auditor general. It lays down requirements related to nature and control of financial records like payments, receipts and vouching, treasury cash books, need for audit trail etc.

(c) Financial orders and treasury accounting circulars

These are a set of instructions and procedures issued to the public entity in control of public funds by Treasury for the purpose of providing guidance on how to collect, spend and manage the public funds.

(d) Internal circulars

These are issued for the purpose of enhancing the overall control of public resources caused by the nature, location and complexity in areas where the Treasury circular may prove to be inadequate. Accounting officers are allowed to give instructions which they deem appropriate for proper execution and control of Government activities under their responsibility and control.

Example

Continuing the above example of the town council of Rwanda, if the council needs to prepare the financial records to show how tax money was utilised in building public parks and sanitation facilities, then it will have to follow the rules and legal requirements mentioned in the Public Finance Act,2001. The act will guide in recording tax receipts as well as the expenses and payments made for the project. Care will have to be taken in order to record all transactions in such a manner so as to create an audit trail and also to make the information easy to understand by general public in order to aid transparency.

Tip

Refer to Learning Outcome 1 of Study Guide A12 for provisions of law and accounting standards relating to public sector accounting.

Test Yourself 2

Public Sector accounting is governed by rules and regulations. Which of the following does not qualify in the list of rules and regulations governing public sector accounting?

A Laws passed by the National Assembly
B Financial Orders and Treasury accounting circulars
C Standing Orders
D International circulars

Test Yourself 3

The main act governing the accounting and auditing of public sector accounts is

A Constitution of United Republic of Tanzania
B The Finance Act
C Public Finance Act, 2001
D The Severance Act

3. Identify the central and local government financial management hierarchy components. [Learning Outcome d]

3.1 The various hierarchy levels and ranks accorded to officers at these levels

The financial management hierarchy intends to explain the functional relationship between officers or departments of the Government as far as performance is concerned. There are three levels: operational, tactical and strategic. There are different officers working on each of these levels. These are listed and identified as below.

(a) Operational level

The operational level officers will generally work at the local level and collect revenue and issue warrants locally. This level consists of the following:

Warrant is the authority that confers power on the Officer controlling expenditure to incur expenditure.

(i) warrant holders
(ii) sub-warrant holders
(iii) collector of revenue
(iv) sub collector of revenue

Example

At the operational level in a town council the collector of revenue and sub collector of revenue will be responsible for collection of various taxes from establishments and individuals. Hence a warrant holder here is the local level authority in financial management.

(b) Tactical level

This level consists of the following:

(i) accounting officers
(ii) receivers of revenue

Example

At the tactical level the accounting officers and receivers of revenue will be responsible for keeping an account of the tax money received and also record the amount utilised in various public duties of the government.

(c) Strategic level

These are the central government level officers who are the main decision makers and main custodians of the Consolidated Fund account and public money. They decide on the revenue requirements of the public sector / government to be raised from levying taxes. These are to be used for various development projects.
This level consists of the following:

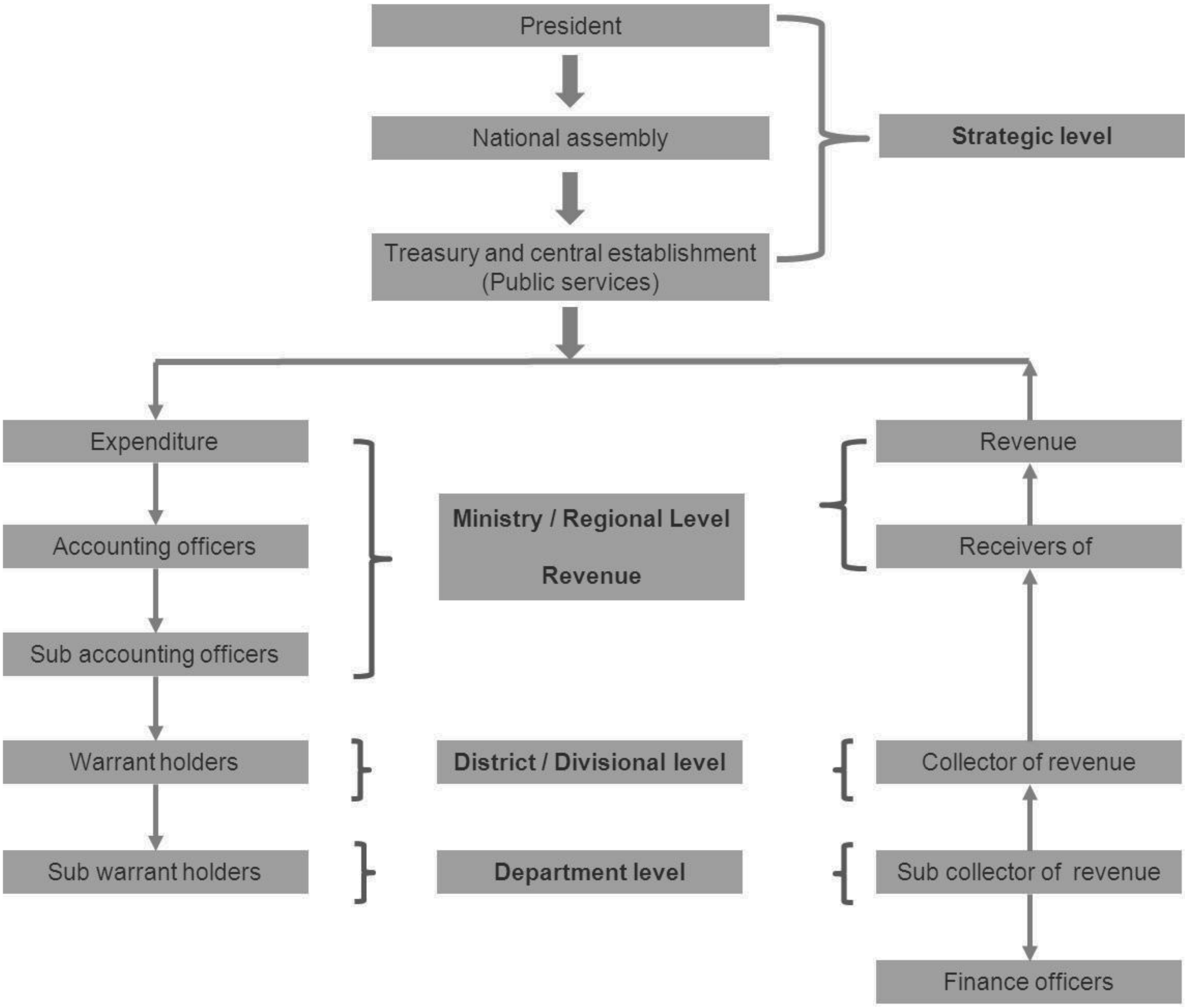
(i) the President of the United Republic of Tanzania
(ii) The Parliament
(iii) The Treasury
(iv) Central establishment

Example

The strategic level management will decide the overall tax structures applicable, the overall requirements of the treasury in order to meet the project costs, the various projects required for public and the capital outlay required and its accounting and auditing procedures.

Management hierarchy can be presented in the following model

Diagram 1: Management hierarchy



1. Strategic / Upper level of Government financial management
2. Technical / middle level of Government financial management
3. Operational / lower level of Governmnt financial management

Test Yourself 4

What do you understand by financial management hierarchy? Briefly explain the three hierarchy levels.

Test Yourself 5

The three levels at which the government financial management hierarchy works. These are strategic, tactical and operational. What are the functions of the strategic level from the following options?

A To decide the treasury requirements for the projects to be completed and inform them to the revenue collectors
B To account for the various tax receipts and the project expenses
C To collect taxes from the public and issue warrants to those who don't pay up
D To record the total revenue from taxes and keep account of receipts on an on-going basis

Example

Which of the following officer / rank belongs to the tactical level?

A Sub collector of revenue
B Warrant holder
C Accounting officer
D Treasurer

---

4. State the roles and responsibilities of central and local government officers as shown in government financial management hierarchy components.
[Learning Outcome e]

The various levels of the governmental financial management hierarchy are entrusted with many different tasks. These tasks are decided according to the level of hierarchy and the responsibilities handled by them. Although the strategic level management is responsible for the overall policy formulation and direction, the lower levels are responsible for monitoring and implementing these policy decisions. Following are the duties and responsibilities starting from the strategic level.

4.1 Strategic level management

(a) The President

(i) The President is an authority for the establishment or abolition of the Government offices and the appointment of certain officers into the public services (Article 36 of the Constitution of URT – United Republic of Tanzania).

(ii) President shall direct the concerned authorities to prepare and submit to the national assembly the estimates of revenue and expenditure for each year.

(iii) The President signs bills to give effect to the Acts like the Finance Act, the Appropriation act etc.

(iv) The President can authorise the withdrawal of funds from the consolidated fund if the Appropriation Act pertaining to a particular year has not come into operation to authorize expenditure has not been in force by the commencement of the year.

(v) The President receives the Audit Report from the Controller and Auditor General (CAG) and presents it to the Parliament as per Article 143(4) of the Constitution of URT and Section 27(2) of the Exchequer and Audit Ordinance.

(b) The national assembly

(i) The National Assembly has the role of authorizing and controlling finance for public expenditure as per the Constitution of URT and the Public Finance Act.

(ii) Approval of the appropriation bill for withdrawal of money from the consolidated fund, where after being signed by the President, it becomes the Appropriation Act.

(iii) Approval of Finance bill that controls revenue from taxes and other non-tax revenue before being signed by the President, which will then be the Finance Act.

(iv) Approval of the write off of all Government losses and investigate all excess unauthorized expenditure.

(v) Deliberation on the report of Controller and Auditor General (CAG) and Annual Reports prepared by Accounting Officers.

(vi) Direct it’s standing committees to receive and discuss the accountability reports and take further action.

(c) The Treasury

(i) Preparing and issuing Financial Regulations and Treasury Circulars

(ii) Supervising the accounts of Federal Government, Ministries and Extra-Ministerial Departments.

(iii) Providing authority to various Government Institutions to open, maintain and operate the bank account.

(iv) Appointing accounting officers and receiver of revenue

(v) Managing the exchequer account

(vi) Formulating accounting principles, policies and control techniques on the day to day administration and control of public funds and other property.

(vii) Designing and approving necessary accounting documents

(viii) Ensuring all revenue is monitored and accounted for

(ix) Servicing public loans and debt.

(x) Managing Government investments

4.2 Tactical level management accounting officers

(a) The accounting officers are responsible:

(i) To ensure that the ministry under his control has proper budgeting and accounting systems in place.

(ii) To aim at eliminating or minimising waste and frauds by having proper management tools in place.

(iii) To ensure that all revenues collected from the public are deposited in the Consolidated Fund account without any delay.

(iv) To submit regular returns and transcripts to the Accountant General of the Federation as required by financial regulations.

(v) To ensure proper safety and maintenance of assets under his custody.

(vi) To respond to all audit queries pertaining to the ministry / extra ministerial departments including appearing before the Public Accounting Committee

(vii) To ensure that the public funds are accurately collected and accounted for.

(viii) To ensure that expenses are prudently accounted for.

(b) Receivers of revenue

The receivers of revenue are responsible for:

(i) Collection of tax revenue from the collectors and sub-collectors of revenue at the village, ward, district and city council levels.

(ii) Ensuring that revenue is promptly deposited in the consolidated fund account

(iii) Facilitating collection of revenue and accounting for it accurately

(iv) Support audit functions by maintaining proper audit trails.

(v) Act as the custodian of public money collected through taxes till it is deposited in the Consolidated Fund Account.

(vi) Support the councils and collectors of revenue in the collection of revenues and provide guidance conforming to the Treasury guidelines.

4.3 Operational Level

(a) Warrant holder

The warrant holders and the sub-warrant holders are responsible for controlling the expenses and accounting function at the council level. They have the following duties:

(i) To have transparent financial and accounting policies in place that are periodically reviewed to check if they are relevant.

(ii) Ensure diligent policy observation and application.

(iii) Institute internal checks through separation of roles in accounting

(iv) To establish budgetary control measures

(v) To cross check book information with physical information

(vi) Have a competent staff and clear job descriptions for staff handling various tasks

(vii) To do strict follow up on audit queries and punish those who are found guilty of misusing funds

(viii) To get reports thoroughly checked by officers responsible for checking them.

(b) Collector of revenue

The main responsibilities of collectors of revenue are:

(i) Collecting cash and cheques from people making payments

(ii) Issuing receipts after verifying the genuineness of the tax bills and authenticating them

(iii) Compiling the cash collected

(iv) Handing over the cash and cheques to the cashier on a daily basis

(v) Prepare daily and weekly collections report and submit it to the assistant accountant

(vi) Issuing authorised online or manual receipts to all tax payers under the approval of the Finance and Administration manager / Managing Director

(vii) Report on cancelled receipts

Test Yourself 7

Which of the following is NOT a function of Treasury Department?

A Preparing and issuing financial regulations and treasury circulars
B To appoint accounting officers and receivers revenue
C Approval of the Appropriation Bill before it is signed by the President
D Servicing public loans and debts

Test Yourself 8

The collector of revenue is required to collect and compile

A All receipts from tax payers
B All cash from tax payers
C All books of account
D All cancelled receipts

Answers to Test Yourself

Answer to TY 1

The correct option is **B**.

Public sector accounting should facilitate the stewardship function by aiding transparency and accountability towards public. It should also help in assisting the audit of accounts by ensuring proper preparation of accounts according to applicable statutes and laws.

Public money is meant to be spent on public welfare activities and for saving it with the government.

Answer to TY 2

The correct option is **D**.

Answer to TY 3

The correct option is **C**.

The Public Finance Act governs the accounting and reporting requirements in the public sector since its inception in 2001.

Answer to TY 4

These are levels used to explain the functional relationship between the officers or department in as far as fund management is concerned. The levels include strategic, tactical and operational levels.

Strategic level – At the strategic level the President, the Treasury and the National Assembly officers mainly device the tax structures, pass the Appropriation act, the Finance Act and other circulars to facilitate the revenue and expenditure from the Consolidated Fund.

Tactical level – these officers mainly consisting of accounting officers and receivers of revenue are responsible for accounting the revenue and expenses from the Consolidated fund and to receive the money from taxes and other contributions.

Operational level – the warrant holders and sub-collectors of revenue are responsible for collection of taxes at the local level.

Answer to TY 5

The correct option is **A**.

The strategic level decides the overall treasury requirements from taxes collected for use in various developmental projects of the public sector / government.

Answer to TY 6

The correct option is **C**.

Options A and C are operational levels and treasurer works at the strategic level.

Answer to TY 7

The correct option is **C**.

Approval of the Appropriation Bill is the work of the National Assembly.

Answer to TY 8

The correct option is **A**.

The collector of revenue is required to collect all cash from tax payers on a daily basis.

Self Examination Questions

Question 1

Describe the duties and functions of the following officials as regards to finance and financial control of the public:

(a) the President of United Republic of Tanzania
(b) Treasury
(c) National Assembly

Answers to Self Examination Questions

Answer to SEQ 1

The main duties and functions of the president, Treasury and the National Assembly are as follows.

(a) The president of the United republic of Tanzania

(i) The appointment and abolition of government offices and the appointment of officers in public service.

(ii) To direct the National assembly to prepare and submit the estimates of revenue and expenditure for each year.

(iii) To receive reports from the CAG and present them to the parliament.

(iv) To authorise expenditure from the Consolidated fund in absence of the operation of the Appropriation Act.

(v) To sign bills and give effect to various acts like Public Finance Act etc.

(b) Treasury

(i) Preparing and issuing Financial Regulations and Treasury Circulars

(ii) Supervising the accounts of Federal Government, Ministries and Extra-Ministerial Departments.

(iii) Providing authority to various Government Institutions to open, maintain and operate the bank account.

(iv) Appointing accounting officers and receiver of revenue

(v) Managing the exchequer account

(vi) Formulating accounting principles, policies and control techniques on the day to day administration and control of public funds and other property.

(vii) Designing and approving necessary accounting documents

(viii) Ensuring all revenue is monitored and accounted for

(ix) Servicing public loans and debt.

(x) Managing Government investments

(c) The National Assembly

(i) To authorise and control finance for public expenditure in accordance with the Constitution of the United republic of Tanzania and the Public Finance Act.

(ii) To approve the Appropriation bill and the finance bill before it is signed by the President.

(iii) Approval of government losses and investigation into those losses and also the excess unauthorised expenses.

(iv) Deliberation on the CAG reports and annual reports prepared by the accounting officers.

(v) Direct standing committees to receive and discuss accountability reports and take further action.

SECTION A

ACCOUNTING FOR PUBLIC SECTOR

A3

STUDY GUIDE A3: BASES OF PUBLIC SECTOR ACCOUNTING AND REPORTING

Get Through Intro

Tanzania has adopted the international public sector accounting standards from 2013. By virtue of this fact, the preparation of public sector financial statements will be governed by IPSAS. This has given the country credibility on reporting systems among users as the standards will facilitate comparability between different years and against other nations.

This Study Guide will explain the various basis of accounting available for public sector entities. Knowledge of this Study Guide will not just help you pass the exam, but also in your career as an accountant or an auditor in a public sector enterprise.

Learning Outcomes

a) Identify basis of accounting in public sector entities.
b) Explain cash basis of accounting – Cash IPSASs.
c) Explain accrual basis of accounting – Accrual IPSASs.
d) Explain accounting models and accounting standards.
e) Explain the commitment accounting concept.
f) Explain the importance and applicability of commitment accounting in public sector.

1. Identify basis of accounting in public sector entities.
Explain cash basis of accounting – cash IPSASs.
Explain accrual basis of accounting – accrual IPSASs.

[Learning Outcomes a, b and c]

1.1 International Public Sector Accounting Standards (IPSAS)

International Public Sector Accounting Standards (IPSAS) are a set of accounting standards issued by the IPSAS Board (IPSAS Board) for use by public sector entities. IPSAS are broadly based on International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). In this regards public sector entities include national governments, regional governments, local government and related government entities such as agencies boards, commission and enterprise.

The use of IPSAS also ensures that financial statements are comparable for organisations that adopt them. The application of the IPSAS gives bodies incorporated under public law greater significance through comparability with general and internationally recognised regulations for submitting accounts. This facilitates dealing financiers and simplifies communication with the general public. Though IPSAS Board has no power to compel countries to adopt the IPSAS standard, the standards play a vital role in the accounting of national public sector of various countries. Many countries, including Tanzania have already introduced IPSAS to account for government accounts.

When preparing general purpose financial statements on an international level, the standards and framework applicable are the IAS / IFRS, in the case of private sector entities, and the International Public Sector Accounting Standards (IPSAS), in the case of public sector entities.

While the IPSAS are IAS / IFRS changed to meet the requirements of public sector entities, the IPSAS state that where there is no currently applicable IPSAS, the IAS / IFRS should be looked to for guidance on disclosure on accounting events.

The framework for preparation of financial statements under IPSASs recognises two governmental accounting systems which include cash basis of accounting and accrual basis of accounting. These two bases of accounting are explained in detailed in the subsequent Learning Outcomes of this Study Guide.

1.2 Cash basis of accounting – Cash IPSASs

Definition

Cash basis means a basis of accounting under which a transaction and other events are recognized when cash and cash equivalent is received or paid.

Cash Basis IPSAS

Under cash basis IPSAS the transactions and other events in the accounting records are recognised in the financial statements only if cash is received or paid.

Under cash basis of accounting, expenses are recorded when expenses are actually paid and revenue is recorded when cash is actually received. The primary focus is on the amount of cash in the bank, and the secondary focus is on making sure all bills are paid. Little effort is made to match revenues to the time period in which they are earned, or to match expenses to the time period in which they are incurred.

Under the cash basis of accounting movement of cash is used as the basis of recognising income and expenses in the financial statements.

Under the cash basis of accounting:

An income is recognised once cash is received, irrespective whether goods or services have been supplied or not.

An expense is recognised once the payment is made, whether benefit has been received or not.

In other words, income is recognised as it is received in the form of cash and expenditure is recognised as money is paid. The treatment of capital is also same and is dependent on receipt or payment of cash. Therefore purchase of fixed assets is not treated as a capital expenditure items under cash basis of accounting. They are written off as revenue expenditure in the years of purchase.

Financial statement under cash basis IPSAS

Under the cash basis, an entity should prepare and present general purpose financial statements which include the following components:

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

(i) recognises all cash receipts, cash payments and cash balances controlled by the entity; and
(ii) separately identifies payments made by third parties on behalf of the entity

(b) accounting policies and explanatory notes; and

(c) when the entity makes publicly available it's approved budget, a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the statement of cash receipts and payments in accordance with this Standard.

When an entity elects to disclose information prepared on a different basis from the cash basis of accounting as defined in this Standard such information should be disclosed in the notes to the financial statements.

Advantages of cash basis of accounting

The advantages of this basis include the following:

(a) It is simple to understand and eliminates the accrual entries at the year-end.

(b) It eliminates existence of accruals and prepayments

(c) It permits easy identification of those who authorise payments and collect revenue.

(d) It allows for comparison between the amount provided in the budget and that actually spent.

(e) It saves time and is easy to operate.

(f) The cost of fixed assets is expensed off in the year of purchase, resulting in fewer accounting entries.

Disadvantages of cash basis

The disadvantages of this basis include the following:

(a) No depreciation is provided for fixed assets as the entire amount is written off in the year of purchase.

(b) The financial statements will not give a true and fair picture as the accrual principle has not been followed.

(c) As the cash basis does not give information regarding trade payables, receivables and fixed assets, important decisions cannot be taken using cash basis financial statements.

(d) The principle of matching concept is also violated using cash basis of accounting.

(e) The financial statements will not give information regarding the liabilities as they are accounted only on settlement basis. Therefore the net worth of the entity is difficult to estimate.

1.3 Accrual basis of accounting – Accrual IPSASs

Definition

Accrual accounting requires transactions to be recognised as the underlying economic events occur, regardless of the timing of the related cash receipts and payments.

Accrual basis means a basis of accounting under which transactions and other events are recognised when they occur and not when cash and cash equivalent is received or paid. Therefore the transactions and events in the accounting records and recognised in the financial statements of the periods to which they relate.

Applying the accrual basis of accounting revenues are recognised when income is earned, and expenses are recognized when liabilities are incurred or resources consumed. This is different from the cash-accounting basis of accounting under which revenues and expenditures are recognised when cash is received and paid respectively.

Accrual basis of accounting under the public sector would involve recording transaction on the basis of their accrual and preparing financial statements using the underlying assumption of accrual basis.

Example

Nachingwea city council had the following transactions during the period ended 31 March 2013:

(i) Received Tshs10 million on 20 Feb 2013 from Korosho Company for completing a project which will be completed in two years' time.
(ii) Paid Tanesco for electricity bill, a total of Tshs5.6 million on 15 March 2013 out of which Tshs800,000 relates to electricity prepayment for the coming year, i.e. 2014.

Required:

Calculate how much should be treated as revenue or expenses under both cash and accrual basis.

Answer

Cash basis

(i) Entire Tshs10 million will be recognised as revenue in the year ended 31 March 2013.
(ii) Entire Tshs5.6 million will be recognised as expense in the year ended 31 March 2013.

Accrual basis

(i) Tshs10 million will be recognised as revenue over a two year period on the basis of percentage of completion of contract.

(ii) Tshs4.8 million will be recognised for the year ended 31 March 2013 and Tshs800,000 will be shown as pre-payment. Tshs800,000 will then be recognised as an expense for the year ended 31 March 2014.

Advantages of Accrual Basis

(a) It takes a realistic view of financial transactions as transactions are recorded on an accrual basis.

(b) Financial statements reveal an accurate picture of the state of financial affairs at the end of the period.

(c) It could be used for decision-making as all parameters for performance appraisal are available.

(d) It is in line with the matching concept as all the expenses and income pertaining to the period is recorded.

(e) It records fixed assets when they are purchased and makes allowances for the diminution in the value of assets used to generate the revenue of the enterprise.

Disadvantages of Accrual Basis

(a) It is difficult to understand, especially by the non-accountants.

(b) It involves lot of year-end entries for recording accruals.

Test Yourself 1

Explain the advantages of using cash basis of accounting.

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2. Explain accounting models and accounting standards.

[Learning Outcome d]

2.1 What are Accounting Standards?

Definition

An accounting standard is a guideline for financial accounting, i.e. how a firm prepares and presents its business income and expense, as well as its assets and liabilities.

In other words, accounting standards prescribe accounting principles to be applied in preparation of the financial statements. Generally, a principle is a fundamental truth that is always accepted. However in accounting, principles relate to an accepted guidance or method. In Study Guide A1, we have seen that that there are various internal and external users of accounting data who are interested in the financial statements of the organisation. If there is no uniformity in the principles followed by different organisations in preparation of financial statements, nobody will be in a position to interpret the financial statements and draw any conclusions. To overcome this difficulty, certain standard principles for preparation of financial statements are given. In accounting terminology we use the words "International Public Accounting Standards", "International Accounting Standards (IAS), International Financial Reporting Standards (IFRS) or Generally Accepted Accounting Practices (GAAP)" instead of 'Principles'.

In case of public sector organisations, we will limit our discussion to International Public Accounting Standards (IPSAS).

2.2 IPSAS

The International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants focuses on the accounting, auditing, and financial reporting needs of national, regional, and local governments, related governmental entities, and the constituencies they serve.

IPSASB has currently issued 32 accrual-based standards and one comprehensive cash-based standard on accounting for public sector entities. All standards are principally published in English. The IPSAS aim to improve the quality and transparency of public sector financial reporting as well to enhance governments' financial management capabilities.

The IPSASB is developing standards based on the IFRS/IAS issued by the IASB. IPSAS are modelled around the International Financial Reporting Standards (IFRS.) The use of IPSAS also ensures that nancial statements are comparable for organisations that adopt them. The application of the IPSAS gives bodies incorporated under public law greater significance through comparability with general and internationally recognised regulations for submitting accounts. This facilitates dealing financiers and simplifies communication with the general public

The following is a list of IPSAS issued till date. These are given for reference purposes and need not be memorised.

	Accrual based IPSAS
IPSAS 1	Presentation of Financial Statements
IPSAS 2	Cash Flow Statements
IPSAS 3	Net Surplus or Deficit for the Period – Fundamental Errors and Changing in Accounting Policies
IPSAS 4	The Effects of changes in Foreign Exchange Rates
IPSAS 5	Borrowing Costs
IPSAS 6	Consolidated Financial Statements – Accounting for Controlled Entities
IPSAS 7	Accounting for Investments in Associates
IPSAS 8	Financial Reporting of Interests in Joint Ventures
IPSAS 9	Revenue from Exchange Transactions
IPSAS 10	Financial Reporting in Hyperinflationary Economies
IPSAS 11	Construction Contracts
IPSAS 12	Inventories

IPSAS 13	Leases
IPSAS 14	Events after the Reporting Date
IPSAS 15	Financial Instruments: Disclosure and Presentation
IPSAS 16	Investment Property
IPSAS 17	Property, Plant and Equipment
IPSAS 18	Segment Reporting
IPSAS 19	Provisions, Contingent Liabilities, Contingent Assets
IPSAS 20	Related Party Disclosures
IPSAS 21	Impairment of Non-cash-generating Assets
IPSAS 22	Disclosure of Financial Information About the General Government Sector
IPSAS 23	Revenue from Non-Exchange Transactions (Taxes and Transfers)
IPSAS 24	Presentation of Budget Information in Financial Statements
IPSAS 25	Employee Benefits
IPSAS 26	Impairment of Cash-Generating Assets
IPSAS 27	Agriculture
IPSAS 28	Financial Instruments: Presentation
IPSAS 29	Financial Instruments: Recognition and Measurement
IPSAS 30	Financial Instruments: Disclosures
IPSAS 31	Intangible Assets
IPSAS 32	Service Concession Arrangements: Grantor
	Cash based IPSAS
Cash Basis IPSAS	Part 1: Financial Reporting Under the Cash Basis of Accounting Part 2: Encouraged Additional Disclosures

2.3 Accounting models

Definition

Accounting models are a set of basic assumptions, concepts, principles and procedures that determine the methods of recognising, recording, measuring and reporting of the entity's financial information transactions.

There are various models of accounting under which the financial statements can be prepared. Some of the popular models of accounting include:

Cash basis Accounting
Accrual basis accounting
Commitment basis accounting

These models of accounting have already been discussed in detail throughout this Study Guide.

Test Yourself 2

The accounting standards applicable for public sector entities are known as:

A IPSAS
B IFRS
C IAS
D INT AS

3. Explain the commitment accounting concept.
Explain the importance and applicability of commitment accounting in public sector.
[Learning Outcomes e and f]

3.1 Commitment accounting concept

Government accounting is different from private sector accounting. The private sector focuses primarily on the bottom-line which is profit, unlike public sector where the bottom line is a budget framed for an activity. The budget represents the legal embodiment of government policy.

Definition

Commitment accounting is the process of earmarking or setting aside funds in response to a purchase requisition. These funds remain committed (encumbered) until the purchased good or service is paid for, after its receipt, thereby converting the encumbrance into expenditure.

Under commitment basis of accounting the methodology adopted is to recognise expenses as soon as decisions related to expenditure are taken. As soon as a decision is taken for the acquisition of a service or goods, accounting records begin and cash is set aside to pay for such cost. Under this basis of accounting, financial transactions are booked as soon as commitments are made. This is different from cash basis where accounting is done when there is movement of cash in a transaction and also different from accrual basis where transactions are recorded based on documentary evidence. It also is referred to as encumbrance accounting as cash is set aside for the budgeted expense.

Example

ABN ammunition a government entity is planning to acquire some assets. They have raised the purchase order to procure the assets. Under commitments basis of accounting, accounting entries are made to reserve money for the items being procured. In this case, the purchase order does not bring about any legal obligation. However an encumbrance entry is made, reserving the necessary amount of money for the order.

Under the commitment basis of accounting, expected expenditures recorded in the accounting system as commitments. Authorised expenditure (budget) is reduced by commitments which have not been liquidated (i.e. not been followed by a cash payment). However, when the cash payment occurs, the sum committed is extinguished

Important

The available budget for spending is often referred to as the "free balance" where:

Free balance = budget – (commitments + obligations + actuals)

Terminology difference

Under commitment accounting, the terminology of commitment may differ from government to government. Generally commitment accounting happens in two steps:

First step: Commitment can occur at the purchase requisition stage where certain money is set aside from the budget to begin the purchasing cycle. This is known as a "commitment", "pre-commitment", "soft commitment" or "pre-encumbrance". At this step no legal obligation is created on the government to pay.

Second step: Some governments do not track soft commitments. In the second step is when the purchase order or contract is provided to a vendor, a legal obligation is created and is termed a "commitment", "hard commitment", "obligation" or "encumbrance" depending on the government. Some governments do not consider a purchase order to be a legal obligation and only obligate when goods/services have been received.

3.2 Importance and applicability of commitment accounting in public sector

(a) Where the financial system cannot generate the accrual, an accounting system on basis of commitments is more useful. This might mean that the budgetary control report will include additional columns to show the value of budget committed by the budget holder.

(b) Commitment accounting is seen as an aid to financial control, as once charged on budget provision; it updates the available resource on the budget line. The comparison of spending plus the committed budget with the available budget is more meaningful and the remainder budget for the year can easily be determined.

(c) Helps in planning for the future costs.

(d) Predicting budget variances to speed up or slow down spending to meet government objectives.

(e) Adjustment made on expenditure when commitment has been done does not affect the final accounts.

(f) It is in alignment with the accounting matching principle.

(g) It takes the realistic view of the financial transactions and ensures that the funds are available for any expenditure which is planned.

Test Yourself 3

Explain in brief the concept of commitment accounting.

Answers to Test Yourself

Answer to TY 1

The advantages of this basis include the following:

(a) It is simple to understand and eliminates the accrual entries at the year-end.

(b) It eliminates existence of accruals and prepayments

(c) It permits easy identification of those who authorise payments and collect revenue.

(d) It allows for comparison between the amount provided in the budget and that actually spent.

(e) It saves time and is easy to operate.

(f) The cost of fixed assets is expensed off in the year of purchase, resulting in fewer accounting entries.

Answer to TY 2

The correct option is A.

In case of public sector financial reporting is done by applying the International Public Accounting Standards (IPSAS).

Answer to TY 3

Commitment accounting is the process of earmarking or setting aside funds in response to a purchase requisition that is raised.

The funds which are earmarked remain committed (encumbered) until the purchased good or service is paid for, after its receipt, thereby converting the encumbrance into expenditure.

Under commitment basis of accounting the methodology adopted is to recognise expenses as soon as decisions related to expenditure are taken. As soon as a decision is taken for the acquisition of a service or goods, accounting records begin and cash is set aside to pay for such cost.

Self Examination Questions

Question 1

Explain the importance of commitment accounting.

Question 2

Which of the following assumptions is not applicable under public sector accounting?

A Going concern
B Cash basis
C Accrual Basis
D Net realisable basis

Answers to Self Examination Questions

Answer to SEQ 1

Importance of commitment accounting

The importance of commitment accounting includes the following:

(a) Where the financial system cannot generate the accrual, an accounting system on basis of commitments is more useful. This might mean that the budgetary control report will include additional columns to show the value of budget committed by the budget holder.

(b) Commitment accounting is seen as an aid to financial control, as once charged on budget provision; it updates the available resource on the budget line. The comparison of spending plus the committed budget with the available budget is more meaningful and the remainder budget for the year can easily be determined.

(c) Helps in planning for the future costs.

(d) Predicting budget variances to speed up or slow down spending to meet government objectives.

(e) Adjustment made on expenditure when commitment has been done does not affect the final accounts.

(f) It is in alignment with the accounting matching principle.

(g) It takes the realistic view of the financial transactions and ensures that the funds are available for any expenditure which is planned.

Answer to SEQ 2

The correct option is **D**.

Net realisable basis is not an example of an assumptions applied under public sector accounting.

STUDY GUIDE A4: FULL ACCRUAL FINANCIAL REPORTING UNDER IPSAS

Get Through Intro

IPSASB develops the accrual IPSAS that are converged with the International Financial Reporting Standards (IFRSs) issued by International Accounting Standard Board (IASB) by adopting them to the public sector when appropriate. Therefore many accrual based IPSASs are based on IFRSs, the IASB's framework for preparation and Presentation of Financial Statements.

This Study Guide explains the adoption, functionality and applicability of IPSASs along with the challenges faced in their adoption.

Knowledge of this Study Guide will give you a very good insight into the practical difficulties faced while adopting IPSAS, which in turn will help in your career after you qualify.

Learning Outcomes

a) Explain the adoption of IPSASs in Tanzania
   i. Relevance and applicability
   ii. Implementation
   iii. Adoption through national standards
   iv. Cash basis standards as a stepping stone.
b) Explain the functionality and applicability of IPSASs
   i. Recognition, measurement, disclosure and de-recognition.
c) Discuss the challenges and the way forward for adoption of IPSASs in Tanzania.

1. Explain the adoption of IPSASs in Tanzania
   i. Relevance and applicability
   ii. Implementation
   iii. Adoption through national standards
   iv. Cash basis standards as a stepping stone.

[Learning Outcome a]

1.1 Overview of current status of adoption of IPSASs in Tanzania

International Public Sector Accounting Standards (IPSAS) are accounting standards issued by IPSASB for application by national governments, regional governments (e.g., state, provincial, territorial), local governments (e.g., city, town) and related governmental entities (e.g., agencies, boards and commissions). IPSAS standards are widely used by inter-governmental organisations. IPSAS do not apply to government business enterprises.

The Central Government, Tanzania, under the Accountant General (ACCGEN) has migrated to accrual based IPSAS for the year ended 30 June 2013. That means the Government financial statements are prepared on the accrual basis. It is on the basis of such decision external audit of the financial statements for that period is conducted on the same basis.

Important

The plan of the Government of Tanzania is to be able to consolidate the local Government authorities and Government Business Enterprises (GBE) from the year 2015. Currently, the transitional provisions of IPSAS 17, IPSAS 23 and IPSAS 31 have all been adopted.

Adoption of IPSAS will facilitate the convergence of international standards and national standards thereby enhancing the quality and uniformity of financial reporting throughout the central and local Government and independent departments.

1.2 Cash basis as a stepping stone to accrual basis IPSAS

The cash basis IPSAS encourage an entity to voluntarily disclose accrual based information to enable users to be more informed, despite the fact that its financial statements will be prepared under cash basis. When an entity migrates from cash basis to accrual accounting, it will be required to include particular accrual based disclosures during this process. The status and credibility (audited or unaudited) will depend on the characteristics of information if faithfully presented, relevant, understandable, comparable etc. and any other legislations governing financial reporting within the jurisdiction.

It is on the basis of this encouragement to disclose accrual based information, cash basis IPSAS are seen as the corner stone of adoption of accrual basis.

Students are advised to refer Study Guide A3 to understand in detail the cash basis of accounting under IPSAS.

1.3 Relevance, applicability and implementation of IPSAS

The relevance, applicability and implementation of IPSAS are discussed in detail in Study Guide A3.

Test Yourself 1

IPSAS do not apply to:

A Local government
B National Government
C Regional government
D Government Business Enterprises

2. Explain the functionality and applicability of IPSASs
i. Recognition, measurement, disclosure and de-recognition.
[Learning Outcome b]

2.1 Recognition of the elements of financial statements

Definition

Recognition is the process of incorporating in the statement of financial position or income statement an item that meets the definition of an element and satisfies the criteria for recognition. It involves the depiction of the item in words and by a monetary amount and the inclusion of that amount in the statement of financial position or income statement.

The following are the elements of financial statements under the IPSAS:

1. **Asset:** An asset is a resource, with the ability to provide an inflow of service potential or economic benefits that an entity presently controls, and which arises from a past event.

2. **Liability:** A liability is a present obligation that arises from a past event where there is little or no realistic alternative to avoid an outflow of service potential or economic benefits from the entity

3. **Revenue:** Revenue is:

(a) Inflows during the current reporting period, which increase the net assets of an entity, other than:

Ownership contributions; and
Increases in deferred inflows; and

(b) Inflows during the current reporting period that result from decreases in deferred inflows

4. **Expenses:** Expenses are:

(a) Outflows during the current reporting period which decreases the net assets of an entity, other than:

Ownership distributions; and
Increases in deferred outflows; and

(b) Outflows during the current reporting period that result from decreases in deferred outflows.

5. **Deferred inflow:** A deferred inflow is an inflow of service potential or economic benefits provided to the entity for use in a specified future reporting period that results from a non-exchange transaction and increases net assets.

6. **Deferred outflow:** A deferred outflow is an outflow of service potential or economic benefits provided to another entity or party for use in a specified future reporting period that results from a non-exchange transaction and decreases net assets.

7. **Net assets:** Net assets is the difference between assets and liabilities.

Recognition criteria

Items that satisfy the recognition criteria should be recognised in the statement of financial position or income statement. The failure to recognise such items is not rectified by disclosure of the accounting policies used nor by notes or explanatory material.

An item that meets the definition of an element discussed above should be recognised if:

(i) it is probable that any future economic benefit associated with the item will flow to or from the entity or there is a service potential flowing from the underlying resource; and

(ii) the item has a cost or value that can be measured reliably.

In assessing whether an item meets these criteria and therefore qualifies for recognition in the financial statements, regard needs to be given to the materiality considerations. Let us understand the above two points in detail below:

(i) Probability of future economic benefit

The concept of probability is used in the recognition criteria to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the entity. The concept is in keeping with the uncertainty that characterises the environment in which an entity operates. Assessments of the degree of uncertainty attached to the flow of future economic benefits are made on the basis of the evidence available when the financial statements are prepared.

Example

When it is probable that a receivable owed to an entity will be paid, it is then justifiable, in the absence of any evidence to the contrary, to recognise the receivable as an asset. For a large population of receivables, however, some degree of non-payment is normally considered probable; hence an expense representing the expected reduction in economic benefits is recognised.

(ii) Reliability of measurement

The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability. In many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When, however, a reasonable estimate cannot be made, the item is not recognised in the statement of financial position or income statement.

Example

The expected proceeds from a lawsuit may meet the definitions of both an asset and income as well as the probability criterion for recognition; however, if it is not possible for the claim to be measured reliably, it should not be recognised as an asset or as income. The existence of the claim, however, would be disclosed in the notes, explanatory material or supplementary schedules.

2.2 Measurement of the elements of financial statements

Definition

Measurement is the process of determining the monetary amounts at which the elements of financial statements are to be recognised and carried in the statement of financial position and income statement. This involves selection of the particular basis of measurement.

A number of different measurement bases are employed to different degrees and in varying combinations in the financial statements. They Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities - Exposure Draft 3 prescribe the following measurement basis for measurement of assets and liabilities:

(i) Historical cost

Under this measurement base, assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

(ii) Market value (fair value model)

The fair value measurement base is the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction at the reporting date. At acquisition market value and historical cost will be the same, if transaction costs are ignored. Market value is particularly appropriate where the asset is being held for sale and where it is judged that the difference between entry and exit values is unlikely to be significant.

(iii) Replacement costs

A replacement cost is the most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date. Replacement cost is the cost of replacing an asset's service potential.

Service potential means the capacity to provide goods and services in accordance with the entity's objectives, whether those objectives are the generation of net cash inflows or the provision of goods and services of a particular volume, quantity and quality to beneficiaries thereof. In the public sector, the concept of service potential takes the place of the test of adequate profitability applied in the private sector.

Example

For example, if an entity owns a school that accommodates 500 pupils but, because of demographic changes since its construction, a school for 100 pupils would be adequate for current and reasonably foreseeable requirements, the replacement cost of the asset is that of a school for 100 pupils.

(iv) Net selling price

Net selling price is defined as the amount that the entity can obtain from sale of the asset at the reporting date, after deducting the costs of sale.

The potential usefulness of net selling price is that an asset cannot be worth less to the entity than the amount it could obtain on sale of the asset. However, it is not appropriate if the entity is able to use its resources more efficiently by employing the asset in another way, for example by using it in the delivery of services. Net selling price is therefore useful where the most resource-efficient course available to the entity is to sell the asset. This is the case where the asset cannot provide service potential or economic benefits at least as valuable as net selling price

(v) Value in use

Value in use is defined as the present value at the reporting date to the entity of the asset's remaining service potential or economic benefits if it continues to be used, and of the net amount that the entity will receive from its disposal at the end of its useful life.

Value in use is appropriate where it is less than replacement cost and greater than net selling price. This occurs where an asset is not worth replacing, but the value of its economic benefits or service potential is greater than its net selling price. In such circumstances value in use represents the value of the asset to the entity. Value in use is an appropriate measurement basis for the assessment of impairments, because it is used in the determination of the recoverable amount for an asset or group of assets.

(vi) Cost of release

"Cost of release" is the term used in the context of liabilities to refer to the same concept as "net selling price" in the context of assets. Cost of release refers to the amount that relates to an immediate exit from the obligation. Cost of release is the amount that either:

- the creditor will accept in settlement of its claim, or

- a third party would charge to accept the transfer of the liability from the obligor.

Where there is more than one way of securing release from the liability, the cost of release is that of the lowest amount.

This is consistent with the approach for assets where net selling price would not reflect the amount that would be received on sale to a scrap dealer, if a higher price could be obtained from sale to a purchaser who would use the asset.

(vii)Cost of fulfilment

This measurement base is used to measure liabilities. Cost of fulfilment is the current value of fulfilling the obligations represented by the liability. Where the obligation is financial, fulfilment will be making the required payments; where the obligation is to provide goods or services, fulfilment consists of providing those goods or services.

(viii) Assumption price

“Assumption price” is the term used in the context of liabilities to refer to the same concept as “replacement cost” in the context of assets. Just as replacement cost represents the amount that an entity would rationally pay to acquire an asset, so assumption price is the amount which the entity would rationally be willing to accept in exchange for assuming an existing liability. Exchange transactions carried out on arms-length terms will provide evidence of assumption price; this is not the case for non-exchange transactions.

2.3 Disclosure

A first-time adopter of IPSAS shall provide information on the progress made towards recognising, measuring, presenting and/or disclosing assets, liabilities revenue and/or expenses in accordance with the requirements of the applicable IPSAS, and an indication of how and by when it intends to comply in full with the requirements of the applicable IPSAS. This disclosure will assist users to track the progress of the first-time adopter in confirming its accounting policies to the requirements in the applicable IPSASs during the period of transition.

A first-time adopter shall disclose:

(a) The date of adoption of IPSASs; and

(b) Information and explanations about how the transition from the previous basis of accounting to IPSASs affected its reported financial position, and, where appropriate, its reported financial performance and cash flows.

A first-time adopter shall present in the notes to its transitional IPSAS financial statements or its first IPSAS financial statements:

(i) A reconciliation of its net assets/equity reported in accordance with its previous basis of accounting to its opening balance of net assets/equity at the date of adoption of IPSASs; and

(ii) A reconciliation of its surplus or deficit in accordance with its previous basis of accounting to its opening balance of surplus or deficit at the date of adoption of IPSASs

The above disclosures pertain specifically to the first time adopter. Later on when the financial statements are published each year, the public sector entities will have to comply with the disclosure requirements of respective IPSAS in preparation and presentation of its financial statements.

Recognition criteria and their relationship to disclosure

Recognition involves an assessment of existence uncertainty and measurement uncertainty. The conditions that give rise to uncertainty can change. Therefore it is important that uncertainty is assessed at each reporting date.

The failure to recognize items that meet the definition of an element and the recognition criteria is not rectified by the disclosure of accounting policies, notes or other explanatory detail. However disclosure can provide information on items that meet many, but not all the essential characteristics of the definition of an element. Disclosure can also provide information on items that meet the definition of an element but cannot be measured in a manner that is sufficiently representationally faithful to meet the objectives of financial reporting. Disclosure is appropriate when knowledge of the item is considered to be relevant to the evaluation of the net financial position of the entity and therefore meets the objectives of financial reporting

2.4 De-recognition

An item that possesses the essential characteristics of an element but fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes, explanatory material or in supplementary schedules. This is appropriate when knowledge of the item is considered to be relevant to the evaluation of the financial position, performance and changes in financial position of an entity by the users of financial statements.

The de-recognition criteria generally incorporate the public sector concept of service potential.

Guidance on the de-recognition of assets and liabilities have been included specifically for de-recognition when:

The asset or liability has been eliminated and

The criteria for recognition of assets and liabilities discussed in Para 2.1 above is no longer met.

Test Yourself 2

__________relates to the amount that relates to an immediate exit from the obligation.

A Cost of release
B Value in use
C Net selling price
D Cost of fulfilment

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3. Discuss the challenges and the way forward for adoption of IPSASs in Tanzania. [Learning Outcome c]

The challenges and the way forward for adoption of accrual based IPSASs in Tanzania

Tanzania, being a developing country, faces a number of challenges in the course of adopting the accrual based accounting system. The Government has to put in strategies before it starts complying with the IPSAS. These challenges include the following:

(a) Accrual accounting information is more difficult and more costly to produce and to use, than cash-based accounting information.

(b) Part of the cost of using accrual-based data is the cost of understanding it. Accrual-based data cannot be easily understood by non-accountants.

(c) The adoption of full accrual accounting is more complex and more costly than the simple cash basis. Asset valuation is an example of complexity and cost; therefore, modifying cash-based systems to produce accrual-type data may make sense.

(d) Less developed countries like Tanzania usually lack accounting skills, and therefore have only few trained people who can either produce complex accounting information or use it. Training will also need to be imparted to various groups such as PAC, Chief Accountants, Accountants, Heads of Sub Treasuries, Financial statement's preparers, Accounts Officer, etc.

(e) The accounting systems of many developing countries suffer from a range of serious defects even though they employ the simplest accounting basis (cash). There may be higher priorities for the use of scarce accounting resources.

(f) In completing the process of adopting IPSAS the Tanzania Government will need cooperation from various stakeholders in order to fulfil this mission.

(g) The adoption of IPSAS is also dependant on availability of proper records. Poor documentation and record keeping is another challenge faced in adoption of IPSAS.

(h) The adoption of IPSAS requires the government to approve budgets which involve huge costs in training accountants and stakeholders, costs involved in amending laws, preparation of accounting manuals and policies to suit the environment and strengthening computer systems to accommodate the changes.

Way forward to help IPSAS migration smoothly

The key decision makers such as the presidency, cabinet and parliamentary committees should support adoption of IPSAS.

The capital markets and securities authorities should ensure that the government agencies and bodies are applying the rules on submission and compliance as required.

The National Boards of Accountants and Auditors is the main body in Tanzania which ensures standard adoption and development. They should be supported by Government and other regulatory bodies in discharging this difficult task. Their experience in adoption of IFRS will immensely help in adoption of IPSAS.

To continue training accountants towards changes in the International Standards (IPSAS) in order to accommodate changes.

Promoting and enhancing awareness to stakeholders so as to support changes.

Many countries such as Ghana, Switzerland, South Africa, etc. have already adopted IPSAS. It will be very beneficial to use the experience of these countries in adopting IPSAS. This will fast track the adoption of IPSAS in Tanzania.

To strengthen uses of Integrated Financial Management Systems (IFMS) and ensure that all Government's payments are effected electronically through Electronic Fund Transfers (EFT)

Ensure that the valuation of Government assets and preparation of fixed asset register is completed in time.

Improve disclosure of government resources in the financial statements to enhance transparency and accountability.

Ensure that all Government resources are properly managed, accounted for, recorded and owned by respective Government entities. This may involve maintaining a proper digital record of the country's assets.

Ensure that laws, rules and regulations governing utilisation of public resources are amended to suit the environment and they are adhered to.

Test Yourself 3

Explain briefly any three main challenges in adoption of accrual based IPSAS in Tanzania.

Answers to Test Yourself

Answer to TY 1

The correct option is **D**.

IPSAS do not apply to Government Business Enterprise.

Answer to TY 2

The correct option is **A**.

Cost of release" is the term used in the context of liabilities to refer to the same concept as "net selling price" in the context of assets. Cost of release refers to the amount that relates to an immediate exit from the obligation.

Answer to TY 3

The challenges in adoption of accrual based IPSAS in Tanzania include:

(a) Accrual accounting information is more difficult and more costly to produce and to use, than cash-based accounting information.

(b) Part of the cost of using accrual-based data is the cost of understanding it. Accrual-based data cannot be easily understood by non-accountants.

(c) The adoption of full accrual accounting is more complex and more costly than the simple cash basis. Asset valuation is an example of complexity and cost; therefore, modifying cash-based systems to produce accrual-type data may make sense.

(d) Less developed countries like Tanzania usually lack accounting skills, and therefore have only few trained people who can either produce complex accounting information or use it. Training will also need to be imparted to various groups such as PAC, Chief Accountants, Accountants, Heads of Sub Treasuries, Financial statement's preparers, Accounts Officer, etc.

Self Examination Questions

Question 1

Write short notes

(i) Deferred outflow

(ii) Service potential

(iii) Value in Use

(iv) Cost of release

Question 2

List the various measurement bases used in measuring assets and liabilities prescribed by the Conceptual Framework to the IPSAS.

Answers to Self Examination Questions

Answer to SEQ 1

(i) Deferred outflow: A deferred outflow is an outflow of service potential or economic benefits provided to another entity or party for use in a specified future reporting period that results from a non-exchange transaction and decreases net assets.

(ii) Service potential: Service potential means the capacity to provide goods and services in accordance with the entity's objectives, whether those objectives are the generation of net cash inflows or the provision of goods and services of a particular volume, quantity and quality to beneficiaries thereof

(iii) Value in Use: Value in use is defined as the present value at the reporting date to the entity of the asset's remaining service potential or economic benefits if it continues to be used, and of the net amount that the entity will receive from its disposal at the end of its useful life.

(iv) Cost of release: Cost of release refers to the amount that relates to an immediate exit from the obligation. Cost of release is the amount that either:

the creditor will accept in settlement of its claim, or

a third party would charge to accept the transfer of the liability from the obligor. Where there is more than one way of securing release from the liability, the cost of release is that of the lowest amount

Answer to SEQ 2

The list of measurement bases as prescribed by the Conceptual Framework for IPSAS are as follows:

(i) Historic cost
(ii) Market value
(iii) Replacement cost
(iv) Net selling price
(v) Value in use
(vi) Cost of release
(vii) Cost of fulfilment
(viii) Assumption price

SECTION A

ACCOUNTING FOR PUBLIC SECTOR

A5

STUDY GUIDE A5: PLANNING AND GOVERNMENT BUDGET

Get Through Intro

The budgeting concept is seen to be the central point of government financial administration; government accounting is driven by the government's budgeting system.

This Study Guide gives a detailed study of the budgeting concept, the budgetary control system and types of budgeting systems, and discusses the budget cycle, giving detailed insight into the annual budgeting process of the government.

The annual budgeting process that has been outlined in this Study Guide is a typical general process that can be used. Out of this process, any government can develop its own process, depending on the system of the government and the stage of development or sophistication of the government.

Learning Outcomes

a) Define plan and budget.
b) Explain the characteristics of planning and types of plans.
c) Identify the relationship between plans and budget.
d) Define purpose and objectives of government budget.
e) Explain the benefits of budgeting.
f) Explain the bases of government budget.
g) Discuss the implementation of budgetary reforms under Public Financial Management (PFM) in Tanzania.
h) Explain the techniques in preparation of government budget.
i) Explain the classification of government chart of accounts.
j) Define coding analysis.
k) State the national budgeting process (budget cycle).
l) Identify the essence of having Government Budget adjustment techniques.
m) Explain the excess vote and supplementary funds.
n) Explain the presentation of budget information in financial statements as per IPSASs requirements.

1. Define plan and budget.
Explain the characteristics of planning and types of plans.
[Learning Outcomes a and b]

1.1 Definitions

Definition

Planning is a management function, concerned with defining goals for future organisational performance and deciding on the tasks and resources to be used in order to attain these goals. It forms the direction of the Government over a period of time in order to accomplish the desired results.

A budget is a quantitative statement for a defined period of time, which may include planned revenues, expenses, assets, liabilities and cash flows. A budget provides a focus for an organisation aids the co-ordination of activities and facilitates control. Planning is achieved by means of a fixed master budget, whereas control is generally exercised through the comparison of actual costs with a flexible budget.

1.2 Characteristics of planning

The main characteristics of planning are given below:

(a) Planning is an intellectual process

Planning is an intellectual process of thinking in advance. It is a process of deciding the future on the series of events to follow. It is a process where a number of steps are to be taken to decide the future course of action. Managers or executives have to consider various courses of action, achieve the desired goals, analyse in detail the pros and cons of every course of action and then finally decide what course of action may suit them best.

(b) Planning contributes to the objectives

Planning contributes positively in attaining the objectives of the business enterprise. Since plans are formed from the very first stage of operation, the management is able to handle every problem successfully. Plans try to set everything right. A purposeful, sound and effective planning process helps to know how and when to tackle a problem. This leads to success. Objectives are thus easily achieved.

(c) Planning is a primary function of management

Planning precedes other functions in the management process. Setting of goals to be achieved and lines of action to be followed precedes the organisation, direction, supervision and control. It is a primary requisite before other managerial functions step in. But all functions are inter-connected. Planning is a part of all managerial functions. It thus gets primary importance everywhere.

(d) Planning is a continuous process

Planning is a continuous process and a never ending activity of a manager in an enterprise based upon some assumptions which may or may not come true in the future. Therefore, the manager has to go on modifying, revising and adjusting plans in the light of changing circumstances. It involves continuous collection, evaluation and selection of data, scientific investigation and analysis of the possible alternative courses of action and the selection of the best alternative.

1.3 Types of plans

Plans can be broadly classified as long term plans and short term plans

1. Long term planning

The long term planning undertaken by an individual organisation or the government of a country can be termed as a strategy. The long term plan provides answers to vital questions such as:

What is the existing environment in which the organisation / economy is operating?

What is the environment that will exist in the organisation / economy in the future based on the future action plans?

Where the organisation / economy really want to go?

What best way should the organisation / economy adopts to reach the desired goal?

This would provide the overall **guidelines regarding the direction in which to proceed**. For example, this kind of planning is used by top level management of a company.

Example

Let us try to understand long term plan with an example of an investment company.

Suppose the investment group's strategic plan has the objective of setting up a travel company.

The strategic plan would outline the type of 'holiday packages' the company would offer. This could be 'budget holidays' (low price, high volume) or the 'high class holidays' for the upper end of the market (high price, low volume). It would also state the required return and any deeply held beliefs by which they would like the company to be run, e.g. the company will employ a certain percentage of people from the physically challenged groups etc.

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2. Short term planning

Long term planning gives us the ultimate goals. To convert these into achievable tasks we need to define short term plans. There are two types of short term planning: tactical planning and operational planning.

(a) **Tactical planning** is typically used by middle management. They consider the production, and the resource requirements, to produce a plan that will ensure the **efficient and effective use of the 4 "M"s** (money, men, materials and machines) whilst **optimising output** and staying within the organisational objectives. It is the implementation of the strategic plan.

Example

If the strategic plan of a firm outlines that the company has to achieve a market share of 25%, the tactical plan will decide the geographical location where the sales can be increased or the product whose sale can help the company to achieve the desired market share.

(b) **Operational planning** is detailed departmental planning often performed by supervisors. The plans may be of any length less than one year, and in the case of production planning, made on a daily basis. There are clear standards and objectives to be met and data is collected to ensure that there is both **measurability and accountability for the use of resources**. It is at this level of planning that the control is tightest and the decision making most frequent.

Example

Continuing the example above, once the tactical plan relating to the geographical location or the product to be sold is finalised, the operational plan will decide the action plan (to implement the tactical plan). This includes day to day requirement of resources such as materials, labour hours etc.

Test Yourself 1

What is a tactical plan?

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2. Identify the relationship between plans and budget.
Define purpose and objectives of government budget.
Explain the benefits of budgeting.

[Learning Outcomes c, d, and e]

2.1 Purpose of government budget

A government budget is an authorised forecast document listing the proposed revenues and expenditure of the government in a financial year. Such a budget can be surplus budget or a deficit budget. A surplus budget occurs when the proposed revenues of the government exceeds its proposed expenditures. A deficit budget occurs when the proposed expenditures of the government exceeds its proposed revenues.

The government, through its budgeting process, aims at achieving various social and economic objectives for the benefit of a nation.

A government budget has the following objectives:

(a) To assist policy makers of a nation to develop policies that will lead the nation to achieve its main objectives.

(b) To estimate the total income of the government to support its expenditure plans and developments.

(c) To give authority to future spending; it is a means of authorising expenditure.

(d) To provide a mechanism to control the nation's revenue and expenditure.

(e) To set standards to enable performance to be monitored and evaluated.

(f) To serve as a motivating method for both government employees and departmental managers.

(g) To bring together the separate subsystems of the nation to enable them to work together towards the achievement of the objectives of the nation.

2.2 Objectives of government budget

The objectives of government budget are as follows:

1. Reallocation of resources

Every nation has its own social and economic priorities. Social priorities aim at promoting welfare of public and economic priorities are aimed at enhancing private businesses in the economy with the objective of profit maximisation. The government, using its budgetary policy, allocates the available resources in a way so as to achieve the social and economic policies. For example, if a government wants to prioritise social welfare, it would allocate a substantial part of the available resources towards building of health care units, schools, colleges, etc.

2. Reducing wealth and income inequalities

Economic inequalities can be found in population across the globe. Every government tries to bridge the gap between a country's rich population and the "have - not's". Through its budgetary policies, a government aims at addressing the issues of economic inequalities existing among the people of a nation. It allocates resources in favour of those sections of people who are economically weak. In this manner, wealth of a nation gets distributed in a fairer manner. For example, a government may allocate the resources of a country towards provision of goods and services to the economically backward sections and make the same available to them at a reduced price.

3. Achieving economic stability

Every country tries to achieve economic stability in order to ensure that businesses being conducted are not adversely affected by phases of the trade cycle like recession, inflation, deflation, etc. These phases are controlled by the government of a country through the process of budgeting. For example, to tackle deflationary trends in an economy, a government may introduce a deficit budget and to deal with inflationary situations, a surplus budget may be introduced.

4. Achieving economic growth

Economic growth of a nation depends upon its attitude towards investment and saving. Real economic growth is achieved through a proper balance between the two. For example, in case the objective of the government is to increase the level of investment in the economy, it would make a provision for reduction of interest rates in the economy.

5. Management of State owned enterprises

An economy may have numerous public sector enterprises which work towards betterment and upliftment of various sections of the population. National budgets can be aimed at strengthening such organisations through means of tax concessions and other subsidies.

6. Balanced regional development

There may be certain areas of an economy which have remained undeveloped economically and socially. The government in such a situation can aim at improving such areas through its budget. Special provisions are made for encouraging setting up of commercial organisations in the underdeveloped areas by providing tax incentives and other subsidies to producers.

2.3 Relationship between plans and budget

The relationship between plans and budget can be understood from the following:

(a) Governments authorise and control most of their revenues and expenditures through budgets. In other words, the long term development plan of a nation is executed by means of annual budgets. The long term annual development plan of a nation may be made for a period of five years. This five year plan may not be executable in its original form. Thus, this long term plan is converted into budgets for operational and managerial efficiency.

(b) By establishing intelligent links between a plan and the annual budgets, it can be examined whether a government is able to effectively steer an economy in the path of growth. The annual budgets should contain provisions for the government's planned capital expenditures and the related current expenditures. A budget allocates resources to various sectors of the economy so that the development plan of all the sectors can be implemented. A government budget should be reflecting the economic and social objectives of a country.

(c) While preparing a government budget, a link is created with the long term development plan so that the multi – annual tasks outlined in the long term plans are achieved on time and efficiently.

(d) When the long term development plan of a nation is drawn up, it is prepared in the light of available resources during the entire plan period. Resources include the natural resources, human resources, financial resources and other physical resources. The annual budgets apportions the available resources between sectors and other governmental projects, keeping in mind the amount that would be required in a particular year.

(e) Annual budgets include the tasks to be performed and the goals to be achieved by public sector organisations, semi-autonomous agencies, government departments, local government bodies, etc. Once these institutions achieve their goals, the economy would be able to successfully implement and achieve the objectives of the long term development plan.

2.4 Benefits of budgeting

The following are the benefits of government budgeting:

(a) Prime tool of social and economic policies: budgets form the government's prime tool of economic and social welfare policies. Every government requires funds to fulfil its social and political commitments and economic goals like enhancing healthcare facilities, improving defence and security, reducing poverty, increasing employment opportunities, etc. Budgets outline the plan of a government regarding how much funds it would require, sources from which it would pool the funds and the ways in which it would allocate the funds to meet the competing needs of the various sections of the country.

(b) Detailed plan of serving citizens: government budgets influence lives of the citizens of a country, particularly those of senior citizens, children, employable youth and businesses. Their well-being is directly influenced by the spending decisions of the government which are outlined in the budget. Thus, budgeting enables the government to have a detailed plan of how the citizens can be served.

(c) Co-ordination: a comprehensive budget requires full coverage of all activities of the government, its various agencies and departments. This can be achieved through establishing the effect of one governmental department budget on another governmental department budget. Through this process, activities of different departments within the government are co-ordinated to ensure that each aspect of operation contributes to the overall economic and social plan of the nation.

(d) Communication: a comprehensive budgeting process involves liaison and discussion between all levels of the government. This opens up an avenue for both top-down or bottom-up communication regarding the various goals. When the budget is approved, it can facilitate communication between different government departments through implementation of various planned activities. In the Government, communication is fostered through the media, representatives and reports from the Parliament.

(e) Control: this is the process of comparing what are the planned and the actual result regularly to establish the deviation so that corrective measures can be taken on time. Control, therefore, sets a discipline which helps the accomplishment of the budget within the agreed expenditure limits.

(f) Motivation: if all levels of government departments participate fully since the beginning of the budgeting process and its implementation and evaluation, then it tends to motivate all involved rather than creating resentment and reaction. It thus improves the performance level of budget implementers.

(g) Government's performance evaluation: whether a government has achieved its stated economic and social objectives or not can be evaluated by comparing the standards set in the budget with the actual achievements.

Test Yourself 2

Which of the following is **FALSE** concerning the basis of distinction between budget and development plan?

A A budget is a short term plan while a development plan is longer term
B A budget is concerned with current problems while a development plan addresses fundamental economic concerns
C A budget relies heavily on internal and indirect taxes while a development plan depends heavily on foreign exchange earnings and heavy capital inflows from abroad.
D A budget is flexible while a development plan is fixed in terms of ends and means specification.
E A budget may not cover the whole system of the economy while a development plan covers the entire structure of the economy.

Test Yourself 3

"Balanced regional development" is one of the objectives of government budget. Which of the following describes government's efforts to promote this objective?

A Comparing the planned and the actual result regularly to establish the deviation so that corrective measures can be taken on time
B Allocating resources to the un-developed sectors of the economy
C Bringing down levels of inflation in order to promote private businesses
D Motivating all stakeholders to be a part of the budget making process

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3. Explain the bases of government budget.
Discuss the implementation of budgetary reforms under Public Financial Management (PFM) in Tanzania.
Explain the techniques in preparation of government budget.
[Learning Outcomes f, g, and h]

3.1 The bases of Government budget

Government budget is prepared based on different approaches or bases as discussed below:

(a) Legal basis

The legal basis comprises of the following:

various laws governing the preparation of the government budgets
administrative regulations concerned with the regulation of the format of the budgets
formal allocation of rights and responsibilities of various entities involved in the budget cycle

In Tanzania, the following legal provisions act as guidelines for preparing the national budget:

(i) The Constitution of the United Republic of Tanzania of 1977 (as amended from time to time): this includes the provisions relating to the finances of the United Republic of Tanzania (URT). This indicates as to who has the mandate of preparing the national budget and submitting the same to the Parliament, permissible categories of revenue receipts, points of authorisation of payments, etc.

(ii) The Public Finance Act of 2004: this outlines the legal framework within which the country's budget should be drawn up, including provisions relating to revenue, control of expenditures and parties accountable for the budget.

(iii) The Annual Appropriation Act: this Act gives the required powers to the Finance Minister to draw and allocate funds from the Consolidated Fund to various votes and also provides for the ways in which funds can be reallocated between votes.

(iv) The Annual Finance Act: this provides the required powers to the Finance Minister decide upon collecting revenues from the public by means of taxation.

(b) Legislative basis

The role played by the Government in formulating rules and regulations which govern budget preparation, authorisation, execution and control is what forms the legislative base. The National Assembly which is responsible for overseeing the legislative aspects of budgeting in Tanzania consists of:

(i) Parliamentary Standing Committee

(ii) Budget Committee

(iii) Finance, Economic and Industrial development Committee

(iv) local Authorities Accounts Committee (LAAC)

(v) Public Accounts Committee (PAC)

(c) Political base

Ruling party election manifesto, which is the contractual document setting out the agreement between the ruling political party and the voters, is taken into account when the Government budget is prepared to ensure that the promises and commitments made to the voters are implemented.

(d) Economic base

Consideration of tax payer's ability to contribute towards Government revenue is the paramount factor when considering realistic budget preparation. In doing so, the incorporation of various economic variables in the determination of the economic ability to pay is considered.

(e) Administrative base

The budget administration process is divided into the following:

(i) The cabinet

It is the cabinet which approves the government budget in principle through the appropriate cabinet economic committee.

(ii) Central ministries

This includes the Treasury planning, Planning Commission, Public service Management, Presidential Bureau and Prime Ministers' Office. They issue budget instructions to coordinate budget preparation across all ministries, regions, independent departments and executive agency.

(iii) Sectorial ministries

These include regions, independent departments and executive agencies where they have the authority to identify programmes, prepare and submit the budget to central ministries, implement the budget and be accountable by preparing reports submitted to the central ministries.

3.2 Budgetary reforms under Public Financial Management (PFM) in Tanzania / techniques used in preparing government budgets

Public sector budgeting has been reformed over many years in Tanzania, especially under the Public Financial Management (PFM) programme. This has led to the following types of systems of budgeting:

(a) The traditional budget

This is the initial system of budgeting that was developed and the main objective was to plan how to utilise the financial resources of the nation to control these resource and also to ensure accountability from the stewards, who are the officials who lead in the use of these resources. Two main features of this type of budget are:

(i) Line Item feature

This system classifies the revenue and expenditure by the nature or type of income and expenditure. The normal types of income are tax, loans, grants etc. The budget is prepared after estimating the revenue to be generated through these. The normal expenditure items are materials, travel and transport, salaries, equipment, repairs and maintenance etc.

(ii) Incrementalism feature

With the incrementalism feature, the budget for any year is prepared by making adjustments in the form of either increases or decreases in the preceding year's budget figures. The advantage is seen in the way budget authorities are made to make annual reviews of activities and policies. The traditional budget is also known by these two features, i.e. either as the line item budget or the incremental budget.

Advantages

Some of the advantages of the traditional budgeting system are as follows:

This budget system is simple to prepare

It is a means of expenditure control

It ensures that moneys are used only for their assigned purposes, and it ensures the protection of the finances of the organisation.

Changes can be made in the line items easily.

It is also easy to make detailed comparisons between budgeted and actual revenues and expenditures.

Disadvantages

Some of the disadvantages of the traditional budgeting system are as follows:

The budget is concerned more with conforming to legal requirements rather than looking at proper planning and development.

It stresses on the importance to spend exactly the amount budgeted for a type of expenditure, without being concerned about the achievement.

It encourages inefficient spending habits by public officers.

Expenditure items are not scrutinised because of the incrementalism.

Again, items of expenditure are often not easily taken out of the budget, so inefficient items at times are still spent on.

(b) Performance Budgeting

This budget stresses on the functions, and projects which are undertaken in the budget as against the traditional budget which stresses on inputs, or expenditure items like materials, wages and stationery.

The functions and projects refer to the output of the expenditure; hence the budget was known as ‘output budget’. For this system of budgeting, the attention is on the general character and relative importance of the work to be done. Attention is centered on the function or activity, and on the accomplishment of the purpose.

Requirements are submitted for budget preparation through programme classification, indicating the past activities of the organisation, their costs, the activities to be undertaken during the next year, the results expected and the pattern of responsibilities assignment.

Advantages

The advantages of using performance budgeting includes:

This budgeting system gives sufficient information since it includes a narrative description of each project and the services provided by the organisation.

Inputs and outputs are both shown and measured.

This is a monitoring device since the result of each activity is noted and measured.

Emphasis is on the activities of the organisation, as well as on controlling costs.

Challenges in implementing performance budgets

The challenges faced in implementing performance budgeting includes:

Many times entities face difficulty regarding the classification of programmes and the provision of cost data in respect of many activities.

The process of allocation of cost estimates over the activity or programme elements is challenging

Availability of suitable personnel for project costing and analysis is difficult another challenge faced by the public sector.

Most public sector activities are not easily measurable in output terms. Therefore availabity of complete date makes the analysis less meaningful.

The technique dies not focus on long-term objectives of the government, just as the traditional budget.

(c) The Zero-Based Budgeting (ZBB)

The budgeting technique stresses that every item of expenditure needs to be budgeted for, and should be scrutinised and justified as to why such item should be funded in the budget. The technique expects that organisations should even justify the reasons that they should continue to exist.

The budget by implication tries to discourage wasteful expenditure, and is aimed at ensuring that useless projects are not undertaken in the government budget. Organisations and personnel are encouraged to do better analysis of their activities of the past and to ensure that only the relevant ones are budgeted for.

This type of budgeting follows three main procedures:

(i) Various decision units are identified, which involve clearly defined and measurable objectives of the organisation or units of the organisation and managers or leaders responsible for such objectives. The effects or impacts of the objectives are also clearly noted.

(ii) Decision packages are developed or determined, which refer to the means of achieving the decision units above, in the form of the services to be performed to achieve the decision units, and the relevant costs or the finance for such services.

(iii) The decision packages are reviewed and then ranked in order of priority. Those decision packages that can be applied very efficiently to the relevant decision units are then selected by the authorities or managers responsible for the achievement of the objectives or programmes. The arrangement of the packages in the order of priority can often be subjective.

Advantages

Items of expenditure are reviewed and justified before they are accepted.

It is a mark of financial discipline which is imposed on the organisation.

The process involves all the personnel in the units, departments or organisations, which is commendable, since it enables every person to feel a part of decision making.

Disadvantages

However, this system also has problems:

The technique requires a lot of time and resources to identify.

The decision units cannot be developed easily because objectives and outputs of public organisations are not easy to identify and measure clearly.

The decision packages or programmes cannot be arranged easily in order of priority; such actions are very subjective, and politicians can decide to carry out certain activities even though the activities are very costly and uneconomical.

(d) Planning Programming Budgeting System (PPBS)

The main features of this budgeting technique are identified in the three main words in the concept:

(i) Planning

This involves the development of long range objectives and goals of the public sector institutions. Such goals and objectives are at times prioritised for the purposes of their achievement.

(ii) Programming

Programmes are developed to achieve the objectives or goals as identified under the planning stage. Alternative programmes are identified here and compared.

(iii) Budgeting

This involves placing money values on the programmes, putting together the costing of the programmes and the relevant benefits that would be derived from the programme. Subsequently, a full system is developed and implemented from an integrated set of selected efficient programmes. This is followed by constant monitoring and reviews.

Advantages

It stresses more on the future, since planning involves looking into the future.

It enables budget authorities to evaluate programmes to determine their efficiency and effectiveness.

It encourages constant review of programmes.

The system prevents programmes that often overlap through departments; similar programmes in different organisations are well coordinated.

Disadvantages

The long range planning process is often difficult since going deep into the future is very subjective.

Planning cannot be done well since most of the goals or objectives in the public sector system cannot be physically identified and measured easily.

The process requires a lot of time, money and personnel who can do good analysis, financially and technically.

There is also the problem that most public sector outputs cannot be quantified and measured; hence performance cannot be measured easily through such budgeting system

(e) Medium Term Expenditure Framework (MTEF)

MTEF is a practical tool or decision-making mechanism to integrate policy priorities into the annual budget, in a multi-year perspective (3-5 years), for fiscal soundness and effective resource allocation and for operational effectiveness and performance management. MTEF contains:

(i) a macro-economic framework setting out the three years, underlying assumptions and evaluation and the analysis of macro-economic projection for the preceding three years.

(ii) fiscal strategy document setting out the following:

Government's medium-term financial objectives

The Government policies for medium term relating to taxation, recurrent expenditure, borrowings, lending and investments and other liabilities.

The strategies and the economic, social and development priorities of the Government for the next three years.

An explanation of the financed objectives, strategies, and economic, social and development priorities as well as fiscal measures.

(iii) an expenditure and revenue framework which will set out:

estimates of aggregate revenue for the Government for each financial year based on pre-determined tax revenue projections

aggregate expenditure for each of the next three years

minimum capital expenditure projection in the Government for the next three years

(iv) a consolidated debt statement indicating and describing the fiscal significance of the debt liability and measures to reduce the liability.

Medium Term Expenditure Framework (MTEF) preparation process

The MTEF budget preparation involves the same process as the traditional budget in terms of effort and time, however ceilings are given for 3years and the budget documentation only provides details for the year that the budget is being presented.

Benefits of the MTEF concept

The following are some of the benefits of MTFEF.

(i) It is a system which has helped to solve the problem between what can be afforded by the government, which is given from the top (top down approach) and the needs of the organisation which are presented from the bottom (bottom up approach).

(ii) It gives more and better information, which enhances transparency and accountability.

(iii) It is a decision-making framework for the consideration of different organisational (ministerial and departmental) policies and agreements among them.

(iv) It enables authorities to predict with some certainty the possible funding support from international organisations.

Test Yourself 4

Which of the following outlines the legal framework within which a country's budget should be drawn up?

A Medium term Expenditure Framework
B The Annual Appropriation Act
C The Public Finance Act
D Planning Programming Budgeting System

Test Yourself 5

Which of the following budgeting techniques says that every item of expenditure needs to be budgeted for, and should be scrutinised and justified as to why such item should be included?

A Zero based budgeting
B Traditional budgeting
C Incremental budgeting
D Planning Programming Budgeting System

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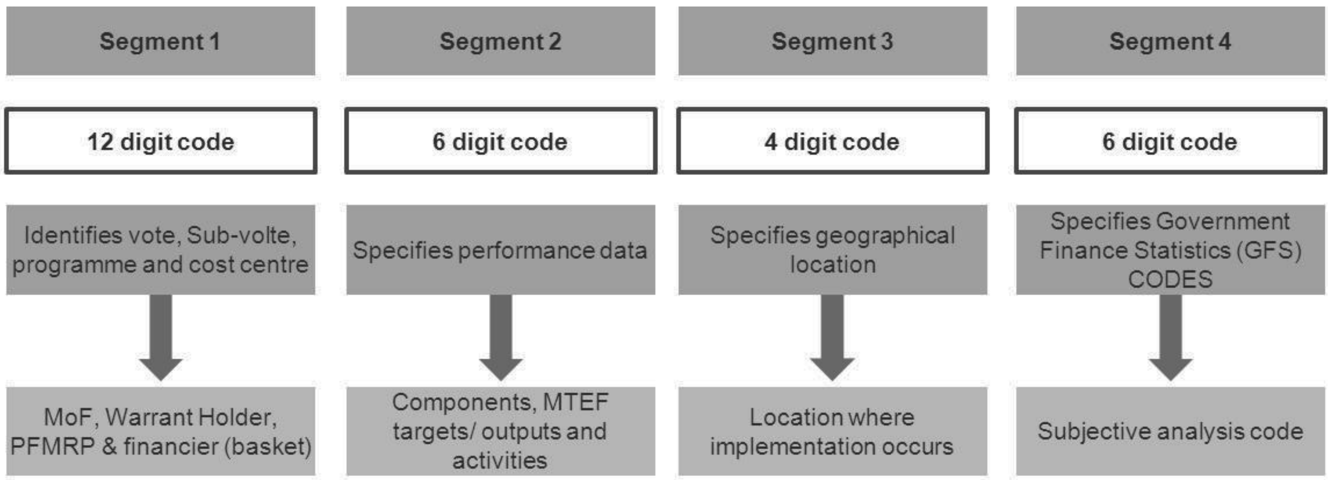
4. Explain the classification of government chart of accounts.
Define coding analysis

[Learning Outcomes i and j]

The government chart of accounts outlines the framework for the identification, collection and reporting of financial information in order to ensure that the government gets adequate corporate information. This chart provides information relating to the various accounts and the codes designated to each account for all sectors.

For recording transactions and thereafter generating reports, the Public Finance Management Reform Programme (PFMRP) utilises the Tanzanian government's chart of accounts. The chart of accounts is prepared by the budget officer. The responsibility of publishing and distributing the chart among the Ministries, Departments and Agencies (MDAs) lies with the commissioner for budgets. The chart has four segments, with a total of 28 digits. The chart of accounts is illustrated in the diagram below.

Diagram 1: Government chart of accounts



Segment 1 of the chart makes a distinction between the funded contributions and related expenditures of government of Tanzania and those of other Development Partners (DPs).

In order to ensure that financial reports can be generated on a component basis, the budgets relating to the general ledger modules and the Integrated Financial Management System (IFMS) are customised. Budget and general ledger are the two modules into which the reference codes are incorporated. These reference codes help in generation of reports. The reports bring out the differences between the budgeted amounts and the actual amounts. Further, IFMS is customised in such a manner that it can facilitate control at both component and sub-component levels.

Test Yourself 6

In which of the following are the reference codes incorporated?

A Budget and general ledger
B Budget and income statement
C Income statement and general ledger
D Income statement and sales day book

5. State the national budgeting process (budget cycle).
Identify the essence of having government budget adjustment techniques.
Explain the excess vote and supplementary funds.
[Learning Outcomes k, l and m]

5.1 Budget cycle

Definition

The budget cycle is the period which begins with the initiation of the preparation of the central government budget for any new financial year. The cycle starts with the budgetary estimates preparation stage, through the authorisation of estimates into budgets for spending, the processes of spending such amounts authorised, and the final accountability of such spending to parliament as confirmed by the audit of the financial reports revealing the spending.

The process of framing the national budget or the general budget cycle involves the following:

(a) A policy paper is often developed by the Commissioner of Budget, which is normally prepared after considering the general economic environment and normally with input from a good public expenditure system to note the general impact of past as well as on-going expenditure plans of the government. The paper shows revenue and expenditure projections and outlines, at times major alternative proposals for change, during the coming year based on the expenditure survey. The central government as represented by the Cabinet discusses this policy paper.

(b) The Cabinet takes provisional decisions on the total amount of expenditures, on major new spending projects or other cut backs and on major tax changes as well as new tax policies. Cabinet decisions are then communicated back to the Ministry responsible for the budget.

(c) The Ministry responsible for the budget or the budget agency then issues guidelines for the spending MDAs to follow in making their spending plans or requests. These instructions are often called the Budget Circular or the Call for Estimates.

(d) Spending MDAs prepare and present their estimates to the ministry responsible for the budget or the budget agency. Where a spending organisation has other departments or agencies under it, the parent organisation meets representatives of the sub-organisations to discuss their various estimates to ensure that their estimates are within the agreed levels. Such discussions are referred to as internal hearing.

(e) Budget examiners at the ministry responsible for the budget or the Central Budget Agency examine the estimates from spending departments for agreement or queries. Their examination is to ensure that estimates presented by the spending departments are within the authorised levels.

(f) Budgetary hearings, known as external hearings, are organised between the spending departments and the budgetary agency to discuss and agree on the departmental estimates.

(g) Agreed departmental estimates are submitted by the budget office to the Minister of Finance for final agreement and submission to the Cabinet. Spending MDAs whose requests are not satisfied can appeal to the Cabinet for consideration.

(h) Cabinet considers and agrees on the final expenditure levels and if possible any necessary tax changes.

(i) Estimates agreed finally by the Cabinet are presented by the Executive, either by the President or the Prime Minister of the concerned nation, to the Parliament of the country. In normal cases, it is the Minister of Finance who presents the estimates to the Parliament in the form of Finance Bills for tax and revenues and Appropriation Bills for expenditures.

(j) Under the Certificate of Urgency, the Finance Bills are passed by the Legislature into Finance Acts to enable the revenue organisations to have the authority to collect tax and other revenues.

5.2 Government budget adjustment techniques

Budget implementation commences after the enactment of the Appropriation Act where the funds are consolidated and allocated to accounting officers and finally to warrant holders and sub-warrant holders for execution of approved activities. If the expectation to collect revenue goes down, then the allocated funds may be insufficient, thus affecting the service delivery.

The government budgetary adjustments may take one of the following forms:

(a) Supplementary appropriation

This is additional supplementary following the enactment of the Supplementary Appropriation Act that allows the accounting officer to get additional funds from consolidated funds.

(b) Supplementary warrants of fund

The accounting officer issues and allocates funds to warrant holders and sub-warrant holders respectively on a quarterly basis. For the purpose of executing control, the accounting officer may issue lower amounts than appropriated for execution of the activities in the quarter. If deficit occurs when implementing the budgeted activities, then application for supplementary warrant of funds shall be made.

(c) Reallocation or virement of funds

Reallocation or virement of funds are authorised transfers of appropriated funds from one source to another within the same vote or from one vote to another**.** The accounting officer is empowered by the Appropriation Act to reallocate the fund from votes with excess funds to votes with deficit but within the same budget ceiling.

(d) Advances of the civil contingency funds

These are unforeseen contingencies which normally happen without immediate attention, and may cause damage to the people and property of the Government.

(e) Omnibus Reallocation

This involves the transfer of funds from items with savings to those with deficit within a particular vote, at the end of a financial year.

(f) Excess vote

Excess vote is resorted to when there is an over expenditure in a vote during a financial year. Excess vote has been discussed in the immediate next part of this Learning Outcome.

5.3 Excess vote and supplementary funds

1. Excess vote

Government departments take decision regarding the manner in which they would manage, distribute and utilise their allocated budget. But, only after the Parliament votes the money stated in the budget through an 'estimates' process, the departments can use the funds to finance their planned projects. In the event a department spends an amount which is more than what the Parliament had originally authorised, the department must seek the approval of the Parliament for an **excess vote,** through the Treasury.

The Appropriation Act specifies the following:

the net expenditure (total of all sub-heads of expenditures less the appropriations-in-aid that have been approved) that has been approved by Parliament for each vote

the appropriations-in-aid figures that have been approved by the Parliament

The Appropriation Act specifies the legalities associated with the maximum expenditure on a vote, including the maximum amount relating to the appropriations-in-aid that can be applied to the concerned vote.

As per the provisions of the Appropriation Act, an excess vote would arise in the following events:

In case the total of the expenditure sub-heads exceed the amount originally approved, an excess vote would be required. Even if a surplus appropriations-in-aid is available, an excess vote needs to be called for as the surplus cannot be used to cover the excess expenditure.

In case an appropriations-in-aid shortfall cannot be matched by expenditure savings, excess vote would be required

In case there is an event of exceeding the total of a grant-in-aid, excess vote would be required.

2. Supplementary funds

At the start of a financial year, it is the duty of the head of each MDA to distribute the budgeted amount allocated to the individual units for the time period specified. The allocated amount should be used by each spending MDA in a controlled manner, ensuring that the expenditure does not exceed the allotted amount. During the execution of a budget if a spending MDA feels that the amount allotted to it is insufficient for it to meet its goals, the concerned MDA can request for **supplementary funds**.

Supplementary funds can be requested only under limited situations and the grant of such funds would need to go through a formalized procedure, just like the original budget. The demand for the supplementary funds are presented before the Parliament and passed by it before expiry of a financial year. However, the demand for these funds can be made by the spending MDA after the said expenditure has been actually incurred and after the financial year to which the expenditure relates is over.

Copies of the demands for the supplementary funds are made available to the members of the Parliament by the Ministry of Finance after such demands have been presented by the spending MDA.

Grant of supplementary funds is regulated and has to go through the same procedure as the grant of the original budget amounts. Parliamentarians take up the discussion on the demand of such funds based solely on the items constituting the demand, that is, the original grant relating to the item is not discussed. The spending MDA has to substantiate its demand by supporting the same with strong facts as to why the expenditure exceeded the original granted amounts.

The conditions under which requests for supplementary funds may be granted are as follows:

the request for the funds are made in the best interest of the public

it was practically impossible to foresee the additional need for funds when the original budget was prepared

the additional amount needed cannot be sourced in the form of reallocation or virement

the need for the funds is emergency in nature, such that it cannot be deferred and included in the budget of the next financial year

Test Yourself 7

Virement of funds refers to which of the following options?

A Re-allocation of funds.
B Demand for excess funds.
C Voting for excess funds.
D Calling for fund estimates.

Test Yourself 8

When does the need for excess vote arise?

6. Explain the presentation of Budget information in financial statements as per IPSASs requirements. [Learning Outcome n]

1. Presentation of Budget Information in Financial Statements – IPSAS 24

The Tanzanian government, under the Accountant General (ACCGEN) has adopted the accrual based International Public Sector Accounting Standards (IPSAS) with effect from the year ended 30 June 2013. Local government authorities and government business enterprises had adopted accrual based IPSAS earlier itself.

The aim is to, by 2015, be able to consolidate the local government authorities and government business enterprises.

IPSAS 24 deals with the presentation of budget information in financial statements.

2. Reasons for Issuing the IPSAS 24

Financial budgets of governments are usually made public by issuing them as public documents. A prime tool of financial management and control, a budget outlines the economic and social goals of a government. This document also acts as the most important component which is overseen by the parliamentary system of a country while the financial plans are being executed.

Prior to the construction of IPSAS 24, presentation of financial statements was contained under IPSAS 1. However, under IPSAS 1, there was no provision requiring the inclusion of a comparison between the budgeted figures and the figures contained in the actual financial statements, both being on the same level. Thus, IPSAS 1 did not provide for disclosure of comparison. It also failed to provide any guidance on how such comparison can be made in case an organisation chose to do so.

IPSAS 24 outlines the disclosures that organisations which are accountable to the public need to make. This includes a comparison of the performance of these organisations against the standards set in the budgets, irrespective of the fact whether the budget and the actual financial statements have been drafted on the same basis or not.

3. Main Features of the IPSAS 24

(a) Applicability

All public sector organisations whose approved budgets are publicly available are subjected to the provisions contained under the IPSAS 24. Such organisations make their budgets publicly available either to comply with legal formalities or on a voluntary basis in order to maintain transparency regarding financial reporting. The standard requires the public sector organisations to make certain disclosures regarding the budgeted figures vis–a–vis the actual figures as reported in their annual financial statements.

(b) Disclosure

(i) The IPSAS 24 provides that the public sector organisations who make their budget documents available in public domain should disclose the following:

A comparison between the original amounts in the final budget document and the actual amounts stated in the financial statements. Such a comparison should be made on the same accounting basis that had been used while making the budget, even if such a basis differs from the accounting practices followed while drawing up the actual financial statements.

An explanation relating to the reasons behind the material differences between the budgeted and the actual figures. Alternatively, such an explanation can also be given in a separate public document issued in conjunction with the organisation's financial statements.

A reconciliation statement, reconciling the actual amounts contained in the financial statements on the basis of the budgeted amounts.

(ii) IPSAS 24 provides for comparing the budgeted and the actual figures by having an additional budget column in the actual financial statements. However, this can be done only where the budget and the actual financial statements are drawn up on a comparable basis.

(iii) IPSAS 24 requires public sector entities to provide explanations in case the there are differences between the original budget figures and the final budget figures. Such differences may arise due to reallocations made within the budget at a later date or due to factors like natural disasters, change in policies, unforeseen economic events, etc. These disclosures can be made in the form of notes included in the financial statements or can be issued as separate reports.

(iv) IPSAS 24 does not require a public sector entity to disclose the comparative figures relating to earlier accounting periods.

Example

Illustrative statement showing comparison of budgeted figures and actual amounts

For Government XX for the Year Ended March 30, 20XX

These examples accompany, but are not part of, IPSAS 24.

Statement of Comparison of Budget and Actual Amounts

For Government XX for the Year Ended December 31, 20XX Budget on Cash Basis (Classification of Payments by Functions)

Note: The budget and the accounting basis are different. This statement of Comparison of Budget and Actual Amounts is prepared on the budget basis.

(in currency units)	**Budgeted Amounts**		**Actual Amounts on Comparable Basis**	**Difference: Final Budget and Actual**
	Original	**Final**		
Receipts				
Taxation	X	X	X	X
Aid Agreements				
International agencies	X	X	X	X
Other Grants and Aid	X	X	X	X
Proceeds: Borrowing	X	X	X	X
Proceeds: Disposal of plant and equipment	X	X	X	X
Trading Activities	X	X	X	X
Other receipts	X	X	X	X
Total receipts	**X**	**X**	**X**	**X**
Payments				
Health	(X)	(X)	(X)	(X)
Education	(X)	(X)	(X)	(X)
Public order/safety	(X)	(X)	(X)	(X)
Social protection	(X)	(X)	(X)	(X)
Defence	(X)	(X)	(X)	(X)
Housing and community amenities	(X)	(X)	(X)	(X)
Recreational, cultural and religion	(X)	(X)	(X)	(X)
Economic affairs	(X)	(X)	(X)	(X)
Other	(X)	(X)	(X)	(X)
Total payments	**(X)**	**(X)**	**(X)**	**(X)**
Net Receipts/(Payments)	**X**	**X**	**X**	**X**

The "Difference....", column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

Continued on the next page

Additional Column Approach

For Government YY for the Year Ended December 31, 20XX

Both Annual Budget And Financial Statements Adopt Accrual Basis (Illustrated only for Statement of Financial Performance. Similar presentation would be adopted for other financial statements.)

Actual 2OXX-1	(in currency units)	Actual 20XX	Final Budget 20XX	Original Budget 20XX	•Difference: Original Budget and Actual
	Revenue				
X	Taxes	X	X	X	X
X	Fees, fines, penalties, and licenses	X	X	X	X
X	Revenue from exchange transactions	X	X	X	X
X	Transfers from other governments	X	X	X	X
X	Other revenue	X	X	X	X
X	**Total revenue**	**X**	**X**	**X**	**X**
	Expenses				
(X)	Wages, salaries, employee benefit	(X)	(X)	(X)	(X)
(X)	Grants and other transfer payment	(X)	(X)	(X)	(X)
(X)	Supplies and consumables used	(X)	(X)	(X)	(X)
(X)	Depreciation/amortization expenses	(X)	(X)	(X)	(X)
(X)	Other expenses	(X)	(X)	(X)	(X)
(X)	Finance costs	(X)	(X)	(X)	(X)
(X)	**Total expenses**	**(X)**	**(X)**	**(X)**	**(X)**
X	Share of surplus of associates	X	X	X	X
X	**Surplus!(deficit) for the period**	**X**	**X**	**X**	**X**
	Attributable to:				
X	Owners of the controlling entity	X	X	X	X
X	Minority interest	X	X	X	X
X		**X**	**X**	**X**	**X**

The "Difference..." column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included

Note: The budget and the accounting basis are different. This Statement of Comparison of Budget and Actual Amounts are prepared on the budget basis.

Test Yourself 9

IPSAS 24 relates to which of the following?

A Presentation of budget information in financial statements.
B Demand for excess funds after the end of the financial year.
C Excess votes.
D Objectives of government budgeting

Answers to Test Yourself

Answer to TY 1

A tactical plan is a short term plan which is prepared and executed by middle level management. Tactical planning translates an entity's long term strategic plans into departmental plans. These plans are based on the current operational status of various parts of an organisation. The information required to prepare the tactical plans are gathered mostly from internal sources.

Answer to TY 2

The correct option is **D**.

A development plan can also be flexible.

Answer to TY 3

The correct option is **B.**

By allocating resources to the un-developed sectors of the economy, the government can ensure that even the most neglected parts of the country are being developed.

Answer to TY 4

The correct option is **C.**

The Public Finance Act outlines the legal framework within which the country's budget should be drawn up, including provisions relating to revenue, control of expenditures and parties accountable for the budget.

Answer to TY 5

The correct option is **A.**

The zero based budgeting technique stresses that every item of expenditure needs to be budgeted for, and should be scrutinised and justified as to why such item should be funded in the budget. The technique expects that organisations should even justify the reasons that they should continue to exist.

Answer to TY 6

The correct option is **A.**

Answer to TY 7

The correct option is **A.**

Reallocation or virement of funds are authorised transfers of appropriated funds from one source to another within the same vote or from one vote to another**.**

Answer to TY 8

In case a spending MDA spends an amount in excess of what had been granted in the original budget, the department must seek the approval of the Parliament for an **excess vote,** through the Treasury.

Answer to TY 9

The correct option is **A**.

IPSAS 24 deals with the presentation of budget information in financial statements.

Self Examination Questions

Question 1

State the conditions under which:

(a) requests for supplementary funds may be granted

(b) an excess vote would arise

Question 2

Explain zero based budgeting system and briefly comment upon its appropriateness in government organisations.

Question 3

Define PPBS, and discuss the strengths and weaknesses of PPBS.

Question 4

What are the techniques of government budget adjustment?

Question 5

(a) Define the term 'Vote'.

(b) Explain what is excess expenditure as provided for under the Statute.

Answers to Self Examination Questions

Answer to SEQ 1

(a) The conditions under which requests for supplementary funds may be granted are as follows:

The funds should be requested in the best interest of the public

It had been practically not possible to foresee the additional need for funds at the time of constituting the original budget

The additional amount needed cannot be procured through reallocation or virement

the need for the supplementary funds is emergency in nature, and it cannot be deferred or included in the budget of the next financial year

(b) As per the provisions of the Appropriation Act, an excess vote would arise in the following events:

Where the total of the expenditure sub-heads is more than the amount granted originally, an excess vote would be required to allow the excess amount.

In case it is not possible to match an appropriations-in-aid shortfall by expenditure savings, excess vote would be required

In case there is the total of a grant-in-aid exceeds, excess vote would be required.

Answer to SEQ 2

A zero-base budget is a method of budgeting which needs each cost element to be specifically justified, as though the activities to which the budget relates were being undertaken for the first time. Without approval, the budget allowance is zero.

ZBB is a cost-benefit approach to budgeting in which each cost element should be evaluated to be included in the budget. Each year when the budget is prepared, all the cost elements have to be evaluated as if the budget is being undertaken for the first time and will be authorised only if these are justified. The justification of any cost should be in relation to the way it helps to meet objectives and how the expenditure benefits the organisation.

ZBB takes away the implied right of existing activities to continue to receive resources, unless it can be shown that this is the best use of those resources.

Appropriateness of zero-base budget

As a zero-base budget aims to curtail unnecessary costs, it is suitable for both profit-seeking as well as government and other not-for profit organisations.

It is **best suited to the service industries and to government and other not-for-profit organisations** where, for each activity, alternative courses of action are possible. In such organisations ZBB helps in deciding the most suitable way of performing the activity.

ZBB can also be successfully applied to the **discretionary costs and support activities**. It may be noted that the discretionary costs are the fixed costs (usually) that arise from periodic budget approximation decisions taken according to organisational policy.

Answer to SEQ 3

Planning Programming Budgeting System (PPBS)

The PPBS can be understood through the three words that constitute it:

(i) Planning: planning refers to the development of long term goals and objectives of public sector entities. These goals and objectives are ranked in order to prioritise their achievement. .

(ii) Programming: in order to achieve the objectives or goals which have been identified under the planning stage, programmes are developed. Alternative programmes are identified here and compared. The programmes (s) best suited to achieve the objectives is / are taken up.

(iii) Budgeting: budgeting refers to deciding upon how much funds would be required for implementing the programmes and also analysing the relevant benefits that the public at large would benefit from the implementation of these programmes. Once the most efficient programmes are selected an implemented, they need to be constantly reviewed and monitored.

Advantages of PPBS

Since planning involves looking into the future, this system encourages an organisation to analyse every aspect of the future.

Budget authorities are encouraged in this system to evaluate the programmes to determine their efficiency and effectiveness in reaching the objectives and goals.

Constant review of programmes is encouraged to make sure that activities are going on in accordance with the plans.

The system prevents programmes that often overlap through departments; similar programmes in different organisations are well coordinated.

Disadvantages of PPBS

PPBS involve long term planning. But, planning for such a time frame is challenging since estimates of future are subjective in nature.

Since it is difficult to physically identify and measure most of the goals or objectives of the public sector, long term planning for them becomes difficult.

There is also the problem that most public sector outputs cannot be quantified and measured; hence performance cannot be measured easily through such budgeting system

Answer to SEQ 4

Techniques of Government Budget Adjustments

(i) Virement

This means transfer of approved funds from one vote to another authorized by the Minister of Finance.

(ii) Ministerial/Regional Reallocation

This is the authority granted by the Accounting Officer to transfer funds from one sub-vote to another within the same vote. This is approved by the Treasury.

(iii) Supplement Estimates

This is the additional financial provision provided by means of mini-budget after the original budget fallen short of target.

(iv) Omnibus Reallocation

This is the transfer of funds at the end of financial year within the vote from items with savings to those with deficit.

(v) Excess Vote: This means over-expenditure in a vote during the financial year. The situation requires A/O to prepare statement of excess vote with reasons for violating Government financial regulations. The statement and reasons are presented to the finance and economic committee for retrospective approval.

(vi) Civil Contingency Fund

A Fund established in order that payment for urgent services, the need for which could not have been foreseen and provided for are not held up pending the approval by the parliament necessary supplementary provision. The fund may be used only on the authority and personal responsibility of the Minister of Finance.

Answer to SEQ 5

(a) Vote

This is a record which is to be maintained by each Accounting officer or officers designated by him and warrant holder for proper control of expenditure against the provision of funds.

(b) By definition excess spending is defined in three ways:

(i) Moneys that have been expended/spent on any expenditure vote in excess of the amount appropriated by the National Assembly by an Appropriations Act or supplementary Appropriations Act, or

(ii) Moneys expended for a purpose for which no moneys were appropriated; or

(iii) Moneys which have been expended in any sub-Vote/sub-Head of an expenditure vote in excess of the sum assigned thereto in the estimates of expenditure for the financial year and which no further sum has been applied under any legislation.

STUDY GUIDE A6: LOCAL GOVERNMENT BUDGETING PROCESS

Get Through Intro

Planning and budgeting is the most important function for any national or local government. Budget is a financial estimate of the revenues and expenses for a specified period, mostly a year. Local governments in Tanzania known as the Local Government Authorities (LGA) are required by law to prepare and submit to the national council / parliament an annual budget detailing the development activities it intends to carry out during the year.

This Study Guide will take you through the process of preparation, approval, monitoring, control and evaluation of budgets. It will also elaborate on the persons involved in the management of the LGA. The principle act governing the operations of local authorities in Tanzania is the local government Finance Act no.9 of 1982, whose purpose is to spell guidelines relating to provision of revenue and management of funds and resources of local authorities.

This Study Guide will help you understand the process of local government budgeting and its importance in the functioning of the LGA. This Study Guide is important from exam focus point since the examiner may ask questions regarding roles and responsibilities of various local government officers and the process of budgeting at the LGA level.

Learning Outcomes

a) Explain the local government planning and budgeting process.
b) Explain recurrent and development budget.
c) Identify the budget approval, monitoring, control and evaluation.
d) State local government planning cycle.
e) Identify the role of Ward Executive Officers (WEO).
f) Identify the role of Village Executive Officers (VEO).
g) Identify the role of the Finance Committee.
h) Identify the role of the Treasurer.
i) Identify the role of Director.
j) Identify the role of Council.
k) Identify the role of Regional Administrative Secretary.
l) Identify the role of Regional Commissioner.
m) Identify the role of Minister responsible for local government.

1. Explain the local government planning and budgeting process.
Explain recurrent and development budget.
[Learning Outcomes a and b]

Budgeting is essentially the identification and allocation of government resources in order to fulfil the government objectives. It is an estimate of the revenue and expenditure required by the government authorities to achieve policy implementation with regard to social, economic and political objectives.

1.1 Local government planning and budgeting process

Definition

Local government budgeting is the planned allocation of the available Local Government Authority (LGA) funds to each department.

The budget preparation process begins with the issuance of national planning and budgeting guideline which are issued before budgeting each year.

On receipt of the budget guidelines, the Ministry responsible for local government clarifies the issues that are relevant to local government authorities and provides guidance on how they should treat them in their plans and budgets.

The local government budgeting process involves the following major stages

(a) The LGA planning and budget cycle requires planning to start at the lowest level of the local Government hierarchy passing the various stages before final approval. This means that the Bottom up planning approach is adopted in budgeting which ensures that the people’s priorities and needs are incorporated in the course of developing LGA plans and budget. The process of Opportunities and Obstacles to Development (O&OD) is followed in this stage where the local priorities are fed into the system of review, debate and approval up to the national level.

(b) The village prepares its plans using the O&OD approach and conveys it through the Ward development Committees to the LGA. These plans are improvised and made suitable to fit into the approved budget at each stage.

(c) The LGA modifies these plans to suit the national guidelines for budget and alignment with the recurrent and development budgets and presents it to the regional council for debate and approval.

(d) These plans are then forwarded to the regional secretariat for review, compilation and forwarding to Ministry of Regional Administration and Local Government in the Prime Minister’s Office. (PMO RALG)

(e) The LGA plans are consolidated into the PMO – RALG plans and submitted to parliament for approval. These plans are approved in the parliament and conveyed to the LGA.

(f) The approved budget is communicated to LGA and disbursement begins. The villages are informed of the final approved budgets and implementation of the plans within the approved budget begins.

Example

In order to understand the budgeting process through an example, let us take an example of a village that wants to build some basic facilities and wants funds in the budget for this.

The village council of Kiganza has developed a plan to build roads, primary schools and water tanks in the coming year. These plans are submitted to the LGA of Kiganza as a part of the O&OD approach to budget. These plans are then studied by the LGA to see if the expenses match the revenue collected from the council and funds received from the central government. These plans are revised if required to suit the requirements of the national budgeting guidelines. After thorough reviews and approvals from the LGA the budget plans are merged in the PMO RALG plans since all the local level budgets need to be merged at the national level. Once the budgets are passed keeping in mind the available resources with the government and revenues raised, these are communicated to the LGA. The LGA then disburses the allotted amount to the village councils who in turn start the budget implementation process.

Diagram 1: Local government budgeting process

- Village level priorities fed into the system using the O&OD approach
- Village level plans prepared and submitted to WDC
- WDC forward plan to the LGA
- LGA submits plans (after alignment with national guidelines) to regional council for approval
- Plans submitted to PMO RALG for approval
- LGA plans consolidated in PMO RALG plans and submitted to parliament for final approval
- Plans approved by parliament
- Approved budget informed to LGA
- Funds disbursed for implementation purposes

1.2 Recurrent Budget and development budget

The Tanzanian government spending is divided in two main divisions – recurrent spending and development spending.

LGA budgets are divided in recurrent and development budget. Recurrent budget refers to revenue and expenditure specifically for the purpose of meeting day to day operating expenditure such as payment of employee's salaries, office expenses, rent etc.

Example

The expenses that recur each year like employee pensions, salaries, cost of running ministries, cost of running vehicles, fuel, repairs to roads, schools etc. are all recurrent costs for any local government office. These will form part of the recurrent budget costs.

There are sub-divisions of the recurrent budget expenses like the Personal Emoluments (PE) which includes salaries of staff, Other Charges (OC) and Consolidated Fund Services (CFS) that relate to interest payment on debts, amortisation expenses of debts and other charges that need to be paid by law.

Development budget on the other hand deals with revenue and capital expenditure raised for the purpose of meeting LGAs developments such as construction of infrastructure, health facilities such hospitals, education infrastructures etc.

Example

The expenditure made for building a hospital, school etc will be classified as development expenditure and will form a part of the development budget. The revenue and expenditure for these works will be drawn from the development budgets.

Test Yourself 1

The Tanzanian budget approval process follows the bottom up approach to budgeting. What is the method that allows the voice of the local Tanzanians to be heard by the National Government in this process?

A The Opportunities and Obstacles to Development Approach (O&OD)
B The Development Budget Approach
C The Local Government Authority Approach (LGA)
D The Recurrent budget Approach

Test Yourself 2

The annual recurrent budget is prepared in order to

A Make provisions for all the expenses of the local government authorities
B Make provision for repetitive expenses like salaries, pensions, repairs, fuel for vehicles etc
C Make provisions for building structures like schools that are built every year
D Make provisions only for the salaries of the head of the departments within the government offices

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2. Identify the budget approval, monitoring, control and evaluation. State local government planning cycle.

[Learning Outcomes c and d]

2.1 The budget approval, monitoring, control and evaluation

1. Budget approval process

The LGA budget approval commences with submission of budget to finance committees which have a mandate to synchronise and revise the budget estimates. Thereafter the finance committee consolidates the estimates, prepares such reports and memoranda as it may deem necessary and submit the same to Parliament for approval.

The budget is presented for approval in the Parliament through a ‘Budget speech’. The budget is finally placed before the Parliament for debates during this speech. However these debates are general debates. The detailed discussions and debate happen at the finance committee levels and the comprehensive budget is presented to the Parliament only for approval purposes. The Parliament does not have the right to change the budget allocations agreed at the committee levels. In case the National Assembly refuses to approve the budget, President has powers to dissolve the Parliament.

Example

The council of Tanga submits its annual budget containing detailed requirements of the city council for the year. These include funds required to build new primary school building, repairs to public transport vehicles and road repair costs among other items. This budget will be submitted to the LGA who will forward it to the finance committees. Likewise the finance committees will receive budgets from many more city and village councils.

The finance committees will discuss and debate on the feasibility of these budgets and approve funds from the consolidated fund account for each council. A consolidated budget will then be forwarded to the Parliament for final approval before the disbursement process starts.

Section 43(4) of the local Government Finance Act no 9 of 1982 provides option to the Council to approve the expenditure up to 15% of the preceding year approved budget if the current budget is not approved by appropriate officer before the commencement of current year.

2. Budget monitoring and evaluation

Definition

A budgetary control system is a means of monitoring revenue and costs and thereby exercising control in an entity by developing budgets and comparing budgeted figures with actual results.

This system highlights any discrepancies and allows corrective action to be taken.

The budgetary monitoring, control and evaluation is essential in order to closely supervise the public projects and ensure that the funds allocated for a specific government task are used properly. The monitoring, evaluation and control function is aimed at

(a) audit both internal and external
(b) the LGA taking timely corrective action in cases where actual performance is not in line with the budget.
(c) accountability towards the public in order to ensure the efficiency and effectiveness of the use of budget funds for the allotted purpose
(d) assisting in management function of the government and LGA to carry out the budget tasks

The Integrated financial management system (IFMS) is the main tool used in the monitoring, control and evaluation of budgets. This is a system through which the Accountant General's office controls expenditure, executes payment and generates reports. This system connects the government paying stations to each other and hence any payment from the government account gets tracked in the system.

Apart from this internal audits are conducted to ensure efficiency in the operation and execution of budget. External audits are also conducted annually and reports submitted by the Controller and auditor general (CAG) after nine months from the end of the financial year and presented in the next session. The CAG has to ensure that the public money is used economically, efficiently and effectively.

The Ministry of Finance shall also submit quarterly Budget Execution Reports so as to maintain transparency regarding the use of funds according to budgets.

Example

Continuing the above example of the city council of Tanga, let us assume that the budget for building the school, vehicle repairs and road repairs is sanctioned and the funds allotted to the council. The sub committees of finance will publish reports on Budget execution which will reveal what amount has been actually spent on road repairs, building school and vehicle repairs through the IFMS that is electronically connected to the city council of Tanga. The LGA will also have to get internal audits conducted in order to reveal any excesses or losses. Therefore the continuous control, monitoring and evaluation of the budget execution process will ensure that public welfare projects are carried out properly.

Test Yourself 3

A budget is proposed to be debated and discussed in the Parliament through a

A Budget execution report
B CAG report on budget
C Budget speech
D Internal audit report on budget

Test Yourself 4

The Integrated Financial Management System – IFMS has been generated in order to

A Link all the government paying stations to central government
B Make payments from the government account
C Receive revenues in the government account in form of taxes
D Create audit reports for management of the Consolidated Fund account

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2.2 Local Government planning cycle

Local government planning cycle is basically driven by a participatory approach. It involves a large number of stakeholders and the community. The 'Opportunities and Obstacles to development' – O&OD approach is used as the major tool in the planning process at this stage. The LGAs in Tanzania are required by law to devise plans and budgets to perform jurisdiction in their designated areas. The plans and budgets need to be prepared according to the national guidelines for planning issued by the central government.

The local government planning cycle generally involves the following steps

(a) **Analysis of requirements:** this stage involves identifying the needs of the village and communities and deciding upon the resources required to fulfil the plans. The O&OD approach helps a lot at this stage since the village groups can put forward their requirements here in order to be considered in the planning and budgeting stage.

(b) **Strategic planning:** this is the stage where the annual plan is prepared highlighting the broad objectives of the annual budget plan. The strategic plan spells out the major development projects and reforms that will be undertaken during the year.

(c) **Annual Budget planning:** Estimation of costs involved in implementation of strategic plans according to and within the limits of the allotted budget is done in this stage. A clear and accurate costing of all the resources involved including material, labour and overheads is taken into account to prepare the annual budgets before sending them for approval. The ward development committees and LGAs work closely to finalise the budget at this stage.

(d) **Action plans:** At this stage the LGA decides on how to carry out the development plans as outlined in the strategic plan. This involves allotting the funds received from the central government among the various committees involved in implementation of the strategic plans.

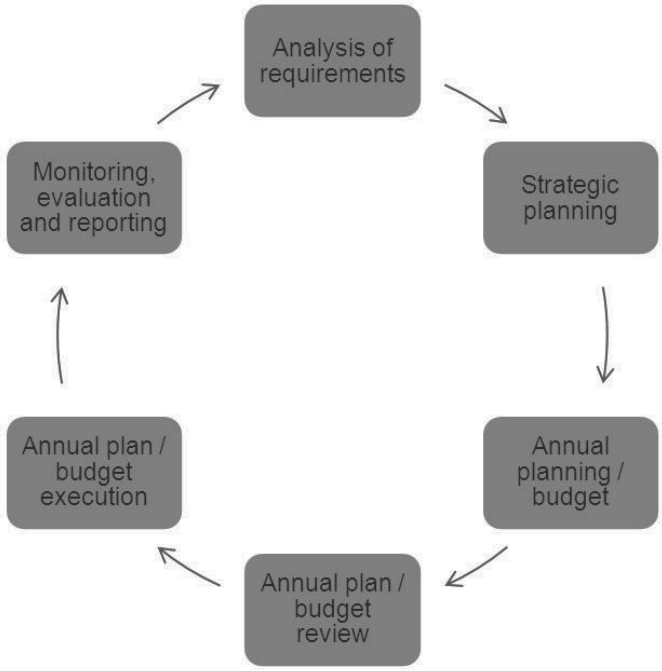
(e) **Implementation/Budget execution:** The IFMS system plays a crucial role at this stage since it controls all the expenses for the public welfare and development activities. All the payments are routed through this system in order to monitor whether the money sanctioned is being utilised for the agreed purposes.

(f) **Monitoring, evaluation and reporting:** This stage is similar to the budget monitoring, control and evaluation process explained in point 2.1 above. Monitoring and control are undertaken through audit procedures at the LGA level and the audit reports evaluated for any deviations from the set plans.

Example

The LGA of Moshi needs to prepare the annual plan and budget for the coming year. In order to start the process it will first approach the local communities using the **O&OD approach** and take inputs from them regarding their **requirement**s. Let us assume that building roads is one of the most crucial requirements. This will then form a part of the **strategic plan.** Keeping this as one of the main component of the strategy for the coming year, the LGA will then **prepare a costing analysis for the revenue and expenses** required to build roads. These plans will be debated and approved by the Parliament and **funds allotted according to budget limits**. The funds will be then **routed through the IFMS** to the LGA and **monitored for end use**. The LGA will **periodically audit its systems** and any **losses or excesses will be evaluated**. A detailed **audit report** will be prepared and **submitted to the LGA** for **review and action**.

Diagram 2: Local government planning cycle



Test Yourself 5

A strategic plan is a plan that communicates

A Stakeholders regarding the expenses planned to be made during the year
B Revenues that will be collected during the financial year
C The major reforms and developments that will take place in the coming year
D The performance evaluation for the past year

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3. Identify the role of Ward Executive Officers (WEO).
Identify the role of Village Executive Officers (VEO).
Identify the role of the Finance Committee.
Identify the role of the Treasurer.
Identify the role of Director.
Identify the role of Council.
Identify the role of Regional Administrative Secretary.
Identify the role of Regional Commissioner.
Identify the role of Minister responsible for Local Government.
[Learning Outcomes e,f,g,h,i,j,k,l and m]

Roles and responsibilities in LGA.

The governance of LGA's starts with Village Executive Officers (VEO), Ward Executive Officers (WEO), and Councillors on one hand and the management team on the other which includes head of departments, treasurer, executive director, Regional Administrative Secretary, Regional commissioner and Minister responsible for local Government.

1. Role of ward executive officers (WEO) and village executive officers (VEO).

The VEO's and WEO's are appointed by the Government and charged with the duties of supervising all issues related to administration, planning, wellbeing of the society, economic affairs etc within the mandate of LGA on behalf of the Executive Director.

Roles of VEOs and WEOs include the following:

(a) Initiating and promoting development projects in the Ward/Village through participatory approaches like O&OD.

(b) Monitoring revenue collections

(c) Supervise all funds established and entrusted to the wards/village

(d) Ensure implementation of decisions and policies of the district councils

Example

The VEO and WEO within the Iringa LGA carry out the functions of regularly having a dialogue with the local residents and collect information on the needs of people to build a better community life. These inputs are used as budget inputs and communicated to higher authorities. They also supervise the revenue collections and expenses from funds allotted from time to time for development activities in the area.

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2. Role of the Finance Committee

The Committee is made of the LGA stakeholders, employees, and elected Councillors and is charged with the duties to oversee all matters related to finance and budget within the Council.

It will be the responsibility of the Finance committee:

(a) To control and supervise the finance of the council as per financial regulations

(b) To consider and recommend changes to the rates of all taxes, fees and other charges made by the council.

(c) To review and recommend on both recurrent and development budget before submission to full council for approval.

(d) To receive, examine and recommend for approval to full council any supplementary estimates.

(e) To received, examine and recommend for approval to full council procurement plans and budgets

(f) To receive, examine and recommend to full Council for approval quarterly financial and procurement reports.

Example

The Finance Committee in the LGA of Iringa will supervise and examine the inputs, estimates and budgets that it receives from the various VEOs and WEOs within the LGA. It will supervise all the expenses as well as recommend if there is any need to revise tax structures in order to increase revenue or regulate it.

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3. Role of treasurer

The treasurer serves as the head of Finance or the chief finance officer in LGA and is charged with the following.

(a) To develop and implement macro-economic fiscal policy for the LGA by supervising and monitoring finances and coordinating inter-governmental fiscal relations.

(b) To advise LGA on resource allocation and appropriate level of resources to be allocated to individual projects.

(c) Ensure full and transparent accounts are maintained by the LGA

(d) Ensure that there are proper systems in place for planning and budgeting and fulfil all requests for public moneys before they become a part of estimates to be submitted to higher authorities / councils.

(e) Ensure that public moneys and funds are utilised with propriety and an account is submitted to the National assembly.

Example

Continuing the example of Iringa LGA,

The role of the treasury department includes ensuring that appropriate amount of funds are allocated to the LGA for the purpose of fulfilling the development activities. It will also ensure that the funds so allotted are used for the purpose they are allotted.

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4. Role of the director.

The director is the accounting officer of the urban or district authority which they serve as the executive director and shall be responsible for:

(a) Accounting for any service in respect of which the LGA has appropriated moneys

(b) Issues of any money to the LGA from the exchequer account

Example

In Moshi district the LGA has undertaken a development project of constructing playgrounds for kids. They will construct the playgrounds and will provide them to public for a charge of a nominal fee. The director in this case will account for all the expenditure and revenue from the playgrounds and will also look into the issue of money from the exchequer account to the LGA if required.

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5. Role of the Council

Councils at the district and the village level are a part of the decentralisation of governance by the Tanzanian government. These councils are established at the town, city and village levels to take care of the local government activities concerning their area. The functions of the Council shall be the following

(a) To maintain and facilitate the maintenance of peace, order and good governance within its area of jurisdiction.

(b) To promote the social welfare and economic well-being of all persons within its area of jurisdiction.

(c) To further the social and economic development of its area of jurisdiction.

(d) To negotiate on all matters relating to terms and conditions of services of local government employees or groups of them.

Example

The district council of Moshi will have all the powers to look onto the administration, law and order in Moshi. It will also be responsible for promoting the development in Moshi by suggesting and helping in implementation of various projects.

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6. Role of Regional Administrative Secretary

This is an administrative post where administrative secretaries have the following responsibilities;

(a) Advise and facilitate proper use of public finances in LGA

(b) Promote good governance in LGA and periodically review the structures and processes

(c) Conduct routine inspections of the LGA

(d) Assist in budget preparations and expenses allocations and advise on administrative matters.

Example

The LGA of Atawa has recently identified that there is a dire need for a concrete bridge on the river that flows through the city to avoid transportation delays and threat to life of people due to the existing dangerous rope bridge. It has been sanctioned funds from the national treasury department for this purpose. In this case the administrative secretary shall scrutinise the plans and decide on the feasibility of the bridge construction and the resultant benefits. Once the work starts the administrative secretary will oversee the project and processes periodically as a part of routine LGA inspections. The secretary will also assist in budget preparation and give advice on administrative matters relating to the project.

7. Role of Regional Commissioner

Regional commissioners are appointed by the President of the United Republic of Tanzania and are leaders in the Government. The following are the functions of the Regional Commissioner.

(a) To exercise all the duties and functions of the Government.

(b) To facilitate and assist local governments in discharging their duties and functions for successful performance. In this function it is his duty to provide a conducive and enabling environment where the effective discharge of duties by LGA is possible.

(c) To be the principle representative of the Government within the region.

(d) To be responsible for the exercise and discharge of other functions conferred by any other law.

(e) To maintain law and order in the region and make efforts for implementing general policies of the government in the region.

8. Role of the minister responsible for local government

Ministers shall, in relation to a local government authority under his/her charge and subject to the provision of the applicable Act, be responsible for

(a) Ensuring the proper management of finances of the local government authority

(b) Promote the timely preparation of the annual budget for the authority and ensures that the authorities operate within the limits of the approved budgets.

(c) Facilitate the availability of funds for operation of local authority

(d) Direct the LGA to maintain such reserves, renewals and special funds as he may deem necessary for special projects.

(e) Give approvals to LGA to operate a banking account in its name and also open additional bank accounts as may be deemed necessary.

Example

The regional commissioner and the minister are responsible to help smooth functioning of the LGA and assist them in every possible manner for discharge of their lawful duties. This is done by the regional commissioner by effective communication of general government policies like – there should be primary education facilities available to all children, there should be proper sanitation facilities for all etc. to the LGA. LGA will in turn prepare a requirements list and submit it to the central authorities under the guidance of the regional commissioner. In this case the Minister will be responsible to make funds available to the LGA and aid LGA functioning.

Test Yourself 6

What are the roles of Councils in budgetary process?

Test Yourself 7

To initiate, promote and implement development projects within the village or ward is the responsibility of

A Ward executive officer or Village executive officer
B The regional commissioner
C The Council
D The Director

Answers to Self Examination Questions

Answer to TY 1

The correct option is **A**.

The O&OD approach helps the village councils present their requirements to the LGA through the Ward development committees. This exercise is done very seriously in order to take into account the needs of the lowest level of people groups including minorities like women and disabled people.

Answer to TY 2

The correct option is **B**.

The recurrent budget includes all the expenses that are made on a repetitive basis. These include salaries, pensions, repairs etc. All the expenses of local authorities will include capital expenses also that will come under development budget, salaries of department officers will be a part of recurrent budget but not the whole of it. Building schools is a part of development budget expenditure.

Answer to TY 3

The correct option is **C**.

A budget is proposed to be debated and discussed in the Parliament through a budget speech. CAG report on budget, internal audit reports and budget execution reports are submitted after and during the budget execution stages.

Answer to TY 4

The correct option is **A**.

The IFMS links all government paying stations electronically so that all the revenues and payments from the government account can be tracked. It facilitates the audit function.

Answer to TY 5

The correct option is **C**.

The strategic plan is the big picture to be presented to stakeholders and the public. It talks of the major reforms and developments that will take place during the coming year.

Answer to TY 6

The functions of the councils are as follows

(a) To maintain and facilitate the maintenance of peace, order and good governance within its area of Jurisdiction.

(b) To promote the social welfare and economic well- being of all persons within its area of Jurisdiction.

(c) To further the social and economic development of its area of Jurisdiction.

(d) To negotiate on all matters relating to terms and conditions of services of local government employees or group of them.

Answer to TY 7

The correct option is **A**.

It is the prime duty of the Ward executive officer or Village executive officer to initiate, promote and implement the development projects in a village or ward area in consultation with the local people using the O&OD approach.

Self Examination Questions

Question 1

Explain in detail the local government budgetary process

Question 2

Explain in detail the local government planning cycle?

Answers to Self Examination Questions

Answer to SEQ 1

The local government budgetary process in Tanzania adopts a participatory approach. This approach involves the following steps

(a) The local priorities are fed into the system using the O&OD approach for review, debate and approval.

(b) The Ward development committees receive the plans and budgets from the village level councils and forward them to the LGA.

(c) The LGA scrutinises and modifies these budgets and plans in order to suit the national budget guidelines, budget limits and to bring them in line with the recurrent and development budgets.

(d) These plans are then forwarded to the regional secretariat for review, compilation and forwarding to Ministry of Regional Administration and Local Government in the Prime Minister’s Office. (PMO RALG)

(e) The LGA plans are consolidated into the PMO – RALG plans and submitted to parliament for approval. These plans are approved in the parliament and conveyed to the LGA.

(f) The approved budget is communicated to LGA and disbursement begins. The villages are informed of the final approved budgets and implementation of the plans within the approved budget begins.

(g) The budgets are further monitored, controlled and evaluated through an audit process. This involves internal and external audits and reporting on the excesses and losses. The Integrated Financial Management System (IFMS) that connects all the government paying stations helps in this process as it tracks all the expenses of each LGA.

Answer to SEQ 2

The local government planning cycle involves the following steps

(a) Analysis of requirements: this stage involves identifying the needs of the village and communities and deciding upon the resources required to fulfil the plans. The O&OD approach helps a lot at this stage since the village groups can put forward their requirements here in order to be considered in the planning and budgeting stage.

(b) Strategic planning: this is the stage where the annual plan is prepared highlighting the broad objectives of the annual budget plan. The strategic plan spells out the major development projects and reforms that will be undertaken during the year.

(c) Annual Budget planning: Estimation of costs involved in implementation of strategic plans according to and within the limits of the allotted budget is done in this stage. A clear and accurate costing of all the resources involved including material, labour and overheads is taken into account to prepare the annual budgets before sending them for approval. The ward development committees and LGAs work closely to finalise the budget at this stage.

(d) Action plans: At this stage the LGA decides on how to carry out the development plans as outlined in the strategic plan. This involves allotting the funds received from the central government among the various committees involved in implementation of the strategic plans.

(e) Implementation/Budget execution: The IFMS system plays a crucial role at this stage since it controls all the expenses for the public welfare and development activities. All the payments are routed through this system in order to monitor whether the money sanctioned is being utilised for the agreed purposes.

(f) Monitoring, evaluation and reporting: This stage is similar to the budget monitoring, control and evaluation process explained performed for LGA budgets. Monitoring and control are undertaken through audit procedures at the LGA level and the audit reports evaluated for any deviations from the set plans.

STUDY GUIDE A7: ACCOUNTING FOR GOVERNMENT REVENUE AND EXPENDITURES

Get Through Intro

Government generates revenue from various sources to run the administration of the nation and to provide the development projects in all sectors of the economy. Such revenues are generated by the revenue generation agencies and organisations through effective machinery, and allocated through the budgetary system to the spending organisations for their operations. A good system of revenue generation is paramount to ensure that government mobilises enough finances for the expenditures of the nation to meet the varied needs of the people.

This Study Guide discusses various aspects of government revenues and expenditure like the regulations applicable for revenue collection, the classification of revenue and expenditures, the sources of revenue for central as well as local government, the refund and retention schemes, tax revenue, the different categories of government expenditure, the cash and bank management procedures and the relevance and applicability of IPSAS 9 and IPSAS 23.

Knowledge of this Study Guide will not just help you pass the exams, but also in your career as an auditor or an employee of a government department.

Learning Outcomes

a) Explain the relevant legislations used in regard to revenue collection.
b) Explain the classification of revenue and expenditures.
c) Identify the sources of revenue for the central government.
d) Identify the sources of revenue for local government authorities.
e) Explain refund of revenue.
f) Explain retention scheme.
g) Explain tax revenue.
h) Recording of revenue and transfer to exchequer account.
i) Explain and record public investment income.
j) Explain different categories of government expenditures.
k) Identify the procedures used in cash and bank account management.
l) Explain relevance and applicability of IPSASs 9 on revenue from exchange transactions and revenue from non-exchange transactions in public sector.

1. Explain the relevant legislations used in regard to revenue collection.
[Learning Outcome a]

According to the Tanzania Revenue Authority Act, revenue means taxes, duties, fees, fines or other monies imposed by or collected under the laws or the specified provisions of the laws set out in the First Schedule.

The various tax laws which oversee taxation process in Tanzania consist of:

The main Laws,
Regulations and
Finance Acts

Each of the above are explained in turn, below.

1.1 The main tax laws

These are the fundamental laws to be read in conjunction with their respective Regulations and Finance Acts

Income Tax Act Revised Edition 2008
Income Tax Act Revised Edition 2006
The Value Added Tax Act, 1997
The Tax Revenue Appeals Act
The Hotels Act
The Tanzania Revenue Authority Act
The Port Service Charges Act, 1973
The Motor vehicle (Tax Registration and Transfer) Act, 1972
The Airport Service Charges Act, 1992
The Road and Fuel Toll Act, 1985
The Stamp Duty Act, 1972
The East African Community Customs Management Act, 2004
The East African Community Customs Management (Amendment) Act, 2011
The East African Community Customs Management Act, 2004 (Revised)
The Excise Management and Tariff Act

Each of the significant tax laws is explained below:

(a) Income Tax Act Revised Edition 2008

The Income Tax Act makes provision for the charge, assessment of income tax, collection of income tax, the ascertainment of the income to be charged and matters incidental thereto.

It spells out all the aspects of computing income-tax like:

persons who are liable to income tax
the methodology of calculating the income tax base
the incomes exempt from tax
the general deductions allowed in the calculation of taxable incomes
tax accounting and timing
rules applicable to particular types of persons like partnerships, trusts, corporations and special industries (like insurance business, retirement savings, charitable organisations)
international taxation

(b) The Value Added Tax Act, 1997

There shall be charged in accordance with the provisions of this Act, a tax known as the Value Added Tax on the supply of goods and services in Mainland Tanzania and on the importation of goods or services from any place outside Mainland Tanzania made on and after the 1st day of July, 1998.

(i) The VAT shall be charged on any supply of goods or services in Mainland Tanzania where it is a taxable supply made by a taxable person in the course of or in furtherance of any business carried on by him.

(ii) The VAT on a taxable supply of goods or services shall be payable by a taxable person at the end of a prescribed accounting period or at any time which the Commissioner may prescribe.

(iii) The VAT on the importation of taxable goods or services from any place outside Mainland Tanzania shall be charged and payable in accordance with this Act and the procedures applicable under the Customs Laws for imported goods shall apply in respect of VAT imports.

(c) The Tax Revenue Appeals Act

This Act provides for the establishment of the Tax Revenue Appeals Board and the Tax Revenue Appeals Tribunal and provides for related matter.

It spells out:

establishment of the tax revenue appeals board and tax revenue appeals tribunal
the methodology of spelling out raising objections to tax assessments
general matters relating to appeals
proceedings of the board and the tribunal
offences and penalties for not meeting with the requirements of the tribunal or the board

(d) The Hotels Act

This Act applies to hotels and guest houses.

Revenues collected under the provisions of this Act are as follows:

(i) Every owner of a hotel or guest house shall pay, in respect of every guest, a levy of 20% of the hotel charges.

(ii) The levy payable by a guest house owner shall be due to the Local Government Authority responsible for the area in question.

(iii) Failure to pay the levy (of 20% of hotel charges) within the time and in the manner which may be prescribed by regulations made under it; will make the owner liable to a penalty of 25%of the unpaid amount of the levy;

(iv) If any amount remains unpaid by the owner for more than thirty days after the date upon which it is due, additional levies are prescribed by the Act.

(e) The Tanzania Revenue Authority Act (TRA)

TRA was established on 31st July 1995 as an autonomous agency of the government of Tanzania; it became operational in 1st July 1996 under the supervision of the Ministry of Finance and Economic affairs. The general aim of establishing TRA was to bring efficiency in revenue administration and collection.

Since 1996 the TRA has been performing the following functions as prescribed in the establishment Act:-

(i) Implementing tax laws in order to assess, collect and account the collected tax revenue;

(ii) Ensuring effective, fair and efficient administration of union tax laws;

(iii) Monitoring and ensuring the collection of other taxes not collected by it but the revenue is for union government.

(iv) Advising the minister and other relevant organs regarding suitability of fiscal policy;

(v) Encouraging voluntary tax compliance;

(vi) Increasing taxpayers' services given by revenue departments to increase revenues collection;

(vii) Taking actions against tax evasion and avoidance;

(viii) Providing trade statistics and publications on a quarterly basis; and

(ix) Performing other functions as direct by the minister of finance.

(f) The Port Service Charges Act, 1973

Subject to the provisions of section 4 and to any exemption granted under this Act, there shall be paid by every passenger, on each occasion on which he embarks on a ship or a ferry, at a port in Mainland Tanzania is required to pay the following port service charges:

Details	Port service charge
Resident on a journey to a destination within or outside the United Republic	five hundred shillings
Non-residents on a journey to a destination within or outside the United Republic	five US Dollars or its equivalent in convertible currency

The above charges are subject to provisions of section 4 and to any exemption granted under this Act.

The charge shall be a debt due to the Government and shall be paid prior to embarkation to a collection agent.

(g) The Motor vehicle (Tax Registration and Transfer) Act, 1972

The provisions of this Act apply to:

a motor vehicle constructed or adapted solely or mainly for the carriage of passengers and their personal luggage and having a seating capacity, as assessed by the licensing authority, for not more than fifteen persons including the driver;

a motor-cycle;

pick-up, panel truck or similar vehicle of less than three tons load carrying capacity.

The provisions of this Act levy the following taxes on motor vehicles:

1	Registration tax	Applicable upon: first registration of any motor vehicle to which this Act applies; the expiry of the exemption from registration tax or on transfer of the motor vehicle to a person not enjoying similar exemption; The registration tax shall be paid to the licensing authority.
2	Tax on transfer	This relates to the charges, levied upon the transfer of any motor vehicle to which this Act applies. Rates are specified in the second schedule of this Act. The tax on transfer shall be paid to the licensing authority.
3	Penalty	Failure to pay registration tax and tax on transfer, within the due date shall be liable to a minimum payment of 25% of the tax due as penalty

(h) The Airport Service Charges Act, 1992

According to section 3 of this Act, there shall be paid by every passenger on every occasion on which he embarks on an aircraft at an airport to begin a journey, or to continue on a journey broken more than twelve hours prior to re-embarking, a charge to be known as airport service charge.

A passenger embarking on an aircraft at an airport within the United Republic who intends to travel to a destination within the United Republic shall pay an airport service charge of five thousand shillings.

Any passenger embarking on an aircraft at an airport within the United Republic who intends to travel to a destination outside the United Republic shall, whether or not a resident of the United Republic, pay in foreign convertible currency an airport service charge equivalent to thirty United States dollars.

The charge shall be a debt due to the Government and shall be paid prior to embarkation to a collection agent or to a revenue office appointed for that purpose.

(i) The Road and Fuel Toll Act, 1985

There is hereby established a fund to be known as the 'Roads Fund' into which shall be paid all monies collected as roads and fuel tolls imposed on diesel and petrol, transit fees, heavy vehicle licences, vehicle overloading fees, or from any other source at the rate or rates to be determined by parliament from time to time. All monies collected as roads and fuel tolls shall be deposited in the account of the fund.

At least ninety percent of the money deposited in the fund shall be used for maintenance and emergency repair of classified roads and related administrative costs in Mainland Tanzania in accordance with approved operational plans made

(j) The Stamp Duty Act, 1972

Every instrument specified in the Schedule to this Act and which is executed in Tanzania Mainland; or if executed outside Tanzania Mainland, relates to any property in Tanzania Mainland or to any matter or thing to be performed or done in Mainland Tanzania, shall be chargeable with duty of the amount specified or calculated in the manner specified in that Schedule in relation to such instrument.

(k) The East African Community Customs Management Act, 2004 and The East African Community Customs Management (Amendment) Act, 2011

It is an Act of the community to make provisions for the management and administration of customs and for related matters.

It addresses various matters relating to customs like:

- administration
- prohibited and restricted imports
- warehousing of goods
- prohibited and restricted exports
- importation and exportation by post
- computation of duties, duty draws back, reliefs, etc.
- custom agents
- prevention of smuggling
- export processing zones and free ports

(l) The Excise Management and Tariff Act

The Act makes provisions for the control of the manufacture of excisable goods, the denaturing of spirits, for the collection of excise duties and for related and connected matters.

It covers various aspects of manufacture of excisable goods like:

- administration of excise
- licensing requirements for manufacture of excisable goods
- licensing required to denature spirits
- controls on manufacture
- provisions relating to securities
- duties-computation, payment, etc.

excise agents
Penalties, forfeiture
Legal proceedings
Excise Tariffs

1.2 Regulations

This part consist of regulations made by the Minister for matters authorised to be made or prescribed and for better carrying into effect of the principles, purposes and provisions of the respective Acts.

(i) Regulations under the Income Tax Act:

The Income Tax Regulation
EFD Regulation 2012
The income Tax (Transfer Pricing) Regulations, 2014
Transfer Pricing Guidelines

(ii) Regulations under VAT:

The Value Added Tax (Registration) Regulations, 1998
The Value Added Tax (General) Regulations, 1998
The VAT (Corrections of errors) Regulations, 2000
The VAT (Imported Services) Regulations, 2001

(iii) Regulations under the EAC Customs Management Act:

EAC customs Management (Duty Remission) Regulations, 2008
EAC customs Management Regulations, 2010
EAC customs Management (compliance and enforcement) Regulations, 2012

Paragraph 1.1 above, discusses in details the tax laws relating to Income tax, VAT, excise and customs. Therefore the regulations are not discussed here.

1.3 Finance Acts

The Finance Act is an Act to impose and alter certain taxes, duties, fees and to amend certain written laws relating to imposition, collection and management of public revenues.

The Finance Acts which provide changes in tax laws made during a particular fiscal year are as follows:

Finance Act 2007
Finance Act 2008
Finance Act 2009
Finance Act 2010
Finance Act 2011
Finance Act 2012
Finance Act 2013
Finance Act 2014

Example

Finance Act 2014 has spelt out many amendments to the existing taxes like:

the fees structure payable as by various businesses as ‘license’.
amendment of certain words like ‘telecommunications’ appearing in the Income Tax Act.
additional imposition of duties on imported vehicles.

1.4 Legislations applicable to industries in Tanzania

In addition to the legislations discussed in paragraph 1.1, certain industries are subject to specific regulations

The legislations applicable to the mining industry in Tanzania include:

Tanzania Mining Policy of 2009
Mining Act 2010 (provides for the imposition of royalty)
Petroleum (exploration and production) Act, 1980.
The Gas Act is under preparation to cover midstream and downstream of petroleum and natural gas production.

1.5 Legislations applicable to the Local Government

Legislations applicable to the Local Government in the mainland the main legislative texts are:

Government (Urban Authorities) Act 1982
Local Government Finance Act 1982
Urban Authorities (Rating) Act 1983
Regional Administration Act 1997
Local Government Laws (Miscellaneous Amendments) Act 1999

Test Yourself 1

Briefly explain the The Excise Management and Tariff Act.

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2. Explain the classification of revenue and expenditures.
Explain tax revenue.

[Learning Outcomes b and g]

2.1 Classification of revenue

As explained in Learning Outcome 1 revenue means taxes, duties, fees, fines or other monies imposed by or collected under the laws or the specified provisions of the laws set out in the First Schedule of The Tanzania Revenue Authority Act

Government revenue can be classified as tax revenue and non-tax revenue:

1. Tax revenue

Tax is a financial charge imposed by the government. The fundamental purpose of taxation is to finance government expenditure. The imposition of taxation by governments withdraws money from the economy, and their expenditure returns the money to the economy.

Taxes are the most important source of public revenue and are necessary for the functioning of the government. Funds collected by way of taxes are utilised by the government to provide various infrastructure / facilities to the taxpayer; however benefits of such public expenditure by the government is enjoyed even by those people who are not liable to pay taxes.

Following are the essential elements of any tax:

it is generally payable in money

it is a proportion or a percentage

it is levied on persons

it is levied by the government

It is levied in order to cater to public purpose

(a) Classification of tax revenue

Tax revenue can be classified based on different parameters:

(i) Classification based on collection

Taxes are generally classified as direct tax and indirect tax.

Direct tax is generally the tax on the income of the person and the burden of tax is borne by the tax payer only whereas in case of indirect tax, the burden can be passed on to another person.

Tax is divided into direct tax and indirect tax.

2. Direct Tax

It is a tax levied on the income of an individual.

Income can be from any sources such as:

income from earnings (e.g. employment income / trade profit)

income from pensions

income from other benefits (e.g. rental income)

income from savings (e.g. interest income)

income from investments (e.g. dividend income)

Income tax is calculated on earned income (i.e. income from employment) as well as on income from savings etc. Income from various sources is pooled together and tax is charged on the aggregate income after deducting the relevant personal allowance. Taxpayers who are employed pay income tax on their earnings under the statutory Pay As You Earn (PAYE) scheme.

(a) Corporate Tax: is the tax payable by companies on their 'chargeable profits'. There are numerous provisions relating to corporation taxes which are dealt with at length in Papers B4 and C4.

(b) Capital gain taxes: is chargeable on the profits arising from the disposal of assets that are in their possession.

Example

For example, Adam sells his business asset at a profit of Tshs5 millions. So, the amount of profit i.e.Tshs5 millions is chargeable to capital gains tax.

3. Indirect Tax

This is a tax which is not paid directly by the person who suffers or bears the burden. This type of tax is put on goods and services that are bought and consumed by individuals. Examples of indirect tax are customs duties, excise duties, VAT, Government borrowings, dividends from Government owned ventures, income from government investments, grants and aids from internal and external agencies and miscellaneous gifts :

Example

Income tax is a direct tax. It is levied as a percentage of the income of a person and has to be borne by the person who is taxed and he cannot pass on the burden to anyone else whereas in case of VAT (which is an indirect tax) the burden can be passed on to the consumers by way of a higher price.

(ii) Classification of bases of levying taxes

The basis, on which taxes are levied, can also be bifurcated into following three categories:

Progressive taxation: a tax such as the income tax demonstrates the progressive principle. As income rises so does the proportion of tax i.e. the rate of tax rises as well as the amount of tax. This can be considered as just and fair, as the higher tax payments are made by those with higher incomes. Taxes which take a higher percentage of the incomes of higher income earners are said to be progressive.

Example

In case of income tax, a tax payer pays no tax up to 10 Tshs of income, pays 20% tax for the income between 10 Tshs and 20 Tshs and pays 30% tax for income above 20 Tshs. In this case, it can be seen that a tax payer will pay more amount (in actual terms) as well as higher percentage of tax as the income rises.

Regressive taxation: This is the tax where, as the amount of income increases, percentage of tax is reduced. So in this case, a tax payer in the high income group may be paying more taxes in absolute terms but the percentage of income is falling.

Example

Poll tax existing in the United Kingdom was such that tax payer earning 10,000 pounds and 5,000 pounds had to pay the same amount of tax say 500 pounds. This meant that a person earning 10,000 pounds would be paying 5% tax whereas a person earning 5,000 pounds would be paying 10% tax.

Proportional taxes: In this case, as the tax payer's income increases, he pays more tax but the amount that is paid as percentage of the tax payer's income remains unchanged.

Example

All tax payers have to pay say two percent of their income as education cess tax then it is proportional tax. Any increase in income does not increase the percentage of tax; same percentage is charged for all tax payers

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(iii) Classification based on occurrence

Public expenditure in Tanzania is broadly classified into two main heads: recurrent and development expenditure.

Recurrent expenditure is expenditure incurred for the day to day operations of the government like, salaries and wages of employees and other overheads, healthcare services, education etc.

Development expenditure is expenditure incurred towards improving infrastructure like roads, bridges, supply of electricity and water etc.

4. Non tax revenue

Non-tax revenue is generated through various sources. They differ in terms of nature and types as follows:

(a) Grants or aids

Grants can be defined as the non- repayable voluntary transfer of resources.

.
The grants could be of the following types:

grants provided by the central government to state government for specific objectives

grants provided by foreign countries to the central / state governments (also called as foreign aid). Foreign aid may be given to support social causes, for contribution during emergencies / natural calamities, for strengthening ties with the country or for commercial purposes.

(b) Debts from other governments or banks/ funds

When public expenditure exceeds public revenue, governments resort to borrowings.

Borrowings may be from:

- foreign countries or
- internal borrowings from the private sector in the form of debentures or bonds etc. or
- internal borrowings from central bank of the country

(c) Income from investments made by the Government

Governments invest excess funds in bonds, mutual funds of other institutions. The revenue that is earned by governments from such investments is in the form of interest or dividend.

(d) Revenue from public enterprises

Government sets up public sector enterprises, which are owned and controlled by the government. The profit earned by such public sector enterprises is a source of revenue for the government. Furthermore when the public sector enterprise earns income from sale of its non-current asset, it is revenue for government, although it is a one- time revenue and is not a recurring income.

(e) Royalties

Royalty is received by the government when it allows private enterprises to use government / public assets or intellectual property. Royalty is generally charged as a percentage of revenue derived from the use of the asset or a percentage of the unit price of the product sold. Example: Private sector enterprise has to pay royalty to the government to extract natural resources like petrol / crude oil from government owned lands.

(f) Fees and penalties

Governments charge fees for a number of services it renders to the general public. For example fees for issuing driving license/ passports, fees for generating copies of official documents, fines/ penalties levied for breaking traffic rules etc.

(g) User fees

The government charges fees for use of its assets / services provided by the government. For example a toll is charged for the use of roads / highways.

(h) Subsidies received from other countries/ banks

Government receives subsidies from international banks / monetary funds which are an indirect source of revenue for the government.

(i) Rent

Government may earn revenue by way of renting of owned buildings or by renting out parking space etc. A local authority like municipality may rent out some empty space to the central government on requirement.

Tip

The non- tax revenue of Tanzania constituted 8% of total government revenue in the year 2003-04.

Test Yourself 2

Explain one sources of non-tax government revenue.

2.2 Classification of expenditure

As discussed in the earlier paragraph, public revenue is collected to make payments towards public expenditure.

Government or public expenditure can be defined as the spending by public authorities like central, state and local authorities on various activities for achieving social and economic objectives. It also includes amounts spent for protecting citizens and amounts incurred to satisfy the general common needs of the public at large. Thus, it brings about social as well as economic development of the state.

There is no fixed basis for classifying public expenditure. In fact, public expenditure has been classified by applying different criteria / bases, as advocated by various economists. Some of the bases of classification are explained below:

1. Classification based on necessity

This classification was advocated by Professor Mill. He classified public expenditure as necessary and optional, and advocated that the state may undertake 'optional' expenditure.

2. Classification based on nature

This classification is based on the nature of the expenditure. Public expenditure is incurred for individuals or groups of individuals.

It is classified as fixed and variable expenditure.

(a) **Fixed expenditure** is that portion of public expenditure which is fixed and has no relationship to the quantum of usage of services. For example, defence expenses, amounts incurred on street lighting etc. Major portion of the expense incurred is fixed in nature; however, it does have an element of variability in it.

(b) **Variable expenditure** is that portion of public expenditure which is variable i.e. the amount incurred has a direct relationship with the quantum of usage of services. For example amounts incurred for postal service, railway services etc.

Example

Although most of the expenses incurred for postal services are variable in nature, it also has an element of fixed expense, as additional postmen are not employed for an increase of only a few letters.

Therefore almost all public expenditure has elements of fixed and variable within them.

3. Classification based on urgency

This classification based on the urgency of usage is as follows:

(a) **Necessary expenditure** is expense which cannot be avoided (like defence expenses).

(b) **Useful expenditure** is expense which can be postponed for some time (like construction of an additional bridge over a river).

(c) **Superfluous expenditure** is expense which can be avoided altogether as it is neither useful nor profitable.

4. Classification based on productivity

This classification of government expenditure is as follows:

(a) **Productive expenditure** relates to expenditure which causes increase in national income due to development / more efficient usage of national or human resources of the economy (e.g. expenditure for setting up an industrial estate in a city).

(b) **Non-productive expenditure** relates to expenses which do not cause increase in national income (e.g. war expenses).

5. Classification based on usage

This classification is based on usage as follows:

(a) **Recurrent expenditure** is expenditure incurred for the day to day operations of the government like salaries and wages of employees and other overheads, healthcare services, education etc.

(b) **Development expenditure** is expenditure incurred towards improving infrastructure like roads, bridges, supply of electricity and water etc.

3. Identify the sources of revenue for the central government.
[Learning Outcome c]

According to the revenue and taxation policy of the ministry of finance, The Union Republic of Tanzania, the central government has two primary sources of revenue: domestic revenue and external assistance.

3.1 Domestic Revenue

Domestic revenue includes tax and non-tax revenue**:**

(a) Tax revenue

Majority of domestic revenue collected in Tanzania is in the form of tax revenues, which, in 2003/04 accounted for 92% of the total central government domestic revenue. These tax revenues are collected by the Tanzania Revenue Authority (TRA), an executive agency under the ministry of finance that was established in 1996.

The TRA is mandated to collect major taxes including income tax, value added tax, import duty and excise duty.

Between 2000/01 and 2003/04 Tanzania has witnessed an average annual increase in central government tax revenues of 12% (adjusted for inflation). These increases have primarily been attributed to economic growth and substantial improvements in the tax administration.

(b) Non-tax revenue

In 2003/04 non-tax revenues accounted for 8% of the total Central Government's domestic revenues.

Non-tax revenues comprise of fees, levies and dividends etc. and are collected by the ministry of finance and other central government ministries.

The following table depicts the sources of revenue collected by central government during 2003-04:

Nature of revenue	Percentage of total revenue	
Tax revenue		
Excise on petroleum	8	
Other excise taxes	7	
PAYE	12	
Corporate tax	7	
Other income tax	5	
Other taxes	8	
Import duties	9	
VAT on petroleum	6	
Other VAT	30	92
Non-tax revenue		**8**
Total		**100**

(source:http://www.mof.go.tz/index.php?option=com_content&view=article&id=37:revenue-a-taxation-policy&Itemid=5)

3.2 External Assistance

External Assistance is the second major avenue of resources for the Central Government's budget. External Assistance **comprises grants and loans from bilateral or multilateral agencies.**

In 2003-04 it accounted for approximately 42% of the Government's resource envelope. External assistance is provided in support of the Government's national development agenda as outlined in the National Strategy for Growth and Reduction of Poverty (NSGRP).

The overall strategy guiding effective management of external assistance is outlined in the Tanzania Assistance Strategy (TAS), which is currently being reviewed and updated.

Test Yourself 3

A grant from bilateral agencies is a source of:

A Tax revenue
B Non-tax revenue
C Internal assistance
D External assistance

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4. Identify the sources of revenue for local government authorities.

[Learning Outcome d]

According to Ministry of finance, The United Republic of Tanzania, local governments have the mandate to raise and retain revenue from various sources by using their own policy which must be within the limits set by the central government revenue.

The taxes, levies, fees and revenue sources which local governments are mandated to rise under the Local Government Finances Act are as follows:

Type of tax	Details of tax
Taxes on Property	Property rates
Taxes on Goods and Services	Crop cess (maximum 5% of farm gate price) Forest produce cess
Taxes on Specific Services	Guest house levy
Business and Professional Licences	Commercial fishing license fees Intoxicating liquor license fee Private health facility license fee Taxi license fee Plying permit fees Other business licenses fees
Motor Vehicles, Other Equipment & Ferry Licences	Vehicle license fees Fishing vessel license fees
Other Taxes on the Use of Goods,	Forest produce license fees Building materials extraction license fee Hunting licenses fees Muzzle loading guns license fees Scaffolding / Hoarding permit fees
Turnover Taxes	Service levy
Entrepreneurial and Property Income	Dividends Other Domestic Property Income Interest Land rent
Administrative Fees and Charges	Market stalls / slabs dues Magulio fees Auction mart fees Meat inspection charges Land survey service fee Building permit fee Permit fees for billboards, posters or hoarding Tender fee Abattoir slaughter service fee Artificial insemination service fee Livestock dipping service fee Livestock market fee Fish landing facilities fee Fish auction fee Health facility user charges Clean water service fee Refuse collection service fee Cesspit emptying service fee Clearing of blocked drains service fee Revenue from sale of building plans Building valuation service fee Central bus stand fees Sale of seedlings Insurance commission service fee Revenue from renting of houses Revenue from renting of assets Parking fees
Fines, Penalties and Forfeitures	Stray animals penalty Share of fines imposed by Magistrates Court Other fines and penalties

Important

Local Governments are not allowed to levy any taxes, levies or fees which are not on the above list.

Test Yourself 4

Identify any four sources of Business and Professional Licences.

5. Explain refund of revenue.
Explain retention scheme.
Recording of revenue and transfer to exchequer account.
[Learning Outcomes e, f and h]

5.1 Refund and retention of revenue

When the revenue collected by a local government, exceeds budgeted revenue it is dealt with in the following ways:

the excess revenue is either refunded; or
reallocation / virement of funds is made
it is retained through a retention scheme

1. Refund of revenue

The excess revenue collected is refunded back to the exchequer.

2. Reallocation / virement of funds

Reallocation or virement of funds are authorised transfers of appropriated funds from one source to another within the same vote or from one vote to another**.** The accounting officer is empowered by the Appropriation Act to reallocate the fund from votes with excess funds to votes with deficit but within the same budget ceiling. This is discussed in detail in Learning Outcome 5 of Study Guide A5.

3. Retention scheme

It is the scheme that allows the accounting officer to retain a certain percentage of the revenue collections in different votes, hence promote the collection of recurrent revenue. Application for this scheme shall be made by ministry to policy department, where if approved a specific collection account shall be opened to commercial banks. Instruction to transfer the collected revenue to retention revenue account at Bank of Tanzania shall be issued monthly by the ministry. Proper notification of the transfer will be sent to respective ministry.

Example

The fisheries department has been allowed by the Ministry of Finance to operate a "Retention Scheme" whereby a percentage of collected revenue can be retained by the sector for use in development of the sector, effectively pre-consigning revenue to the sector of origin.

During budgeting, projection is made of revenue to be collected, and the department's annual budget is then developed on the basis of the retention of a percentage of that revenue. Should revenue collection exceed the projection, surplus funds are taken into the treasury's consolidated funds, and not retained in fisheries.

In practice the fisheries department does not itself operate the retention scheme, any and all collected revenue is deposited with the ministry of finance which in turn transfers funds (according to the department's budget) directly to the MNRT's current account. Under the terms of the retention scheme the MNRT is in turn permitted to take up to 6 percent of retained revenues for administrative purposes, and the remaining 94 percent is then the fisheries department's annual budget.

http://www.fao.org/docrep/007/j2760e/j2760e0b.htm

5.2 Recording of revenue and transfer to exchequer account.

(a) Tax revenue

The treasury recognises monthly tax revenue (based on the tax collection summary) by raising invoices of accounts receivables. It is through this process the revenue collected and amount due from TRA will be recognized.

(b) Recording of non-tax revenue and transfer to exchequer account

Collection and banking of non-tax revenue to Paymaster General (PMG) account are done by respective ministry or independent department. On receipt of notification from the bank that the money has been deposited in PMG's account, the treasury will instruct the bank to transfer the money to exchequer and issue acknowledgement receipt to respective collector.

Test Yourself 5

Write a brief note on retention schemes.

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6. Explain different categories of government expenditures.

[Learning Outcome j]

Government expenditure includes consumption and investments but excludes transfer payments. They include the acquisition of goods and services for either current use or future uses. Government expenditure can be categorised into statutory, voted and un-voted expenditure.

(a) Statutory expenditure

This is sometimes known as consolidated fund expenditure which has been provided by article 86 of the constitution of Tanzania or any other Act of the Parliament to be paid directly from consolidated fund without requiring any annual approval of the National Assembly. Such payment includes the following.

(i) Salaries and allowances, pension and gratuity payable to the President of United Republic of Tanzania.

(ii) Expenses in connection of the state house

(iii) Salaries and allowances including pension and gratuity of the holder of the following offices;

judges of the high court or court of appeal
members of human rights and good governance commission
controller and auditor general
chairman of the permanent commission of enquiry.

(iv) Repayment of public debt including interest and cost charges related to debt management.

(v) Payment due under contractual and liability Act No 3 of 1962.

These expenditure are included in the Government expenditure estimates but is not subjected to National Assembly voting.

(b) Voted expenditure

These refer to payments out of public funds after the approval by the National Assembly through Appropriation Act or Supplementary Appropriation Act and released to Accounting Officers or Warrant Holders on the basis of their approved annual budgets. These can be divided into recurrent and development expenditure.

(i) Recurrent expenditure

These covers payment of day to day operational government expenses such as personnel emoluments, office expenses, hospital drugs and medicines, electricity, water bill.

(ii) Development expenditure

These covers payment to long term development projects (capital expenditure) which includes roads, bridges, railways ,dams, hospital infrastructure constructions.

Test Yourself 6

Write short notes on statutory expenditure.

7. Identify the procedures used in cash and bank account management.

[Learning Outcome k]

7.1 Objective of cash and bank management

The main objectives of cash and bank transactions are to ensure that:

- all money received is recorded.
- all money received is banked.
- money is properly safeguarded.
- payments are made to correct persons and properly recorded.

7.2 Maintenance of records

Cash office has duties of receiving and paying cash, posting cash transaction into cash books, opening a bank account on which cheques are drawn and providing information on the cash position at a given time.

The sub-accounting officer has a duty of maintaining a treasury cash book, which contains the records of all receipt of revenues, payment towards various expenses, etc. of the organisations. The book like any other cash book consists of two parts; the debit and the credit. All receipts towards revenue or any other purpose are recorded on the debit side of the book, while all payments towards expenses or any other purpose are recorded on the credit side of the book. The book is to be authorised by the Central Pay Officer, should be balanced daily. The book should also clearly specify the denominations of cash balance each day.

Format of a treasury cash book is as follows:

TRV No /Date	From whom received	Sub-head	Receipt no.	Bank Cr slip no.	Amount			Treasury PV No.	Dept PV No.	To whom payable	Sub-head	Payee Bank	Cheque No	Amount		
					Gross	Bank	Cash							Gross	Bank	Cash

A revenue collector also maintains records of the official receipts in a cash book. The amounts collected need to be accounted for as it is i.e. without making any payments for expenses.

The revenue collector should supervise the receipts and ensure that all moneys collected are:

- lodged promptly in the bank
- recorded in the cash book under the appropriate sub-head

Furthermore the revenue collector should ensure that:

- public funds and securities are maintained under safe custody
- all officers entrusted with the receipt and custody of public funds are supervised
- internal checks on cash are strictly complied to avoid occurrence of fraud
- cash and stamps in their custody are agreed with the cash balances and stamp registers

The following is a format of the Revenue collector's cash book:

Date	Revenue receipt No.	Sub-head	From whom received	Amount	Date	Treasury receipt No.	Amount

7.3 Safeguarding of cash

Generally cash balance is immaterial to the financial statements. However, cash is an area which is prone to fraud; therefore security of cash is essential in cash management. Thus the cashier's 'cage' is secured and permission to enter therein is allowed only to authorised persons.

7.4 Efficient internal controls

Effective internal check is also of utmost important operation to minimize fraud and detect errors. This is achieved by the following:

Transaction	Control activity
Receipts All genuine receipts (cash and cheques) are received and deposited. Cash receipts recorded at correct amount.	Segregation of duties between the person receiving the money, the person depositing it in the bank and the one making the payments. Cheque and cash receipt register maintained specifying the date of deposit of the cheques. Independent check for agreement of bank deposit slips with the cash and cheque receipt register. Daily cash receipts immediately recorded in the customers' accounts. Cash receipt register reconciled daily with the customer accounts. Regular management review of the register is to be conducted to ensure that cheques are promptly deposited into the bank. Bank reconciliation to be prepared periodically and differences to be investigated. Receivables' ledger reconciled with control account.
Custody and control of cash	Cash kept under the custody of the cashier. Restricted access to cashier's room. Security personnel to accompany the cashier while depositing or withdrawing cash from the bank. A proper procedure for handling the cash keys to be devised e.g. cash box keys to be opened using two keys which are with the cashier and another official. Minimum cash balance to be maintained needs to be decided. Whenever cash balance exceeds minimum balance, excess balance deposited to be in the bank. Physical verification of cash conducted daily by a person from outside the accounts department. Management to review the sheets and confirm that there were no irregularities.
Custody of cheque books and bank Accounts	Cash to be suitably insured for cash in hand, and cash in transit. Periodic review of the actual cash balance and the cash amount insured needs to be carried out. Unused cheques to be kept under lock and key. Cheques books to be in the custody of a responsible person.

Recording of transactions	
All receipts and payments are recorded for the correct amount and in the correct account.	All cash receipts and payment recorded on a daily basis. Bank reconciliation statement (BRS) made each month and at the period end. Receivables' ledger reconciled with control account. Special attention paid in the BRS for the following: If "amounts deposited but not credited by the bank" are outstanding for a long time. All entries of amounts debited by bank such as interest, commission, bank charges recorded after verifying the accuracy. The rates charged for these transactions need to match with the original terms of the bank account.

Test Yourself 7

Write short notes on the functions of a revenue collector.

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8. Explain relevance and applicability of IPSAS 9 – revenue from exchange transactions and IPSAS 23 – revenue from non-exchange transactions in public sector.
Explain and record Public Investment Income.

[Learning Outcomes i and l]

8.1 IPSAS 9 Revenue from exchange transactions

1. Objective of the standard

(a) Accounting treatment

The objective of this Standard is to prescribe the accounting treatment of revenue arising from exchange transactions and events

This Standard uses the term "revenue," which encompasses both revenues and gains, in place of the term "income."

Important

An exchange transaction is one in which the entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of goods, services, or use of assets) to the other party in exchange.

Example

Examples of exchange transactions include:

- The purchase or sale of goods or services; or
- The lease of property, plant, and equipment at market rates.

Examples of services rendered by public sector entities for which revenue is typically received in exchange may include the provision of housing, management of water facilities, management of toll roads, and management of transfer payments.

(b) Timing for recognition of revenue

The primary issue in accounting for revenue is determining when to recognise revenue.

Revenue is recognized when it is probable that

future economic benefits or service potential will flow to the entity, and

these benefits can be measured reliably.

This Standard identifies the circumstances in which these criteria will be met and, therefore, revenue will be recognised. It also provides practical guidance on the application of these criteria.

(c) Measurement

The standard identifies the basis of measuring revenue for exchange transactions.

2. Scope of standard

An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this standard in accounting for revenue arising from the following exchange transactions and events:

the rendering of services;

the sale of goods; and

the use by others of entity assets yielding interest, royalties, and dividends or similar distributions.

This Standard applies to all public sector entities other than Government Business Enterprises.

This Standard does not deal with revenue arising from non-exchange transactions.

Example

Examples of non-exchange transactions include revenue from the use of sovereign powers (for example, direct and indirect taxes, duties, and fines), grants, and donations.

This Standard does not deal with revenues arising from:

(a) Lease agreements (see IPSAS 13, Leases);

(b) Dividends or similar distributions arising from investments that are accounted for under the equity method (see IPSAS 7, Investments in Associates);

(c) Gains from the sale of property, plant, and equipment (which are dealt with in IPSAS 17, Property, Plant, and Equipment);

(d) Insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts;

(e) Changes in the fair value of financial assets and financial liabilities or their disposal (guidance on the recognition and measurement of financial instruments can be found in IPSAS 29, Financial Instruments: Recognition and Measurement);

(f) Changes in the value of other current assets;

(g) Initial recognition, and from changes in the fair value of biological assets related to agricultural activity (see IPSAS 27, Agriculture);

(h) Initial recognition of agricultural produce (see IPSAS 27); and

(i) The extraction of mineral ores.

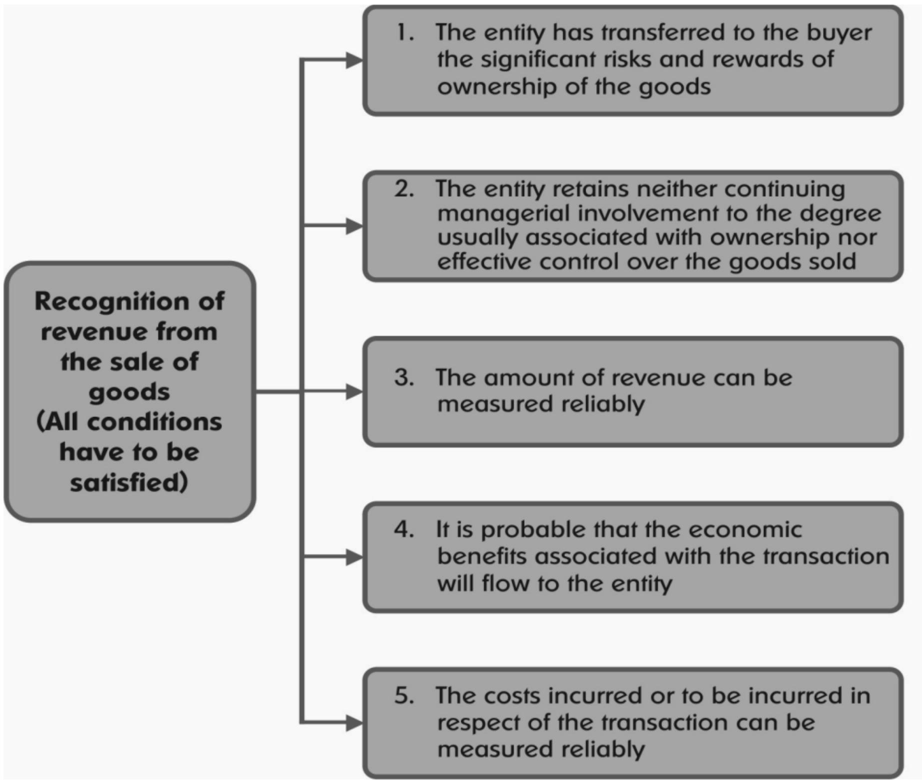
3. Measurement of revenue

Revenue arising from exchange transactions should be measured at fair value of consideration received or receivable.

4. Recognition of revenue

(a) **Revenue from the sale of goods** shall be **recognised** when **all** the following conditions have been satisfied:

Diagram 1: Recognition of revenue from the sale of goods



(b) Revenue from services

Recognition of revenue depends upon whether the outcome of a transaction involving the rendering of services can be estimated reliably:

1. If outcome can be estimated reliably, revenue from services rendered is recognised using the stage of completion method.

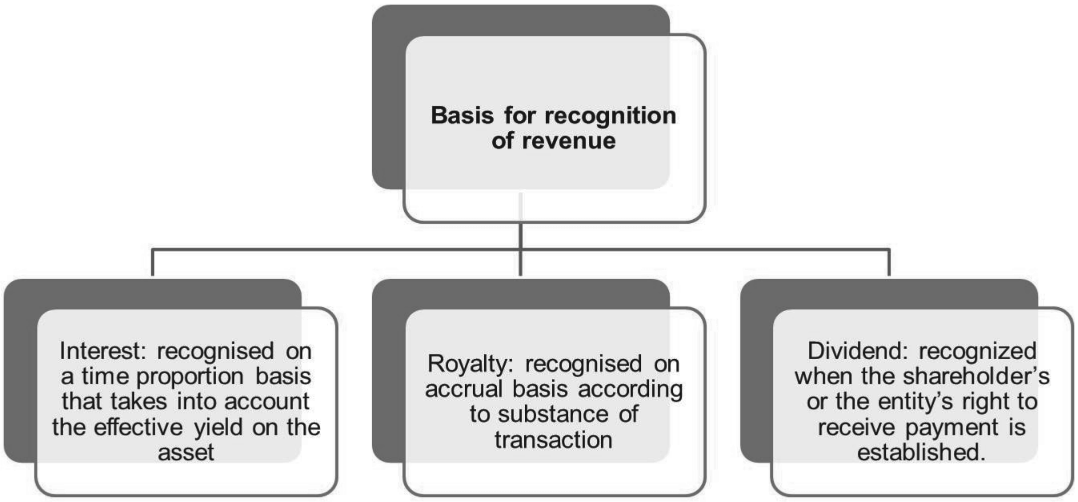
2. If outcome cannot be estimated reliably, revenue shall be recognised only to the extent of the expenses recognised that are recoverable.

(c) **Revenue** received on account of **use by others of entity assets** (yielding **interest royalties and dividends)** are **recognised** when **all** the following conditions are satisfied:

it is probable that the **economic benefits associated with the transaction will flow to the entity;** and

the amount of the revenue can be **measured reliably.**

Diagram 2: Basis of recognition of revenue



(i) Interest

Interest shall be recognized on a time proportion basis that takes into account the effective yield on the asset.

The effective yield on an asset is the rate of interest required to discount the stream of future cash receipts expected over the life of the asset to equate to the initial carrying amount of the asset. Interest revenue includes the amount of amortization of any discount, premium, or other difference between the initial carrying amount of a debt security and its amount at maturity.

Example

On 1 January 20Y1, Makambako Co purchased a bond worth $10,000. The bond attracts interest of 5% every year. On 31 December 20Y3, it will be redeemed for $11,660. The effective interest rate is 10%.

In this case, the total revenue is not only interest but also the premium on redemption. Total amount receivable as interest and premium on this bond is:

	$
On account of interest ($10,000 x 5%) x 3 years)	1,500
On account of premium on redemption ($11,660 – $10,000)	1,660
Total amount receivable	**3,160**

Makambako Co must allocate the amount receivable over the life of the bond at a constant rate on the carrying amount of the bond. The effective interest rate it has to apply in order to allocate the amount receivable over three years is 10%.

Year	Amortised cost at beginning of year (1)	Amount receivable at effective rate of 10% (2)	Amount actually received during year (3)	Amortised cost at end of year
20Y1	10,000	1000	(500)	10,500
20Y2	10,500	1050	(500)	11,050
20Y3	11,050	*1110	(11,660 + 500)	-

* - rounding adjustment at end

Amortised cost at the end of the year = Amortised cost at the beginning of the year (1)
+ Amount receivable at effective rate of 10% (2)
- Amount actually received during the year (3)

Thus, the effective rate is that rate which helps allocate the estimated future cash payments or receipts over the expected life of the financial instrument.

Test Yourself 8

On 1 January 20X5, Wear Co purchased a bond worth $5,000. The bond attracts interest of 5% every year. On 31 December 20X7, it will be redeemed for $5,830. The effective interest rate is 10%.

Required:

How will the interest be calculated for the bond and what entries would be made in the financial statements each year?

(ii) Royalty

Revenue from royalty is recognised on an accruals basis according to the substance of the agreement.

Example

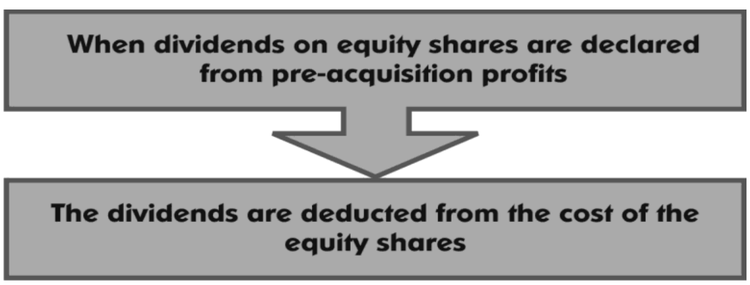
On 1 July 20X6 Shigongo entered into an agreement with the publisher of his book. According to this agreement the royalty on sale of his new book will be paid in the following manner for sales made in month 1 the royalty will be payable on day 1 of month 3.

This means that for sales in November 20X6 he will receive royalty on 1 January 20X7 and for sales in December 20X6 he will receive royalty on 1 February 20X7.

In this case the financial statements for the year to 31 December 20X6 will recognise royalty only on the sales between 1 July 20X6 to 31 December 20X6. This is because the royalty has accrued even on sales made in November 20X6 and December 20X6 even if it has not been paid till the statement of financial position date.

(iii) Dividend

Diagram 3: Treatment of dividends in the first year after acquisition of a subsidiary



Dividends are recognised when the shareholder’s **right to receive payment is established.**

8.2 Revenue from non-exchange transactions in public sector

1. Introduction

The International Public Sector Accounting Standards Board (IPSASB) decided to develop an IPSAS on revenue from non-exchange transactions because:

(a) Non-exchange revenues (taxes and transfers) form the majority of revenue for most public sector entities; and

(b) Until this standard was published, there has been no generally accepted international financial reporting standard that addresses the recognition and measurement of taxation revenue.

2. Objective

The objective of this Standard is to prescribe requirements for the financial reporting of revenue arising from non-exchange transactions.

In a non-exchange transaction, an entity:

receives value from another entity without directly giving approximately equal value in exchange, or

gives value to another entity without directly receiving approximately equal value in exchange.

This Standard deals with issues that need to be considered in recognizing and measuring revenue from non-exchange transactions, including the identification of contributions from owners.

3. Scope of standard

An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for revenue from non-exchange transactions.

Example

Examples of revenue received by public sector entities arising from non-exchange transactions are as follows:

Taxes; and

Transfers (whether cash or noncash), including grants, debt forgiveness, fines, bequests, gifts, donations, goods and services in kind, and the off-market portion of concessionary loans received.

Important

Taxes are considered as non-exchange transactions as taxpayers pay taxes because the tax law mandates the payment of those taxes. While the taxing government will provide a variety of public services to taxpayers, it does not do so in consideration for the payment of taxes.

This Standard does not apply to an entity combination that is a non-exchange transaction.

This Standard applies to all public sector entities other than Government Business Enterprises.

Revenues received from non-exchange transactions are excluded from the scope of this standard. Furthermore the IPSASB has not addressed entity combinations, and has excluded them from the scope of this Standard.

4. Recognition

(a) Recognition of assets

An entity will recognize an asset arising from a non-exchange transaction when:

it gains control of resources that meet the definition of an asset

it is probable future economic benefits or service potential associated with the asset will flow to the entity and

the fair value of the asset can be measured reliably

(b) Revenue from Taxes

An entity shall recognize an asset in respect of taxes when the taxable event occurs and the asset recognition criteria are met.

(c) Revenue from Transfers

An entity shall recognize an asset in respect of transfers when the transferred resources:

meet the definition of an asset and

satisfy the criteria for recognition as an asset

Transfers satisfy the definition of an asset when the entity controls the resources as a result of a past event (the transfer), and expects to receive future economic benefits or service potential from those resources.

Transfers satisfy the criteria for recognition as an asset when it is probable that the inflow of resources will occur, and their fair value can be reliably measured.

(d) Revenue from Non-Exchange Transactions

An inflow of resources from a non-exchange transaction recognized as an asset shall be recognized as revenue, except to the extent that a liability is also recognized in respect of the same inflow.

5. Measurement

(a) Measurement of Assets on Initial Recognition

An asset acquired through a non-exchange transaction shall initially be measured at its fair value as at the date of acquisition.

(b) Measurement of Liabilities on Initial Recognition

The amount recognized as a liability shall be the best estimate of the amount required to settle the present obligation at the reporting date.

(c) Measurement of Revenue from Non-Exchange Transactions

Revenue from non-exchange transactions shall be measured at the amount of the increase in net assets recognized by the entity.

Disclosures

The following diagram lists the disclosures to be made by an entity either on the face of, or in the notes to, the general purpose financial statements

Diagram 4: Disclosures relating to IPSAS 23

Either on the face of, or in the notes to the general purpose FS	Notes to the general purpose FS
• Amount of revenue from non-exchange transactions recognised during the period by major classes (like taxes, transfers) • Amount of receivables recognised in respect of non-exchange revenue • Amount of liabilities recognised in respect of transferred assets • Amount of liabilities recognised in respect of concessionary loans that are subject to conditions on transferred assets • Amount of assets recognised that are subject to restrictions and the nature of those restrictions • The existence and amounts of any advance receipts in respect of Non-exchange transactions • Amount of any liabilities forgiven	• The accounting policies adopted for the recognition of revenue from non-exchange transactions • For major classes of revenue from non-exchange transactions, the basis on which the fair value of inflowing resources was measured • For major classes of taxation revenue that the entity cannot measure reliably during the period in which the taxable event occurs, information about the nature of the tax • The nature and type of major classes of bequests, gifts, and donations, showing separately major classes of goods in-kind received.

8.3 Public investment income

The government owns various investments in different sectors.

1. Value of public investments

According to the Treasury Registrar Statement of Government Investments (mentioned in guidelines for the preparation of medium term plan and budget framework for 2009/10 - 2011/12) there were 244 listed Government Parastatals, Institutions and Agencies under various ministries, out of which, 64 were commercial and 180 were non-commercial. The total value of the public investments have increased from Tshs. 4.1 trillion in year 2007 to Tshs. 5.1 trillion as at 30th June, 2008.

2. Management of Public Investments

The following regulations govern the management of government enterprises:

The Treasury Registrar (Powers and Functions) Ordinance No. 35 of 1959 as amended;
The Public Corporations Act Cap 257 as amended;
The Public Finance Act Cap 348 as amended;
The Public Service Act Cap. 298; and
The Executive Agencies Act, Cap. 245.

The Government's thrust is to ensure improved performance and sustainability of the public institutions and strengthening the monitoring and evaluation mechanism.

3. Contribution of Public Investments to the Government Coffers 193

The public investments have been contributing to the government coffers through paying dividends, corporate tax, other taxes and levies in the case of commercial enterprises. However, there are some government institutions which have been established to regulate and oversee certain activities or areas. The legislations establishing the respective institutions have empowered them to impose various levies, charges and fees. As a result, these institutions have been able to collect a lot of revenues and spend part of the proceeds to finance their operations, while the rest have been accumulating in their bank accounts as surpluses. Despite creating enormous surpluses, these institutions have neither been paying dividends nor corporate tax to the government because of the nature of their establishing legislations.

In view of this, the government has decided to tap such revenues from these institutions by empowering the minister responsible for finance to access the surpluses generated through the Finance Act, 2008.

Government institutions which have been contributing dividends / surplus for the last three years and have been able to repay their loans are; NMB, TCC, TBL, TPA, TCRA, CELTEL (T), NHC, Gaming Board of Tanzania, TPDC, TANAPA, CHC and Tanzania Standard Newspapers.

A summary of revenue collection for four years is as follows:-

Revenue Collection from Public Institutions

Amounts in Tshs

ITEM	2004/05	2005/06	2006/07	2007/08
Dividends	13,051,091,771.15	12208498673.50	13,389,709,984.98	57,147,501,890.90
Principal & Interest	25,059,355,758.18	12178605209.84	12,664,740,769.78	11,503,625,043.26
Other Proceeds & Remittances	3,500,000,000.00	36309197460.00	330,000.00	8,300,000,000.00
Total	**41,610,447,529.33**	**60696301343.34**	**26,054,780,754.76**	**76,951,126,934.10**

The amount collected in respect of dividends, loan repayments and other proceeds as at 30th June 2008 shows that, the total collection of Government revenue collected by the Treasury Registrar during the year 2007/08 was Tshs 76,951,126,934.16 compared to Tshs 26,054,780,754.76 collected during 2005/06.

The ways of recognising and measuring investment income have been discussed in Learning Outcome 8.

Answers to Test Yourself

Answer to TY 1

The Act makes provisions for the control of the manufacture of excisable goods, the denaturing of spirits, for the collection of excise duties and for related and connected matters.

It covers various aspects of manufacture of excisable goods like:

- Administration of excise
- Licensing requirements for manufacture of excisable goods
- Licensing required to denature spirits
- Controls on manufacture
- Provisions relating to securities
- Duties: computation, payment, etc.
- Excise agents
- Penalties, forfeiture
- Legal proceedings
- Excise Tariffs

Answer to TY 2

Non-tax revenue is generated through various sources. One main sources of non-tax revenue is grants or aids.

Grants can be defined as the non- repayable voluntary transfer of resources.

The grants could be of the following types:

- Grants provided by the central government to state government for specific objectives

Grants provided by foreign countries to the Central / State Governments (also called as foreign aid). Foreign aid may be given to support social causes, for contribution during emergencies/ natural calamities, for strengthening ties with the country or for commercial purposes.

Answer to TY 3

The correct option is **D.**

External Assistance **comprises grants and loans from bilateral or multilateral agencies.**

Answer to TY 4

Following are four sources of Business and Professional Licences:

- Commercial fishing license fees
- Intoxicating liquor license fee
- Private health facility license fee
- Taxi license fee
- Plying permit fees

Answer to TY 5

It is the scheme that allows the accounting officer to retain a certain percentage of the revenue collections in different votes, hence promote the collection of recurrent revenue. Application for this scheme shall be made by ministry to policy department, where if approved a specific collection account shall be opened to commercial banks. Instruction to transfer the collected revenue to retention revenue account at BOT shall be issued monthly by ministry. Proper notification of the transfer will be sent to respective ministry.

Answer to TY 6

This is sometimes known as consolidated fund expenditure which has been provided by article 86 of the constitution of Tanzania or any other Act of the Parliament to be paid directly from consolidated fund without requiring any annual approval of the National Assembly. Such payment includes the following.

(i) Salaries and allowances, pension and gratuity payable to the president of United Republic of Tanzania.

(ii) expenses in connection of the state house

(iii) salaries and allowances including pension and gratuity of the holder of the following offices;

Judges of the High Court or Court of Appeal
members of human rights and good governance commission
controller and auditor general
Chairman of the permanent Commission of enquiry.

(iv) Repayment of public debt including interest and cost charges related to debt management.

(v) Payment due under contractual and liability Act No 3 of 1962.

These expenditure are included in the Government expenditure estimates but is not subjected to National Assembly voting.

Answer to TY 7

A revenue collector maintains records of the official receipts in a cash book. The amounts collected need to be accounted for as it is i.e. without making any payments for expenses.

The revenue collector should supervise the receipts and ensure that all moneys collected are:

lodged promptly in the bank
recorded in the cash book under the appropriate sub-head

Furthermore the revenue collector should ensure that:

public funds and securities are maintained under safe custody
all officers entrusted with the receipt and custody of public funds are supervised
internal checks on cash are strictly complied to avoid occurrence of fraud
cash and stamps in their custody are agreed with the cash balances and stamp registers

The following is a format of the Revenue collector's cash book:

Date	Revenue receipt No.	Sub-head	From whom received	Amount	Date	Treasury receipt No.	Amount

Answer to TY 8

In this case, the amount receivable as interest and premium on this bond is:

	$
On account of interest (5,000 x 5%) x 3 years)	750
On account of premium on redemption (5,830 – 5,000)	830
Total amount receivable	**1,580**

Wear Co must allocate the amount receivable over the life of the bond at a constant rate on the carrying amount of the bond. The effective interest rate it has to apply in order to allocate the amount receivable over three years is 10%.

Year	Amortised cost at beginning of year (1)	Amount receivable at effective rate of 10% (2)	Amount actually received during year (3)	Amortised cost at end of year
20X5	5,000	500	(250)	5,250
20X6	5,250	525	(250)	5,525
20X7	5,525	*555	(5,830 + 250)	-

* - rounding adjustment at end

Amortised cost at the end of the year = Amortised cost at the beginning of the year (1)
+ Amount receivable at effective rate of 10% (2)
- Amount actually received during the year (3)

Thus, the effective rate is that rate which helps allocate the estimated future cash payments or receipts through the expected life of the financial instrument. In an examination question, it is likely that this rate will be provided. The interest is recognised in the following manner

In 20X5:

Dr Bank	$250	
Cr Interest received		$250
Being amount received as interest		

Dr Bond	$250	
Cr Interest received		$250
Being bond revalued at amortised cost ($500 - $250)		

In 20X6:

Dr Bank	$250	
Cr Interest received		$250
Being amount received as interest		

Dr Bond	$275	
Cr Interest received		$275
Being bond revalued at amortised cost ($525 - $275)		

In 20X7:

Dr Bank	$250	
Cr Interest received		$250
Being amount received as interest		

Dr Bond	$305	
Cr Interest received		$305
Being bond revalued at amortised cost ($555 - $250)		

Dr Bank	$5,830	
Cr Bond		$5,830
Being amount received on maturity of bond ($5,000 + $250 +$275 + $305)		

Self Examination Questions

Question 1

What are the sources of central Government revenue?

Question 2

Explain the objective and scope of IPSAS 23 - Revenue from non-exchange transactions.

Question 3

Which of the following is NOT Capital expenditure?

A Construction of Road
B Construction of Bridge
C Construction of Runaway
D Payment of salaries
E Purchase and installation of a new power plant.

Question 4

Identify the fund operated by the government to take care of all forms of natural disaster is fund.

A Road Fund
B Education Fund
C Contingencies funds
D Consolidated fund
E Development fund.

Question 5

Central Government collects its revenue through either direct or indirect taxes. Briefly explain what is direct tax, along with examples.

Question 6

Perfect Industries bought an 80% holding in Concept Inc on 30 June 20X6 for $25,000. Concept Inc declares and pays a dividend of $3,600 to Perfect on 30 November 20X6 .The dividend was distributed out of the profits for the year ended 30 September 2006. Both companies have a year end of 30 September 20X6.

Required:

How will this dividend be recognised in the financial statements of Perfect Industries for the year to 30 September 20X6?

Answers to Self Examination Question

Answer to SEQ 1

The central government has two primary sources of revenue: domestic revenue and external assistance.

1. Domestic Revenue

Domestic revenue includes tax and non-tax revenue**:**

(a) Tax revenue

Majority of domestic revenue collected in Tanzania is in the form of tax revenues, which, in 2003/04 accounted for 92% of the total central government domestic revenue. These tax revenues are collected by the Tanzania Revenue Authority (TRA), an executive agency under the ministry of finance that was established in 1996.

The TRA is mandated to collect major taxes including income tax, value added tax, import duty and excise duty.

Between 2000/01 and 2003/04 Tanzania has witnessed an average annual increase in central government tax revenues of 12% (adjusted for inflation). These increases have primarily been attributed to economic growth and substantial improvements in the tax administration.

(b) Non-tax revenue

In 2003/04 non-tax revenues accounted for 8% of the total Central Government's domestic revenues.

Non-tax revenues comprise of fees, levies and dividends etc. and are collected by the ministry of finance and other central government ministries.

2. External Assistance

External Assistance is the second major avenue of resources for the Central Government's budget. External Assistance **comprises grants and loans from bilateral or multilateral agencies.**

In 2003-04 it accounted for approximately 42% of the Government's resource envelope. External assistance is provided in support of the Government's national development agenda as outlined in the National Strategy for Growth and Reduction of Poverty (NSGRP).

The overall strategy guiding effective management of external assistance is outlined in the Tanzania Assistance Strategy (TAS), which is currently being reviewed and updated.

Answer to SEQ 2

Objective

The objective of this Standard is to prescribe requirements for the financial reporting of revenue arising from non-exchange transactions.

In a non-exchange transaction, an entity:

receives value from another entity without directly giving approximately equal value in exchange, or

gives value to another entity without directly receiving approximately equal value in exchange.

Scope

An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for revenue from non-exchange transactions.

This Standard does not apply to an entity combination that is a non-exchange transaction.

This Standard applies to all public sector entities other than Government Business Enterprises.

Revenues received from non-exchange transactions are excluded from the scope of this standard. Furthermore the IPSASB has not addressed entity combinations, and has excluded them from the scope of this Standard.

Answer to SEQ 3

The correct option is **D.**

Answer to SEQ 4

The correct option is **C.**

Answer to SEQ 5

This tax is paid directly by individuals and organisations and is charged on the income that they earn from their professions and operations.
Examples of direct tax include income tax, corporate tax, capital gain tax, estate duties, stamp duties.

Answer to SEQ 6

The dividend of $3,600 is split into a pre-acquisition element (9/12 x 3,600 representing 9 months to June 20X6) = $2,700 and post-acquisition element (3/12 x 3,600) = $900.
The pre-acquisition element of $2,700 is deducted from the cost of shares, as technically Perfect has no right on this portion of the dividend (as the dividend is declared out of profits earned prior to Perfect buying its share of Concept). So the accounting treatment is to reduce the purchase price of $25,000 by $2,700 while calculating the goodwill.
$900 will be recognised as revenue in the statement of profit or loss.

STUDY GUIDE A8: GOVERNMENT GENERAL CASH MANAGEMENT AND CONTROL

Get Through Intro

Cash management is concerned with accurate forecasting and managing of cash inflows and outflows. This is based on revenue and expenditure by all government departments. The agency responsible for cash centrally then collates all the forecasts and updates all stakeholders concerned regarding overall cash inflows and outflows.

The central bank also needs adequate data to manage liquidity. In this Study Guide we shall discuss the objectives and policies in cash management, cash forecasting techniques and cash flow statements.

Knowledge of this Study Guide will give you a good insight into preparing cash flow statements.

Learning Outcomes

a) Explain cash management in the government and its objectives.
b) Identify cash budget preparation process.
c) Explain the legal obligation of Accounting Officers.
d) Identify the cash management policies and practices used by the government.
e) Identify the techniques for forecasting and managing cash flows.
f) Identify the cash flow management technique.
g) Identify the basic contents and format of the statement of cash flows.
h) Apply IPSASs on Cash Flow Statements, in preparation of statements of cash flow.
i) Explain financial reporting under cash basis of accounting.

1. Explain cash management in the government and its objectives.
[Learning Outcome a]

1.1 Cash management in the government

Cash management in the government context is the process of managing the collection and disbursal of public funds both within the government and between the Government and other sectors with the objective of ensuring cost efficiency. In other words, maintaining adequate cash balances so that there is neither a problem of shortage or excess liquidity.

Therefore while on one hand it includes management of daily cash inflows and outflows, it also has to ensure minimisation of revenue loss in ensuring that adequate cash is available to all councils departments concerned.

1.2 Requirement of cash

The government, just like any entity requires cash to fulfil three motives which are transaction, precautionary and speculative motives.

(a) Transaction motives

Government needs cash to meet the day to day transactions, such as payment of goods and services offered to the public. Cash is collected through various sources which need to be synchronized to ensure that buffer cash is available.

(b) Precautionary motives

Some cash may be held by the Government for meeting unforeseen contingencies such as floods, earthquakes, outbreak of diseases etc. If such events happen without alternative plans, it may paralyse Government operations and cause unbearable catastrophes in the society.

(c) Speculative purposes

The Government may hold cash for investment opportunities that may rise periodically. It may invest directly or through agencies or parastatals on anticipation of dividend or interest income, depending on the nature of investments made.

1.3 Objectives of cash management

Macroeconomic management is not possible without effective cash management. Since cash if the lifeline that flows through every enterprise, efficient cash management is paramount in fulfilling any budgetary requirement.

The objectives of cash management in the Government are as follows:

(a) Overall control on spending

One of the basic objectives of any cash management system is to ensure efficiency is spending. This is part of the overall objective of maintaining operational efficiency.

(b) Minimise overall transaction cost

Transaction cost is the cost involved is disbursing and receiving money in tranches rather than in lump sum. There is always a trade-off being carrying cost and procurement cost. Therefore determining the ideal cash amount ensures minimisation in transaction cost.

(c) Minimise the opportunity cost

Opportunity cost involves loss of investment income on account of holding asset in liquid form (cash). This loss has to be kept in mind while deciding on the cash management strategy.

(d) Encouraging budget discipline

Cash management ensures Government departments forecast their expenditures adequately, leading to better budgeting process and ensuring minimal gaps between budgeted and actual spends.

(e) Control over the cost of Government borrowing

Cash management should aim at minimizing the volumes of idle cash held by government bodies, most of which is unlikely to be fully remunerated, and reducing the cheques and other instruments awaiting clearance or in transit. This will result in direct saving to the government in the form of reduced borrowing cost due to reduced requirement to finance that cash.

(f) Mitigating risk – operational, credit and market risk

Effective handling of cash should ensure that receipts are handled and payments are disbursed without any delay resulting in reduction in operational risk. This also ensures mitigation of fraud and misappropriation of funds. Further ensuring centralised movement of funds such that all government accounts are interlinked reduces risk in terms of exposure to financial markets and banking system.

(g) Ensuring flexibility

Cash management should provide flexibility in handling of Government receipts and payments and matching of cash inflows and outflows.

(h) Facilitate liquidity management

Another important objective of cash management is to enable the BOT (Build-Operate-Transfer) to undertake the appropriate volume of liquidity management transactions to manage the liquidity in the financial system. This will facilitate efficient interbank market and allow for more stable short-term interest rates.

Test Yourself 1

Fill in the blanks:

1. ________________________________ involves loss of investment income on account of holding asset in liquid form (cash).

2. Effective handling of ______________ should ensure that receipts are handled and payments are disbursed without any delay resulting in reduction in ______________________________.

---

2. Identify cash budget preparation process.

[Learning Outcome b]

2.1 Cash budget preparation process

The preparation of cash budgets is part of the budgetary control exercise. It forecasts the cash inflows and outflows of a ministry, independent departments, agencies or parastatals over a period of three or six months at a time. **Cash budget is designed principally to avoid the liquidity problem**.

Cash budget preparation requires the figures for receipts and payments be arrayed in a columnar form under each month, covering the period to which the cash budget relates. The opening balances of the cash on hand would be the closing figures for the previous month(s). It should be noted that items that do not involve the movement of cash such as depreciation, sunk cost and amortization, are not included in cash budgets.

Example

National Milling Cooporation (NMC) has a problem of not being able to pay the salaries of workers promptly. Apart from the statutory allocation receivable from the Central Government, internally generated revenue is meager.

The following information has been provided:

On 31 May 20Y5, the Corporation anticipated the following transactions up to 31 December 20Y5:

	Statutory allocation	Internally generated revenue	Salaries	Others
	Tshs'000	Tshs'000	Tshs'000	Tshs'000
June	50,000	10,000	5,000	600
July	70,000	12,0000	4,900	620
August	65,000	8,000	5,100	650
September	72,000	11,000	6,000	630
October	61,000	5,000	7,200	580
November	42,000	3,000	15,000	710
December	49,000	1,500	15,550	490

Required:

Prepare the cash budget for NMC for June to November 20Y5.

Answer

NMC cash budget - June to November, 20Y5

	June	July	August	September	October	November
	Tsh000	Tsh000	Tsh000	Tsh000	Tsh000	Tsh000
Balance b/d	-	54,400	130,880	198,130	274,500	332,720
Receipts						
Statutory allocation	50,000	70,000	65,000	72,000	61,000	42,000
Internal revenue	10,000	12,000	8,000	11,000	5,000	3,000
	60,000	**136,400**	**203,880**	**281,130**	**340,500**	**377,720**
Payments						
Salaries	5,000	4,900	5,100	6,000	7,200	15,000
Others	600	620	650	630	580	710
	5,600	**5,520**	**5,750**	**6,630**	**7,780**	**15,710**
Balance c/f	54,400	130,880	198,130	274,500	332,720	362,010

Test Yourself 2

Choose then correct answer

Cash budget is designed to avoid the _______________ problem.

A Financial
B Liquidity
C Solvency
D None of the above

3. Explain the legal obligation of accounting officers.

[Learning Outcomes c]

3.1 Accounting officer

As per the Public Finance Act, 2001; "accounting officer" means any officer appointed by the Paymaster General and charged with the duty of accounting for any service in respect of which money have been appropriated by the National Assembly or any person to whom issues are made from the Consolidated Fund

3.2 Obligations of Accounting officer

There shall be appointed by name and office and in writing by the Paymaster-General an **accounting officer** in respect of each expenditure vote, who shall control and be accountable for the expenditure of money applied to that vote by an Appropriation Act and for all revenues and other public moneys received, held or disposed of, by or on account of the department or service for which the vote provides.

Every accounting officer shall comply with any subsidiary legislation made or issued under this Act and all instructions that may from time to time be given by the Accountant-General in respect of the custody and handling of, and the accounting for public money, public stores, investments, securities or negotiable instruments, whether the property of the Government on deposit with or entrusted to the government or to any public officer in his official capacity or any other person.

The functions and powers of the accounting officer are set out in Section 36 of The Public Procurement Act, 2011

The accounting officer shall have the overall responsibility for the execution of the procurement process in the procuring entity, and in particular, shall be responsible for:

(a) establishing a tender board in accordance with this Act

(b) appointing the members of the tender board

(c) causing to be established a procurement management unit staffed to an appropriate level approving all procurement opportunities;

(d) appointing the evaluation committee and negotiation team communicating award decisions

(e) certifying the availability of funds to support the procurement activities

(f) signing contracts for the procurement activities on behalf of the procuring entity

(g) handling complaints by suppliers, contractors or consultants

(h) submitting a copy of complaints and reports of the finding to the Authority

(i) ensuring that the implementation of the awarded contract is in accordance with the terms and conditions of the award

(j) submitting to the Authority a list of contracts awarded, annual procurement plan and a list of blacklisted firms

(k) implementing decisions made by the Authority and Appeals Authority after investigation or adjudication of a complaint

(l) providing feedback on the implementation of the decision of the Authority or the Appeals Authority within fourteen days of receiving communicating of the decision.

The Head of the Procurement Management Unit shall report directly to the accounting officer of the procuring entity. The accounting officer shall ensure that the procurement management unit has a sub vote and is allocated fund in the budget to carry out its responsibilities under this Act.

Test Yourself 3

Explain the accounting officer’s role in procurement process

4. Identify the cash management policies and practices used by the government. [Learning Outcomes d]

4.1 Cash management policies

Cash management policy should be drafted such that it aids in debt management and supports monetary policy.

The policy adopted by the Government should be in line with the objectives of effective cash management.

There are two approaches to cash management

(a) Active approach

This is a contemporary approach wherein cash is managed actively. A lower cash balance is retained thereby providing benefits to public debt management and other areas. There is active borrowing and lending undertaken by the Government to monitor weekly and even daily cash flows. Expenditures are also forecasted using budgeting tools to mitigate imbalances in cash.

(b) Passive approach

Under this approach cash balances are monitored. There is a sufficient cash balance which is maintained to provide for unanticipated cash outflows. This is a traditional approach where there is no active cash management. Whenever the need arises, expenditures are slowed down or payments are delayed.

4.2 Cash management practices used by the government

1. The best practices arise in the following of policy:

(a) Cash flow management (i.e. flow of receipts and payments within government), i.e. by government departments, agencies and other bodies, and the associated account structure and processes, to ensure timely processing and to reduce unnecessary idle balances.

(b) Investment in the associated systems

(c) Balances which are required to be maintained – managing and investing outside government.

(d) With a view to keep a low target balance at the central bank, proactive policies to manage short-term borrowing and lending outside government to offset volatility in government cash flows.

(e) Monetary policy and the related objectives for the control of financial sector liquidity, interest rates and inflation.

(f) The objectives of the Government for its own balance-sheet and management of balance sheet risk.

(g) Debt management policies.

(h) Financial market development policies.

2. Certain international practices of cash management in the Government context are:

(a) Government transactions (payments) should be executed in limited steps through reliance on electronic transactions, centralised systems. This differs from country to country.

(b) All the cash balances should be accumulated in a single account with the central bank - Treasury Single Account (TSA). This is critical as it has distinct advantages in terms of:

Cost savings due to minimal idle balances in the banking system

Better control contributing to better financial planning

(c) There should be sound systems for monitoring cash inflows and outflows:

Support monetary policy

Ensure adequate availability for funds for any planned expenditure at required time

Adequate forecasting of revenues

Streamlining cash flows to ensure limited instances of idle cash and rationalization of borrowing cost

(d) There should be exchange of information between the MoF/Treasury and the central bank on:

Government expected cash flows and balances – from MoF

Government actual cash balances – to MoF

(e) Cash management should be done in close co-ordination with debt management. If cash flows can be predicted, it is possible to plan the timing of borrowing using various debt instruments depending on the need in each situation and tenure for which the funds are required.

(f) Short term liquidity requirements can be met through use of Treasury Bills (and repo and reverse repo).

(g) The payment gateways and mechanisms used by the Government should be efficient so that real time cash management is possible.

Test Yourself 4

Match the following

Sr. No.	Column A	Sr. No.	Column B
1	Traditional approach	A	Active approach
2	Modern approach	B	Treasury Single account
3	Cash balances accumulated in a single account with the central bank	C	Passive approach

5. Identify the techniques for forecasting and managing cash flows.

[Learning Outcome e]

5.1 Cash flow forecasting

Definition

Cash flow forecasting means the process of estimating the cash inflows and outflows of the government and the estimated cash balances with various departments.

Cash inflows would include various sources of government revenue, grants and loans, asset sale etc. Outflows include various expenditures for which cash would be required. It also covers debt redemptions, debt service. The forecast is normally made in the domestic currency of the country.

Cash flow forecasting requires identification of all periods of high / peak cash requirements in future as also periods of low economic activity which would help decide the timing and extent of borrowing or lending. Forecasting is done forward for say three –six months and adjusted for any additional information obtained. It is also divided to daily / weekly estimates and rolled out as required.

5.2 Techniques for forecasting and managing cash flows

(a) The cash forecasts should more or less **mirror the budget** at the year beginning. With the month or month movement focus on actual data indicating movements in cash flows.

(b) Any **deviations from budgeted flows** should be **analysed** to arrest any gaps in execution. Also the events/ happenings in particular month / week should be kept in mind while forecasting for the next period. Econometrics will help in forecasting short term flows. Past experience should be taken into account while forecasting.

(c) List **all major cash flows** in terms of amount and timing which can be forecasted.

Example

Singida Holding Corporation (SHC) had borrowed Tsh5,000 million against a debt instrument repayable 20% at the each year commencing from Year 2. SHC has to support the local government through an annual aid of Tshs350 million.

These are ascertained cash outflow and should be taken into account well in advance while forecasting cash flows.

(d) Revenue forecasting

(i) Tax revenue is the major cash inflow to be forecasted firstly annually, then quarterly – monthly – daily. The tax department provides forecasts on the annual estimated tax revenue by months. Econometrics can be deployed. Regular payments can be identified through VAT and other returns. Whenever new taxes are introduced inflows can be estimated based on payment due date.

(ii) Non-tax revenue would depend on the nature of receipt.

(iii) Any receipts of non-recurrent nature example – disinvestment or public issue arising out of stake sale by the Government should be taken into account based on the Government plans and forecasted dates of capital receipts.

(e) Any seasonality in cash inflows and outflows should be taken into account while forecasting for same month next year.

(f) Expenditure forecasting

(i) Obtain expenditure forecasts from various departments. All major departments should be covered first.

(ii) Regular payments – social security, subsidies etc. should be factored in

(iii) Identify seasonal payments

(g) Daily monitoring and forecasting

(i) Using Treasury Single account the actual transactions can be monitored. If there have been any changes in timing of inflows / outflows the same should be noted

(ii) Daily forecasting is the optimum scenario. The end of day balances can be forecasted using updates during the day.

(iii) Analyse bank statements to find exact position the next morning against estimated EOD.

Test Yourself 5

State True or False

1. Daily forecasting of cash flows is an unnecessary exercise
2. Cash forecasting is restricted to revenue forecasting
3. Tax revenue is the major cash inflow to be forecasted firstly annually, then quarterly – monthly – daily.

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6. Identify the cash flow management technique.

[Learning Outcome f]

We have discussed the approaches to cash management, the techniques used in forecasting and managing cash flows. Let's analyse certain scenarios and identify which technique is being applied

Scenario I

Coal Corporation is a Government Enterprise. There are currently no cash flow issues in the functioning of the enterprise. The manager ensures sufficient balance in each of the expense accounts. There is no daily monitoring or forecasting of cash flows.

In the above scenario the approach is one of passive cash management which was followed traditionally in Government Enterprises. There is no daily monitoring of cash inflows and outflows. Although there is sufficient liquidity available with all departments there is lack of optimum utilisation of funds leading to loss on account of reduced investment income through lower investment of short term surplus.

Scenario II

Transport Delta Co. is engaged in providing transport services throughout the continent. Every department is required to provide estimates of cash inflows and outflows well. There is detailed forecasting done split from yearly to quarterly to monthly.

In this case, active management is employed. Further the following techniques are deployed:

Revenue and expenditure forecasting
Daily monitoring
Cash management in line with budgeting
Treasury single account

Test Yourself 6

Container Ltd. is a government entity. Mention any three cash flow management techniques

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7. Identify the basic contents and format of the statement of cash flows.

[Learning Outcome g]

A cash flow statement is a statement showing the movement of cash during the period in terms of the sources of funds and the items on which funds were expended.

Cash flow statement helps in analysing cash movements during the period, predicting future cash flows and analysing the ability of the enterprise to fulfil various obligations.

The basic information in the statement of cash flows comprises of cash from various activities which would indicate the net increase in cash and cash equivalents. This when added to the cash and cash equivalents at the beginning of the period would give the cash position at the end of the period.

The cash flow statement should report cash flows during the period classified by operating, investing, and financing activities.

7.1 Operating activities

Cash flows from operating activities are primarily driven from the principal cash generating activities of the entity. Examples of cash flows from operating activities are:

(a) Cash receipts from taxes and levies

(b) Cash receipts from charges for goods and services provided by the entity.

(c) Cash receipts from grants or transfers and other appropriations or other budget authority made by the central government

(d) Cash receipt from royalties, fees, commissions and other revenue

(e) Cash payment to other public sector entities to finance their operations

(f) Cash payment to suppliers of goods and services

(g) Cash payment to and on behalf of employees etc.

7.2 Cash flows from investing activities

Cash flows derived from acquisition and disposal of long term assets and other investments not included in cash equivalents, which represent the extent to which cash flows have been made for resources that are intended to contribute to the entity's future service delivery.

Examples of cash flows arising from investing activities are:

(a) Cash payment to acquire property, plant and equipment, intangible and other long term assets.

(b) Cash receipts from sale of property, plant and equipment, intangible and other long term assets.

(c) Cash payment to acquire equity or debt instruments of other entities

(d) Cash receipt from sale of equity or debt instruments of other entities

(e) Cash advances and loans made to other entities.

(f) Cash receipt from repayment of advances and loans made to other entities

7.3 Cash flows from financing activities

These are cash flows arising from activities that result in changes in the size and composition of the contributed capital and borrowing of the entity. They are useful in predicting claims on the future cash flows by providers of capital to the entity. Examples of cash flows arising from financing activities are:

(a) Cash proceeds from issuing of debentures, loans, notes, bonds, mortgages and other short term borrowings;

(b) Cash repayment of amount borrowed; and

(c) Cash payments by lease for reduction of the outstanding liability relating to finance lease.

8. Apply IPSASs 2 – Cash Flow Statements, in preparation of statements of cash flow. [Learning Outcome h]

8.1 IPSASs 2 - Cash Flow Statements applies to all public sector entities other than Government Business Enterprises (GBE).

GBEs include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions.

GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge.

An entity presents its cash flows from operating, investing, and financing activities in a manner that is most appropriate to its activities.

8.2 Reporting cash flows from operating activities

An entity should report cash flows from operating activities using either:

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby net surplus or deficit is adjusted for the effects of the transactions of non-cash nature, any deferrals or accruals of the past or future operating cash receipts or payments, and the items of revenue or expenses associated with investing or financing cash flow activities.

Entities are encouraged to report cash flows from operating activities using the direct method. The direct method provides information that (a) may be useful in estimating future cash flows, and (b) not available under the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:

(a) From the accounting records of the entity; or

(b) By adjusting operating revenues, operating expenses (interest and similar revenue, and interest expense and similar charges for a public financial institution), and other items in the statement of financial performance for:

Changes during the period in inventories and operating receivables and payables;

Other noncash items; and

Other items for which the cash effects are investing or financing cash flows.

8.3 Foreign Currency Cash Flows

Cash flows arising from transactions in a foreign currency shall be recorded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

The cash flows of a foreign controlled entity shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.

Cash flows from interest and dividends or similar distributions received and paid shall each be disclosed separately. Each shall be classified in a consistent manner from period to period as either operating, investing or financing activities.

8.4 Other important points

1. Cash flows arising from taxes on net surplus should be separately disclosed and should be classified as cash flows from operating activities, unless they can be specifically identified with financing and investing activities.

2. The aggregate cash flows arising from acquisitions and from disposals of controlled entities or other operating units should be presented separately and classified as investing activities.

3. An entity should disclose, in aggregate, in respect of both acquisitions and disposals of controlled entities or other operating units during the period, each of the following:

(a) The total purchase or disposal consideration;

(b) The portion of the purchase or disposal consideration discharged by means of cash and cash equivalents;

(c) Amount of cash and cash equivalents in the controlled entity or operating unit acquired or disposed of; and

(d) The amount of the assets and liabilities, other than cash or cash equivalents, recognized by the controlled entity or operating unit acquired or disposed of, summarized by each major category.

4. Investing and financing transactions that do not require the use of cash or cash equivalents should be excluded from a cash flow statement. Such transactions should be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

5. An entity should disclose, together with a commentary by management in the notes to the financial statements, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the economic entity.

8.5 Cash Flow Statement (For an Entity Other Than a Financial Institution)

Public Sector Entity—Consolidated Cash Flow Statement for Year Ended December 31 20X2 (In Thousands of Currency Units)

Direct Method Cash Flow Statement

particulars	20X2	20X1
Cash flows from operating activities		
Receipts		
Taxation		
Sales of goods and services		
Grants		
Interest received		
Other receipts		
Payments		
Employee costs		
Superannuation		
Suppliers		
Interest paid		
Other payments		
Net cash flows from operating activities		
Cash flows from investing activities		
Purchase of plant and equipment		
Proceeds from sale of plant and equipment		
Proceeds from sale of investments		
Purchase of foreign currency securities		
Net cash flows from investing activities		

Cash flows from financing activities		
Proceeds from borrowings		
Repayment of borrowings		
Distribution/dividend to government		
Net cash flows from financing activities		
Net increase/(decrease) in cash and cash equivalents		
Cash and cash equivalents at beginning of period		
Cash and cash equivalents at end of period		
Reconciliation of Net Cash Flows from Operating Activities to Surplus/(Deficit)		
(in thousands of currency units)		
Surplus/(deficit)		
Non-cash movements		
Depreciation		
Amortization		
Increase in provision for doubtful debts		
Increase in payables		
Increase in borrowings		
Increase in provisions relating to employee costs		
(Gains)/losses on sale of property, plant and equipment		
(Gains)/losses on sale of investments		
Increase in other current assets		
Increase in investments due to revaluation		
Increase in receivables		
Net cash flows from operating activities		

Public Sector Entity—Consolidated Cash Flow Statement for Year Ended (Indirect Method Cash Flow Statement)

PARTICULARS	20X2	20X1
Cash flows from operating activities		
Surplus/(deficit)		
Non-cash movements		
Depreciation		
Amortisation		
Increase in provision for doubtful debts		
Increase in payables		
Increase in borrowings		
Increase in provisions relating to employee costs		
(Gains)/losses on sale of property, plant and equipment		
(Gains)/losses on sale of investments		
Increase in other current assets		
Increase in investments due to revaluation		
Increase in receivables		
Net cash flows from operating activities		

Note: The other heads i.e. cash flow from investing activities and financing activities are same under direct and indirect method. Therefore the above format under indirect shows only the cash flow from operating activities.

Test Yourself 7

Classify the following for preparation of cash flow statement:

1. Tax receipts
2. Depreciation
3. Proceeds from sale of investments

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9. Explain financial reporting under cash basis of accounting

[Learning Outcome i]

9.1 Cash basis of accounting

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

9.2 Financial reporting

The general purpose financial statements comprises the statement of cash receipts and payments and other statements that disclose additional information about the cash receipts, payments and balances controlled by the entity and accounting policies and notes. In accordance with the requirements only cash receipts, cash payments and cash balances controlled by the reporting entity will be recognized as such in the statement of cash receipts and payments or other statements that might be prepared.

The general purpose financial statements may include a comparison of budget and actual amounts as an additional financial statement.

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

1. A statement of cash receipts and payments which:

   Recognizes all cash receipts, cash payments and cash balances controlled by the entity; and

   Separately identifies payments made by third parties on behalf of the entity

2. Accounting policies and explanatory notes; and

3. When the entity makes publicly available its approved budget, a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the statement of cash receipts and payments

9.3 Information to be presented in the statement of cash receipts and payments

1. The statement of cash receipts and payments should present the following amounts for the reporting period:

(a) Total cash receipts of the entity showing separately a sub classification of total cash receipts using a classification basis appropriate to the entity's operations;

(b) Total cash payments of the entity showing separately a sub classification of total cash payments using a classification basis appropriate to the entity's operations; and

(c) Beginning and closing cash balances of the entity.

(d) Total cash receipts and total cash payments, and cash receipts and cash payments for each sub- classification of cash receipt and payment, should be reported on a gross basis, except that cash receipts and payments may be reported on a net basis when:

They arise from transactions which the entity administers on behalf of other parties and which are recognized in the statement of cash receipts and payments; or

They are for items in which the turnover is quick, the amounts are large, and the maturities are short.

(e) Line items, headings and sub-totals should be presented in the statement of cash receipts and payments when such presentation is necessary to present fairly the entity's cash receipts, cash payments and cash balances.

2. The sub-classifications (or classes) of total cash receipts and payments which will be disclosed in are a matter of professional judgment.

(a) Total cash receipts may be classified separately to identify cash receipts from: taxation or appropriation; grants and donations; borrowings; proceeds from the disposal of property, plant and equipment; and other on-going service delivery and trading activities.

(b) Total cash payments may be classified separately to identify cash payments in respect of on-going service delivery activities including transfers to constituents or other governments or entities; debt reduction programs; acquisitions of property, plant and equipment; and any trading activities. Alternative presentations are also possible

3. Where, during a reporting period, a third party directly settles the obligations of an entity or purchases goods and services for the benefit of the entity, the entity should disclose in separate columns on the face of the statement of cash receipts and payments:

(a) Total payments made by third parties which are part of the economic entity to which the reporting entity belongs, showing separately a sub-classification of the sources and uses of total payments using a classification basis appropriate to the entity's operations; and

(b) Total payments made by third parties which are not part of the economic entity to which the reporting entity belongs, showing separately a sub-classification of the sources and uses of total payments using a classification basis appropriate to the entity's operation.

(c) Such disclosure should only be made when during the reporting period the entity has been formally advised by the third party or the recipient that such payment has been made or has otherwise verified the payment.

4. The notes to the financial statements of an entity should:

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

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

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

6. The General purpose financial statements should present information that is understandable, relevant and reliable.

7. An entity should disclose in the notes to the financial statements together with a commentary, the nature and amount of:

(a) Significant cash balances that are not available for use by the entity

(b) Significant cash balances that are subject to external restrictions

(c) Undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities.

Test Yourself 8

What is cash basis of accounting? How does it differ from accrual basis?

Answers to Test Yourself

Answer to TY 1

1. Opportunity cost

2. Cash, operational risk

Answer to TY 2

The correct option is **B.**

Answer to TY 3

The accounting officer is completely responsible for the procurement process. Right from establishment of the tender board to approving contracts, executing decisions taken by the Authority are his responsibility. The head of the Procurement Management Unit reports to him.

Answer to TY 4

1. C
2. A
3. B

Answer to TY 5

1. False
2. False
3. True

Answer to TY 6

1. Revenue and expenditure forecasting
2. Seasonality in cash flows to be incorporated for future periods
3. Daily monitoring

Answer to TY 7

1. Operating activities
2. Non cash item (added back in indirect method)
3. Investing activities

Answer to TY 8

Under cash basis of accounting transactions and events are accounted for only when cash (including cash equivalents) is received or paid by the entity.

Financial statements prepared under the cash basis provide readers with information about the sources of cash raised during the period, the purposes for which cash was used and the cash balances at the reporting date.

On the other hand accrual basis of accounting recognises incomes and expenses as and when they become due i.e. when the right to receive the revenue is established and the services for which payment is due has been rendered.

Self Examination Questions

Question 1

Choose the right option in each of the following

1. The head of procurement function reports to:

   A Accounting officer
   B Payment general
   C Treasury head
   D None of above

2. Cash basis of accounting accounts for:

   A revenue when cash is received
   B expenses when cash is paid
   C when it becomes due
   D a & b

3. Proceeds from sale of asset is classified under cash from which of the following in preparation of cash flow statement:

   A Operating activities
   B Financing activities
   C Investing activities
   D None of above as it is capital receipt

4. Opportunity cost is:

   A Cost of borrowing
   B loss of investment income on account of holding asset in liquid form (cash)
   C cost of the project
   D none of above

Question 2

Prepare cash flow statement by applying IPSAS 2 based on following information extracted from the financial records for the year ended 31st December 20X4 for Tanzania Welfare State

Particulars	**Tshs million**
Tax collection	40,000
Revenue fund charges	2,000
Personal emolument	4,000
Purchase of securities	100
Fixed assets acquisition	1,000
Share of value added tax	400
Sale of fixed assets (proceeds)	200
Internally generated revenue	20,000
Social security payments (primarily pension)	30,000
Overheads	92
Grants made (recurrent)	40
Grants and aid received	400
Servicing of public debt	200
Dividend income	200
Proceeds from loans taken	600

Answers to Self Examination Questions

Answer to SEQ 1

1. The correct option is **A.**

   The head of procurement function reports to accounting officer

2. The correct option is **D.**

   Cash basis of accounting accounts for, revenue when cash is received and expenses when cash is paid.

3. The correct option is **C**.

   Proceeds from sale of asset is classified under cash from investment activities in preparation of cash flow statement

4. The correct option is **B**.

   Opportunity cost is loss of investment income on account of holding asset in liquid from (cash)

Answer to SEQ 2

ABC Corporation

Statement of cash flows for the year ended 31st December 20x4

Particulars	Tshs million	Tshs million
Operating activities		
Tax collection		40,000
Internally generated revenue		20,000
Grants and aid received		400
Share of value added tax		400
Personal emolument		(4,000)
Revenue fund charges		(2,000)
Social security payments (primarily pension)		(30,000)
Overheads		(92)
Grants made (recurrent)		(40)
Servicing of public debt		(200)
		24,468
Investing activities		
Sale of fixed assets (proceeds)		200
Dividend income		200
Purchase of securities		(100)
Fixed assets acquisition		(1,000)
		(700)
Financing Activities		
Proceeds from loans taken		600
		600
Net increase / (decrease) in cash and cash equivalents		**24,368**

STUDY GUIDE A9: PAYMENT PROCEDURES

Get Through Intro

Tanzania had a socially planned economy with one government owned bank dominating the banking industry for about 25 years until the liberalisation of financial industry. The dominant payment instrument had been cash with less use of cheques and telegraphic instruments. This resulted in most transactions and payments being effected outside the banking system. This had further trebled the currency in circulation thereby increasing costs due to cost of printing and distribution.

In 1996, Tanzania launched a payment systems modernisation project. Its basic object was to modernise the country's payment, clearing and settlement systems so as to attain internationally acceptable best practices by increasing the speed of exchange and settlement of funds and securities and to shift from cash to cash-less modes of payment. There was success in the process of modernisation because there was public need for efficient payment systems to serve a new market economy.

This Study Guide explains the various aspects of payments and expenditure like development expenditure, recurrent expenditure, payment for goods and services, illegal payments along with the roles and responsibilities of the officials involved in the process.

Learning Outcomes

a) Explain the role of the central payment office and Sub-Treasuries.
b) Explain the responsibility of accounting officers and Accountant General.
c) Identify the payment procedures.
d) Prepare records for development expenditure and recurrent expenditure.
e) Prepare records for projects grants and payments.
f) Prepare records of payments for goods and services.
g) Discuss the applicability of relevant regulations on the identification and treatment of illegal payments/expenditures such as Nugatory, improperly vouched and non-vouched expenditures.

1. Explain the role of the central payment office and sub-treasuries [Learning Outcome a]

1.1 The role of Central Payment Office and Sub-Treasury

In 1996, the Government of United Republic of Tanzania took a major step in reforming the public sector with regards to the financial management. A Central Payment Office (CPO) was created at the Treasury under central payment system and all payments for government, ministries, departments and agencies (MDAs) were consolidated.

The reason for taking such a step was due to excessive indiscipline in expenditure management by MDAs. MDAs were spending more than the funds available to them and the same were not satisfactorily reported. This necessitated the need of introducing a cash budget system. This system was introduced to have control over government expenditure and apply only those funds those were reasonably available.

Under Central Payment System, MDAs were asked to prepare payment documents or payment vouchers, Local Purchase Order (LPO) at their premises and then submit to the CPO at the Treasury. At the CPO, the purchase document would be put into a computer system using COBOL and thereafter cheques would be issued as per directions from MDAs. This was the first step towards financial discipline amongst MDAs and their respective accounting officers.

In 1998, further steps were taken and 10 MDAs were selected and connected to a dedicated Computer Network System using radio link technology under Integrated Financial Management System (IFMS). This was to ensure the effectiveness of IFMS in the management of funds before taking the entire MDAs into IFMS. As per this system, 10 MDAs were to use a single server which was located at the Treasury and each MDA had a unique database. This system was a success and thereafter, entire MDAs were taken in the IFMS in 1999, which is sustained till date.

In 2001/2002, IFMS was given out to all the Regional Sub Treasuries in the country. They are 20 in all today. Each Sub Treasury was allocated a local standalone IFMS which catered to all government offices in the respective region. The Regional Offices were asked to prepare payment documents manually and later submit them to the Sub treasuries where they are trapped into the system and an appropriate cheque is issued. Hence, the Sub Treasury acts as a custodian of the server which contain separate databases for each relevant office.

Further, in 2003/2004, IFMS was given out to all the Regional Administrative Services offices. These offices are connected to the servers at the Sub Treasuries thus enabling to be online to the servers. Thereby, all the offices have been integrated with the system at Sub Treasury.

The advantage of this would be that there will be no need to physically carry payment documents to the Sub Treasury as they are online like MDAs in the government. This will ensure that MDAs do not incur debt those exceed the budget due to lack of funds and there is no accumulation of suppliers' debt. By this method, LPOs are issued only when there are funds in respective expenditure item. In case of insufficient funds, LPO will not be generated in other expenditure items of the same subhead and the same would require the approval of Ministry of Finance. This has reduced the level of supplier debt considerably, thereby increasing creditability of government.

Diagram 1: Role of CPO and Sub-Treasury

- A central Payment Office was created under the Central payment System to control excessive expenditure.
- Cash Budget System was introduced to have control over government expenses
- MDAs were asked to prepare payment documents and purchase document to be put into a computer using COBOL
- In 1998, 10 MDAs were connected to a dedicated Computer Network System using radio link technology under IFMS
- In 2001/2002, IFMS given to all Regional Sub Treasuries and Sub Treasury act as a custodian of the server.
- In 2003/2004, IFMS given to all Regional Administrative Services offices which were connected to the servers thus enabling to be online to the servers.
- Thus reduced the level of supplier debt considerably and increased government's creditability.

1.2 The Sub-Treasury performs the following functions:

(a) Receives funds allocation from votes in respect of each sub-warrant holder for revenue and development expenditures.

(b) Records warrant of funds allocations for each warrant holder.

(c) Makes payment on behalf of RAS and sub-warrant holders.

(d) Prepares and prints all LPOs on behalf of sub-warrant holders

(e) Receive death/survivors benefits from court and employers ad make payments to appropriate beneficiaries.

(f) Receive revenue collected by the sub-warrant holders on behalf of Accounting Officers.

(g) Transfers funds collected by sub-Warrant holders to Treasury/Accounting Officers.

(h) Performs bank reconciliation

(i) Prepares reports to different users

Test Yourself 1

What was created at the Treasury at the Central Payment System?

A MD A i.e. Government Ministries, Departments and Agencies
B CPO i.e. Central Payment Office
C LPO i.e. Local Purchase Order
D IFMS i.e. Integrated Financial Management System

Test Yourself 2

Which computer language was used to put the purchase document in the computer at the CPO?

A JAVA
B Q basic
C COBOL

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2. Explain the responsibility of accounting officers and Accountant General.
[Learning Outcome b]

Responsibilities of Accounting Officers and Accountant General

2.1 Responsibility of Accounting Officer

Definition

There shall be appointed by name and office and in writing by the Paymaster-General an accounting officer in respect of each expenditure vote, who shall control and be accountable for the expenditure of money applied to that vote by an Appropriation Act and for all revenues and other public moneys received, held or disposed of, by or on account of the department or service for which the vote provides.

Section 8 of Public Finance Act 2001

Accounting Officers are responsible for the day to day financial affairs of the government enterprise. His functions are as follows:

(a) To ensure that all revenue accruable are collected and accounted for as and when due.

(b) To ensure all payments are backed with proper authority and refuse payments or any voucher which is wrong or insufficient in content or authority or which contravenes any financial regulation.

(c) To ensure proper books of accounts and systems are kept.

(d) To ensure that adequate preventive measures against frauds and misappropriation of funds are installed.

(e) To prepare promptly and accurately the financial statements and returns which he/she is responsible to render for auditing.

(f) To sign accounts of their respective votes and accept personal responsibility for their proper presentations as required by the Accountant General.

(g) To ensure that the financial regulations and procedures established by the treasury and instructions issued by the Accountant General are adhered to.

(h) To ensure that public resources entrusted to accounting officers are properly managed and safeguarded.

(i) To ensure prudence and accountability of public expenditures.

(j) To establish and maintain an effective system of internal control over the financials and related operations.

2.2 Responsibility of Accountant General

Definition

There shall be an Accountant-General under the Permanent Secretary, who shall be appointed by the President from amongst senior professional accountants and auditors on such terms and conditions as shall be specified in the appointment.

Section 7 of Public Finance Act, 2001

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1. The Accountant-General

(i) shall be responsible to the Permanent Secretary for the compilation and management of the accounts and the custody and safety of the public money and public property of the government.

(ii) may, with the prior consent of the Permanent Secretary, give such instructions to accounting officers for the effective implementation of the purposes and provisions of this Act.

An Accountant General is the Chief Accounting Officer of the receipts and payments of government money.

2. His responsibilities include

(a) To ensure that adequate provision is made for the safe custody of public money and other property.

(b) To exercise supervision over the receipts of public money to ensure that they are collected and under safe custody.

(c) To supervise expenditure and disbursement of public money and report to the Paymaster General (PMG).

(d) To exercise effective supervision over all the officers of the treasury entrusted with the receipt and disbursement of public money.

(e) To report to the PMG in writing any defect over the custody, control and collection of public money.

(f) To ensure that financial terms and conditions of loans and grants are fully complied with.

(g) To prepare promptly the financial statements and other reports and render them for auditing.

(h) To ensure all revenue is monitored and accounted for

(i) Investigate financial malpractices like loss of funds, fraud cases, assets and store items

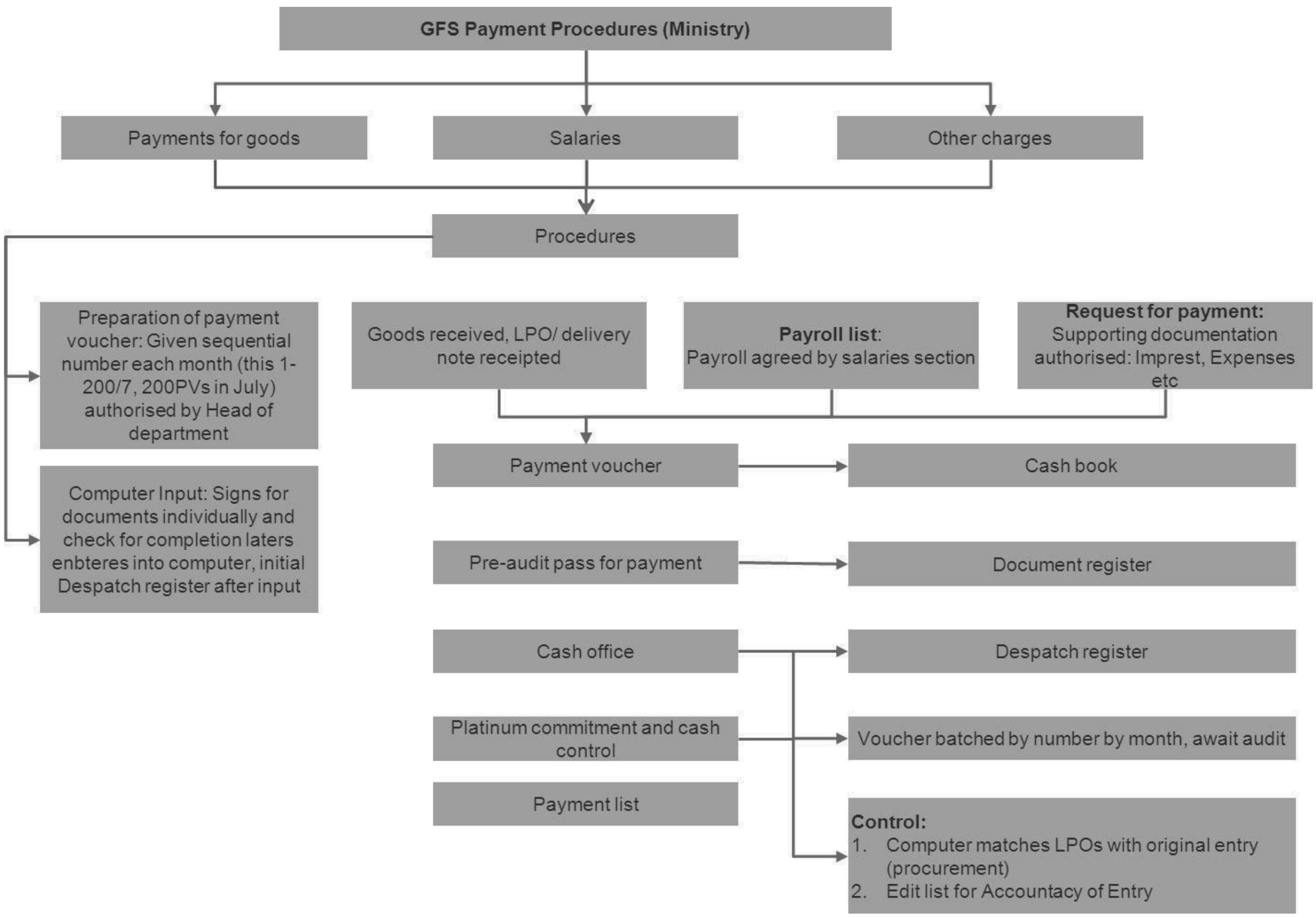
Test Yourself 3

Identify the Chief Accounting Officer of government money.

A Accounting Officer
B Accountant General
C Accountant

3. Identify the payment procedures.
Prepare records of payment of goods and services.
[Learning Outcomes c and f]

Diagram 2: GFS payment procedures (Ministry)



3.1 Payment procedure

1. Every payment needs to be supported by vouchers and documents (refer to paragraph (5) below.

2. The officers concerned should ensure the following before approving and authorizing payment:

(a) In order to verify the accuracy of the claim, proper records are maintained.

(b) Proper internal control measures are taken to see if the claims are actually due.

(c) In case of employees, it is ensured that their claims are genuine and in line with the Authority's Staff regulations and Financial Regulations.

(d) In respect of payments for the supply of materials and services, the laid down procedures of the water Authority are adhered to.

3. Payment vouchers must be complete in all respects such as detailing the authority, complete description and coding of the expenditure or reason for payment. There should be reference to the numbers of invoices so as to identify the payment in case the supporting documents are lost.

4. The approving and authorised persons must sign all alterations to the material particulars given in the application.

5. All payment vouchers should be supported by the following supporting documents:

(a) Original invoices, statements relating to the payment.

(b) Certificate to show fulfilment of certain conditions of jobs from the relevant authority

(c) Goods Received note for goods received

(d) Certificate of proper performance for services rendered.

(e) In case payment is made on duplicate and Photostat invoices, the certificate of indemnity is required.

(f) In case of payment to employee, relevant claim forms are duly completed.

6. In order to prevent abuse, both used and unused payment vouchers should be kept under maximum security.

7. It has to be ensured that the person claiming the payment is the person who is authorised to receive it or the authorised representative.

8. The person certifying the payment claim has to ensure that the certificate is in accordance with the facts and is liable for any loss in the event of any improper payment due to incorrect certificate.

9. The original payment voucher should affix the authority by the payee to a nominee if there is one.

10. The payments should be made by crossed cheques. Open cheques may be issued in extraordinary cases by the management in case the payee applies in writing. The receipt of cheques can be supported by witnessed signature or thumb mark of payee. Blank cheques are not allowed to be issued.

11. In case of lost cheques before presentation to bank, replacement cheques cannot be issued until:

(a) The non-presentation to the bank has been authenticated.

(b) A police report and a certificate of indemnity have been received from the payee.

(c) Instructions have been given to the bank to stop payment for the lost cheque by the authority.

12. After the payment of voucher, the payment voucher and all the supporting documents shall be stamped with the date and with the words “PAID” by the paying officer. It is for the Finance and Administration Manager to see that proper procedures are followed to ensure safe custody of the unused cheque forms.

13. The cash office shall be open during working hours to the public and the staff for making payments and receiving cash at the hours prescribed by the Managing Director.

14. It is only during office hours that the enquiries on payments can be made.

3.2 Payment Vouchers

A voucher is a document which is a proof of receipts or payment of money. Any money to be paid by the government should have a payment voucher. It is a proof that payment is made for goods purchased or services rendered. Vouchers are made at the point where payments are to be effected.

1. Important features of a Valid Payment Voucher

A valid payment voucher must contain the full particulars such as date, quantity, serial number and price. It has to be supported by relevant documents such as local purchase orders, invoices and letters of authority.

A well prepared payment voucher should contain the following features:

(a) Date of the voucher

(b) Voucher Number

(c) Amount in words and figures

(d) Head and sub head of expenditure

(e) Name and address of payee beneficiary

(f) Details of payment

(g) Supporting documents such as invoices, store receipt vouchers and contract agreements.

(h) Authority such as the type of Warrant which will release the money

(i) Signature of the Officer controlling expenditure

(j) Signature of the payee

(k) Signature of the cashier

(l) Certification of Voucher, which shows the following in a box:

Prepared by:…………………….
Checked by:……………………..
Entered into Vote Book by
Passed by:…………………………
Paid by:…………………………….

(m) Cheque number, in case of cheque payment

(n) Stamp by the cashier showing 'PAID' which prevents re-presentation of the voucher for payment a second time.

Example

Below is the specimen of a valid payment voucher

Head……………………………….. Station………………………..
Sub-Head………………………………………………
Voucher Serial No…………………….. Amount……………. Name of Beneficiary………………………………………
Address:………
……

Date	Description of payment	Rate	Amount payable

Authority by: Warrant…………
Officer Controlling Expenditure……………………
Amount in words……………………………………………
Signature of payee………………………………………
Signature of Cashier………………………………………

I certify that the above voucher has been entered in my Vote Book

…………………………………………………………………………………………..
Signature of Officer Authorising the Expenditure

2. Rules for issuance of Payment Vouchers

As per the Financial Regulations, a Sub-Accounting Officer may not make payment against a voucher unless:

(a) The voucher is certified for payment by the authorised officer.

(b) The voucher is stamped " checked and passed" for payment and thereby signed by the checking officer.

(c) The voucher is stamped, " Entered in the Vote Book" and is signed by the officer keeping the Vote Book.

Following rules should be strictly observed in the preparation of the payment vouchers:

(a) Vouchers shall be made in ink or ball point pens or indelible pencils or shall be type-written. All copies must be legible.

(b) There should be no use of erasure of any kind,

(c) Also, use of correcting fluid is not allowed

In case, a payment voucher is presented to the Sub-Treasury or Cash Office for obtaining cash for payment to be made elsewhere, as in the case of payment of salaries, a cheque/cash order form has to be signed by the authorised Officer. It should bear the signature of the authorized Officer to receive the cheque or cash. In such a case, a separate cheque/cash order form is required for each voucher.

3.3 Modes of payment

The public sectors use different modes of payment:

1. Cash Payments

Cash is the primary form of payment. The cash is in the form of issue notes of 7 denominations and coins of 10 denominations. The usage of cash relative to other payments has reduced over the years.

2. Non cash payments

(a) Credit transfers

Credit transfer systems are used using telegraphic transfers and mail transfers. The transfers are performed by coded telex transfers. Where telecommunication is not possible, transfers through mail transfer are common for local inter branch and non-local payments.

(b) Cheques

There is an increase in the use of cheques. Only central banks and commercial banks that maintain current accounts with the central bank are allowed to issue cheques. Though it takes as long as 28 days for the cheque to get cleared in remote areas, the paper cheques is the most common non-cash payment instrument in Tanzania.

(c) Direct Debits

Some banks use "Standing/Bankers orders" to provide direct debit services to customers. This service is limited to intra-bank transactions. However, sometimes it is used for recurring loan repayments, insurance premiums etc.

(d) Other payment instruments

There are other payment instruments used by public sector organisations such as banker's payment cheque, promissory notes, traveller's cheques etc.

Case Study

Following is an extract of the 'General Procedures for all payments' relating to Arusha Urban Water Supply and Sewerage authority

All payments to outside parties shall be made by crossed cheques in accordance with the Authority's procedures as prescribed in the Public Finance Regulations 2001 and these Regulations.

The date of payment of any amount governs the date of the record of the transaction in the accounts.

All payments, particularly to outside parties, shall be supported by a claim in the form of invoice, work order, goods received note etc. The Head of Accounts Section shall verify the accuracy of amounts payable before effecting payment.

Copy invoices and photostat invoices shall be supported by certificates of indemnity from the payee. The indemnity certificate shall require the payee to make good the full value of the payment in the event of double payment being evident.

Financial regulations issued by Arusha Urban Water Supply and Sewerage authority

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Test Yourself 4

All payments to outside parties shall be supported by the following documents like …………………, ……………………. and ………………

Test Yourself 5

All payments generally should be made by:

A Crossed cheque
B Blank cheque **C**
Open cheque **D**
Bearer cheque

Test Yourself 6

State whether the following are true or false:

(i) Payment vouchers can be made in pencil.
(ii) Payment vouchers should be supported by supporting documents like invoices, goods receipt note.
(iii) Payment vouchers may not be signed by the cashier.
(iv) Correcting fluid can be used in a valid payment voucher.
(v) Payment vouchers should be serially numbered.

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4. Prepare records for development expenditure and recurrent expenditure. [Learning Outcomes d]

1. There are two types of expenditures:

Recurrent or revenue Expenditure is expenditures incurred by government enterprises in the day to day affairs of the enterprise. Few examples are salary, postage, stationary and other administration expenses**.**

Development or capital expenditures are the expenditures incurred to acquire physical and permanent assets. They may be equipments, vehicles, furniture, land or buildings.

2. Vote

This is a record which is to be maintained by each Accounting officer or officers designated by him and warrant holder for proper control of expenditure against the provision of funds.

3. Warrants

Warrant is the authority that confers power on the Officer controlling expenditure to incur expenditure. It is the process used by the Ministry of Finance to authorise moneys to be released by government departments and agencies for spending.

The authorised officers need to ensure that all payments are made from available money for the correct type of expenditure as authorised by the Parliament.

Warrants are of two types:

(a) Recurrent Expenditure Warrants
(b) Capital or Development Expenditure Warrants

Furthermore warrants can be provisional, general or specific.

(a) Recurrent Expenditure Warrants

The authorisations for expenditures of revenue nature are recurrent expenditure warrants. There are different types of revenue expenditure warrants.

(i) Imprest Warrant: This warrant is issued to authorise funds to be released to any senior officer who needs to spend money (to meet incidental and other petty expenses on government official trips, or activities). This imprest amount is settled periodically. (Refer to Learning Outcome 1 of Study Guide A10 for more details of imprest accounts)

(ii) Annual General Warrant: After annual estimates have been approved for all recurrent expenditures, the annual general warrant is issued to the Controller and Accountant General.

(iii) Provisional General Warrant: Warrants for expenditures made in respect of existing services and continuing projects in the beginning of the financial year while the annual estimates of the government are examined for approval. It is normally for the first three months of the year and is for 25% of the annual estimates.

(iv) Reserved Expenditure Warrant: This warrant is issued to release money out of the approved annual Estimates. These warrants are released to the organisations that apply for such money giving the explanation giving the reason for request.

(v) Establishment Warrant: This warrant relates to the promotions when the Controller and Accountant General's department uses to fix the salary of the staff who is promoted.

(vi) Contingencies Warrant: This warrant is issued for urgent and unexpected expenditures those cannot be delayed.

(vii) Virement Warrant: These are needed for money to be transferred from an expenditure where there is surplus money to another expenditure where all moneys have been spent. This refers to transfer of approved funds from one vote to another as authorized by the Ministry of Finance. This takes place when there is change of functions between ministries.

The requisites of virement warrant are:

It should be in writing
State that a particular sub-head is in deficit and the other is in surplus
State that after the transfers, the other sub-heads will not be in deficit.

(b) Development expenditure warrant

This warrant is issued by the Minister of Finance to the Controller and Accountant General for capital expenditures.

The different types of development expenditure warrants are:

(i) Provisional Development Fund general Warrant

(ii) This warrant is issued from the Development Fund to the spending ministries for the first three months of the budget year to enable the relevant ministry to carry on with capital project that were begun in the previous years.

(iii) Development Fund General Warrant: this is issued after Parliament has issued the Appropriation Act to enable various spending organisations to get moneys for the current year capital projects.

(iv) Development Fund Supplementary General Warrant: this is issued to release moneys that have been approved by the Parliament in the development supplementary estimates.

(v) Development Fund Reserved Expenditure Warrant: this is issued for the release of project development moneys those were reserved earlier from approved development estimates.

(vi) Development Fund Supplementary warrant: this is issued for release of moneys that are to be spent over and above the normal annual development estimate approved for the year. It is release of moneys for past project approved but not spent in the past year.

(vii) Development Fund Special Warrant: this is for the release of moneys for urgent projects whose estimates have been submitted but is yet to be approved by the Parliament.

(viii) Development Fund Virement Warrant: these are needed for money to be transferred from an estimate of one capital project where there are surplus moneys to another estimate of a capital project where all money is not enough.

4. The new legislation prohibits not only excess vote/spending but also both virement of funds from one vote to another, and transfer of funds from one item to another item within the same vote. However in case of need to vary the approved amounts allocated to each subhead, or item of a vote, the Accounting Officer must apply to the Minister of Finance who is empowered to make transfers within the sub-heads and items provided that such activity does not exceed the total amount authorized by the National Assembly in that vote. The Minister of Finance may delegate this power to the accounting officer upon written notification, either generally or specifically in respect of amounts involved.

All virement of funds must be forwarded to the Paymaster General (PMG) by way of application for virement and this application must be copied to the Accountant General and the Controller and Auditor General, indicating the amounts involved, the items affected and any delegated authority to make such virement.

The items for which funds will have been transferred will no longer be eligible for the provision of additional of funds by way of Supplementary Appropriation.

By definition excess spending is defined in three ways:

(a) Moneys that have been expended/spent on any expenditure vote in excess of the amount appropriated by the National Assembly by an Appropriations Act or supplementary Appropriations Act, or

(b) Moneys expended for a purpose for which no moneys were appropriated; or

Moneys which have been expended in any sub-Vote/sub-Head of an expenditure vote in excess of the sum assigned thereto in the estimates of expenditure for the financial year and which no further sum has been applied under any legislation.

5. **Statement of Vote account for recurrent and development** is a summary amount budgeted for expenditure against funds received/ issued from the consolidated fund and actual expenditure reported by the MDAs & regions.

Example

Here is the statement of consolidated revenue fund.

Consolidated revenue fund for the year ended 31st December 20XX

Actual previous year		Notes	Budget Current Year	Actual Current Year	Variance %
Tz			Tz	Tz	
XX	Opening balance		XX	XX	X
	Add revenue(income)				
XX	Statutory revenue allocation				
XX	Earning & sales	20	XX	XX	X
XX	Interest & dividend	21	XX	XX	X
XX	Taxes(direct & indirect)	22	XX	XX	X
XX	Miscellaneous	23	XX	XX	X
XXX	**Total revenue(a)**		**XXX**	**XXX**	**X**
	Less: expenditure				
XX	Administrative services expenses		XX	XX	XX
XX	Education services expenses		XX	XX	XX
XX	Transport services expenses	24	XX	XX	XX
XX	Health services expenses		XX	XX	XX
XX	Agricultural services expenses	25	XX	XX	XX
XX	Subsidies		XX	XX	XX
XX	Miscelleneous	26	XX	XX	XX
XXX	**Total expenditure(b)**		**XXX**	**XXX**	**XXX**
XXX	**Operating balance (a-b)**		**XXX**	**XXX**	**XXX**
Appropriate / transfers					
XX	Loan repayment fund		XX	XX	X
XX	Capital development fund		XX	XX	X
XXX	**Closing balance**		**XXX**	**XXX**	**X**

The accompanying notes are an integral part of these Statements

Here is the statement of consolidated development fund.

Capital development fund for the year ended 31st December 20XX

Actual previous year		Notes	Budget current year	Actual current year	Variance %
Tz			**Tz**	**Tz**	
XX	Opening balance		XX	XX	X
	Add capital receipts				
XX	Value Added tax		XX	XX	X
XX	Transfer from CRF		XX	XX	X
XX	Loans	27	XX	XX	X
XX	Grants	28	XX	XX	X
XX	Miscellaneous	29	XX	XX	X
XXX	**Total capital receipts(a)**		**XXX**	**XXX**	**X**
	Less: Capital expenditure				
	Economic sector				
XX	Agriculture	30	XX	XX	X
XX	Livestock		XX	XX	X
XX	Forestry		XX	XX	X
XX	Manufacture		XX	XX	X
XX	Power		XX	XX	X
XX	Commerce and Finance		XX	XX	X
	Social service sector				
XX	Education	31	XX	XX	X
XX	Housing		XX	XX	X
XX	Health		XX	XX	X
XX	Miscellaneous		XX	XX	X
	Administration sector				
XX	Administration sector	32	XX	XX	X
XXX	**Total expenditure(b)**		XXX	XXX	XXX
XXX	**Closing balance(a-b)**		**XXX**	**XXX**	**XXX**

The accompanying notes are an integral part of these Statements

Test Yourself 7

Which of these is revenue expenditure?

A Salary
B Computer
C Machinery
D Telephone expense

5. Prepare records for projects grants and payments.

[Learning Outcomes e]

Grant refers to any form of assistance from the government or a donor agency in the form of cash or transfers of assets to the authority.

The grant applicants should be aware of the special rules associated with receiving and spending grant funds and should adhere to the grant requirements. A grant comes with certain conditions for complying with the funding requirements.

Grants management generally require monthly reporting on the status of the project and also back up data for the month which includes accounts receivable, accounts payable and payroll. The grantee is responsible for the grant money it receives. The grantee needs to know the grant agreement requirements. At a specific point, a grantee needs to know how much money was received, how much spent and how much is left and also the status of the particular grant project.

1. Grant record keeping and maintenance

(a) The grantee has to set up a record keeping system that organises the data in a manner that it can be easily retrieved and understood.

(b) A grant budget needs to be formulated. The grant budget is a plan to know how the grant money will be spent and the costs involved as well as all the money available in the project.

(c) The grantee needs to keep records of all financial transactions and back up documentation such as invoices and receipts related to grant. The grantee needs to prove that the grant was used for exactly what it was intended for and this he can do by keeping complete record of everything related to grant.

(d) In case the grantee is unable to prove that the money taken for grant was not spent as per the agreement, it is possible the grantee will have to pay money back and may not get any further grants in future.

(e) The grant recipient is responsible for administering any grant received. The day to day affairs are given to a dedicated staff that ordinarily would handle administrative and financial duties.

(f) It is necessary to have a reliable, user-friendly financial management and reporting system in place.

The system needs to have:

A reliable, working system for tracking revenues and expenses.
A reliable, working financial reporting system.
A reliable storage system for retrieval of documents and files.

(g) Each grant should have special identifier so as to keep a track and report of each grant separately. All the data related to the grant should be filed in the grant file. The grant file should atleast have four folders for grant application, back up documents, grant correspondence and contracts.

(h) The grant recipient needs to keep a separate bank account for the grant money so that the grant funds are not used for operating and administrative expenses.

(i) Apart from the financial records, construction and inspection reports, permits and engineering reports and all other documents those show progress of the grant project should be kept.

(j) A correspondence file with copies of all the letters related to grant project should be kept.

Case Study

The following is an extract of the reporting requirements relating to grants from 'The United Republic of Tanzania, Ministry of natural resources and tourism' is as follows:

As a general rule Progress and completion reports (narrative and financial ones) should be prepared and submitted to Tanzania Forest Fund. Generally, Progress reports (both narrative and financial reports) shall determine whether to disburse funds for the 2nd and 3rd instalment, to suspend the grant or even to terminate it.

Small grants: Recipients of small grants are expected to complete their operations during the second instalment. Therefore, they are expected to prepare one Progress report and a completion report which summarizes what have been achieved by the project compared to the planned objectives and activities. Attained achievement should be compared to the resources used to determine value for money.

Medium grants: Recipients of this grant are required to submit Progress technical and financial reports at the end of 1st, 2nd and 3rd instalment as well as a completion report at the end of the project.

Large grants: Large grant recipients are also required to submit Progress reports at the end of 1st, 2nd, and 3rd instalments as well as completion report. The Progress reports should provide both technical and financial reports.

Case Study

Format for financial report relating to grants from 'The United Republic of Tanzania, Ministry of natural resources and tourism' is as follows:

Instructions for preparing the financial reports:

1. **Project Number:** include the number assigned to the project by the Fund
2. **Project Name:** as stated in the approved proposal
3. **Grantee:** name of beneficiary organization
4. **Author of report:** name of person responsible for compiling the information, elaborating and presenting the report
5. **Report period:** indicate beginning and ending date of period being reported
6. **Expenses:**

(a) Budget items: list the budget items indicated in the approved budget

(b) Approved budget: insert the total amounts per budget item

(c) Expenses:

i. First Report: total expenses incurred by budget item during the first reporting period

ii. Second Report: total expenses incurred by budget item during the second reporting period

iii. Third report: total expenses incurred by budget item during the third reporting period

iv. Final Report: total expenses incurred from the end of the third reporting period until project completion

(d) Accumulated to date: total expenses incurred since the beginning of the project (this will be accumulative throughout project duration).

(e) Balance: balance by budget item for each reporting period

Continued on the next page

7. Summary:

(a) Amount received:

i. This period: amount received from the Fund during this reporting period

ii. Accumulated to date: total amount received to date from the Fund

(b) Previous balance:

i. This period: total balance carried over from previous period(s)

(c) Total expenses:

i. This period: expenses corresponding to this reporting period

ii. Accumulated to date: sum of expenses of all reporting periods, including this period

(d) Balance:

i. This period: funds left over, that were not used during this reporting period

(e) Reimbursement: indicate amount to be reimbursed to the Fund at the end of the project, if that is the case, and only in the final financial report. Include check number and attach the deposit slip.

8. Date of completion of report

9. Signature of author of report: signature of person responsible for compiling the information, elaborating and presenting the report

10. Detail of expenses: list individual expenses by date, with the following information: date, number of invoice/receipt, amount in Tshs.

Financial reports must include photocopies of all invoices/receipts. Please present them taped to sheets of paper and organized by date.

Reports that do not have the information requested in these formats and do not present adequate support documents, such as invoices or receipts, will not be accepted.

Continued on the next page

Tanzania Forest Fund
Financial Reports

Project number:
Project name:
1. Grantee:
2. Author of report:
3. Report period:
4. Expenses:

		1st Installment	**2nd Installment**	**3rd Installment**	**Accumulated to date**		
Budget items	**Approved budget**	**Expenses**	**Expenses**	**Expenses**		**Expenses**	**Balance**
Total							

7 Summary		**This period**	**Accumulated to date**
Amount received			
(-) (+) Previous balance			
Total expenses this period			
Balance			
Reimbursement	Cheque no		
Bank:			

8. Date of complition report___________________
9. Signature of report author___________________
10. Details of expenses

Continued on the next page

No and Name of project:
Grantee:
Report period:

Date	Doc Number	Budget category	Item description	Total expenses
			Total	

Test Yourself 8

Why should the grantee need to have separate bank account for grant money?

6. Discuss the applicability of relevant regulations on the identification and treatment of illegal payments/expenditures such as Nugatory, improperly vouched and non-vouched expenditures.

[Learning Outcomes g]

6.1 Meaning of illegal payments

Illegal payments are payments which are not properly supported by documents and vouchers or are supported by incomplete documents. They are payments for which goods and services are not received or payments made in excess of approved rates.

Illegal payments can be divided into the following categories:

1. **Nugatory Expenditure** is expenditures incurred by the government for which goods or services have not been received. They are also expenditures which include:

   over payments for materials and services made twice,
   overpayments which are not recovered
   payments in excess of approved rates
   Irrecoverable overpayments

2. **Non-vouched Expenditures are expenditures those have no vouchers or support to them.**

3. **Improperly vouched expenditures** are expenditures those are not supported by complete, proper and acceptable documents such as payment vouchers, local purchase order, invoices and receipts or other supported schedules.

The following case study contians some examples of the above explained expenditure:

Case Study

Extracts of **annual general report of the Controller and Auditor General on the Audit of the Financial Statements of Central Government for the Year ended 30th June, 2008**

Vote 40 – Judiciary

As at the year end, there were deferred Payments adding to Shs. 31,005,000
Unclaimed salaries for the year could not be ascertained since schedule of assets and liabilities (deposit account) was not prepared and submitted for audit. However the available records show suspected nugatory payments of Shs. 84,082,675 in the form of payment of unclaimed salaries.

Vote 68: Ministry of Communication, Science and Technology

Fuel not properly accounted for Shs. 32,353,580.
Inadequately supported expenditures Shs.1,309,443,872.
Penalty for delayed remittance of statutory deductions (nugatory expenditure Shs.1,023,283.
Outstanding imprests – Shs. 33,750,969.

New York – United Nations

Nugatory expenditure Shs.5,033,160 (Payment USD 4,100)

We noted USD 4100 (equivalent to Shs.5,033,160), paid as house rent for the month of May, 2008 in respect of an officer of the embassy. However records show that, in April 2008 the officer was transferred to the Tanzanian Embassy in Addis Ababa, Ethiopia. Hence, the Mission incurred a nugatory expenditure.

6.2 Identification of illegal expenditure

The illegal expenditures can be identified by audit procedures. The purpose of audit tests is to allow the auditor to collect sufficient audit evidence to be reasonably sure that the financial statements are free of errors. In case sufficient audit evidence is not obtained, then the auditor can issue a modified audit opinion.

Illegal expenditure can be identified by carrying out the following audit procedures:

Tests of control ; and
Substantive procedures

Tip

Before understanding the concept of tests of control, you need to understand the concept of ‘internal controls.
Internal control is a process which is implemented by those charged with governance, management and other personnel. It provides a reasonable assurance regarding the achievement of the objectives in the following categories:
efficiency and effectiveness of operation
reliability of financial reporting
compliance with applicable laws and regulations

Therefore testing the efficiency of an entity’s internal controls plays an important role in identification of illegal expenditure.

1. Tests of control

An audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Example

Tests of control to **detect** material misstatements in the amount of bad debts, will involve checking the documentary evidence of authorisation of the bad debt write-off.

Test of control to **prevent** material misstatements involves segregation of duties between the salesman who receives the sales order, sales executive who raises the invoice, cashier who collects the cheques and accounts executive who handles the accounts receivable ledger.

Test of control to **correct** material misstatements involves preparation of a bank reconciliation statement will enable to correct any material misstatement in the financial statement with respect to bank transactions.

(a) Tests of controls include:

(i) Observation of procedures: once the auditor has gathered information about the hierarchy of authority and responsibility, segregation of duties, authorisation levels, business processes etc. the auditor will observe various procedures and processes to confirm the effective implementation of written policies and procedures. By observing certain procedures, the auditor can identify deficiencies i.e. cases where the procedure is not followed according to the written instructions.

(ii) Inspection of documents: this is also a method by which an auditor can test the effectiveness of the operation of controls. The auditor may inspect the documents of a sample of transactions, to determine whether they have been checked for calculations, authorised according to the requirements etc.

(iii) Enquiry of personnel: an auditor should question personnel at various levels.

Personnel at operating level: enquiry of personnel at operating level enables an auditor to find out how the procedures are carried out and whether the personnel are following policies and procedures of the entity.

Personnel at supervisory level: enquiry of personnel at the supervisory level enables an auditor to find out whether they supervise the work according to the requirements of the policies and procedures of the entity, review exception reports and other reports regularly and take corrective action if required.

(iv) Re-performance and recalculations: an auditor can also test a control by:

re-performing tasks (like checking whether purchase vouchers which are recorded have supporting goods receipt notes and purchase orders) and

conducting recalculations, already performed by the internal control (like carrying out manual recalculation of interest on loan accounts already calculated by an automatic program and compare the results to confirm the accuracy and proper working of the program.

Example

To detect any misstatement in amounts receivable in financial statements is if they are incorrectly valued because a large balance was owed by a customer who was unlikely to pay.

The controls those would help to prevent are:

Proper system of assessing credit worthiness of new customers
Close monitoring of customer's payments
Timely follow up of amounts not paid on time.

The auditor would assess the credit worthiness of every customer before offering credit by verifying that:

the entity has prepared a detailed report of the new customers, their creditworthiness and the basis on which the credit is granted.
the report is authorised by a credit rating manager.

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2. Substantive procedures: substantive procedures comprise:

Tests of details (of classes of transactions, account balances; and disclosures) and

Substantive analytical procedures.

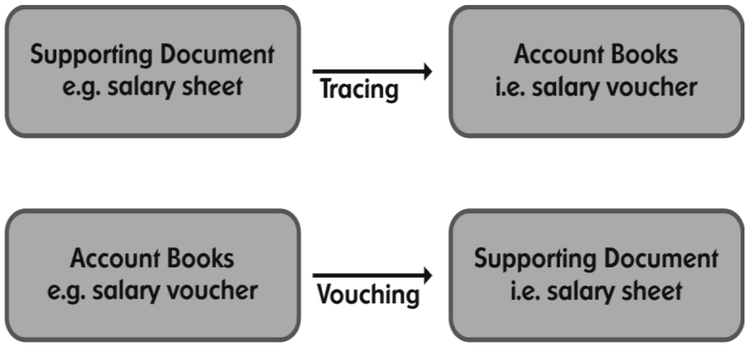
(a) Test of detail is carried out for transactions and balances.

Details of transaction

These are tests to obtain evidence of individual debits and credits that make up an account to reach a conclusion about the account.

The tests can be made through tracing and vouching of transactions.

Diagram 3: Vouching and tracing



The tests enable to ensure monetary accuracy of debits and credits.

Detail of balances

These are tests to obtain evidence about the accuracy of the closing balances on the reporting date e.g. accounts receivable balance, accounts payable balance etc.

(b) Substantive analytical procedures

Analytical procedures mean the analysis of significant ratios and trends and comparison of data with relevant data in the previous year. It also involves the investigation of resulting fluctuations and inconsistent relationships.

Analytical procedures are normally considered to be **less effective than tests of detail** and are used as a supplementary technique.

Example

The auditor of a manufacturing unit, tests the reasonableness of the actual freight charges for the year with the expected freight charges. Suppose: average freight rate is 5% of the sales, if sales are $500,000, freight should not exceed $25,000.

However if the actual freight is significantly more than $25,000, it indicates a possibility of some illegal payments of freight. The auditor will therefore carry out a detailed verification of freight invoices recorded by the entity and confirm whether some illegal payments have taken place.

6.3 Treatment of illegal expenditure

1. Responsibility and recovery of illegal expenditure

Following are the persons held responsible for illegal expenditure:

(a) The responsibility for the recovery of any nugatory payments rests with the Finance and Administration Manager.

(b) Debts written as irrecoverable through negligence or delay in enforcing payment may fall on the person responsible for failure to recover money.

(c) In case any person makes payment without proper authority, he shall be personally responsible for the amount of payment.

(d) Any person who makes a payment without proper authority shall be personally accountable for the amount of the payment.

(e) In case of error or losses in payment, persons who prepare, check and approve payment vouchers would be held responsible.

(f) In case payment arises due to negligence of employees, the same would be recoverable from such person.

(g) The Finance and Administration Manager would be held responsible for issuing of bouncing cheque as he ought to know the bank balance before signing the cheques.

(h) The aforesaid employees would be held responsible for surcharge or penalty:

Those who incur unproductive expenditure.
Those who have caused payment of unproductive expenditure.
Those who are responsible for authorising disallowed expenditure.
Those who incur disallowed expenses
Those who have caused loss or damage by reason of negligence, misconduct or otherwise.

2. Effect on audit opinion

(a) The audit opinion on the financial statements of government agencies having illegal expenditure can be adversely affected.

Case Study

Continuing the earlier Case Study relating

The extracts provided in the earlier Case Study have caused an unqualified opinion with Emphasis of Matter for individual Votes.

(b) Background information of audit opinion

(i) Emphasis of matter paragraph (matters that do not affect the auditor’s opinion, ISA 706)

A paragraph included in the auditor’s report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor’s judgment, is of such importance that it is fundamental to users’ understanding of the financial statements.

(ii) Modified audit opinion

If a material matter is not disclosed, then the auditor’s opinion will be modified (qualification, adverse or disclaimer).

(c) Qualified Opinion

The auditor shall express a **qualified opinion** under the following circumstances:

(i) Inability to obtain sufficient appropriate audit evidence

The auditor is unable to obtain sufficient appropriate audit evidence on which to base their opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Inability of the auditor **to obtain sufficient appropriate audit evidence** arises when the scope of the auditor's work has been limited in some way.

It **may be due to** the following reasons:

limitations imposed by management, i.e. the entity imposed certain conditions on the auditor because of which they could not perform the necessary audit procedures e.g. the entity did not allow the auditor to send letters to their clients so the auditor could not confirm the existence of receivables.

circumstances relating to the nature or timing of the audit work, i.e. the auditor is unable to perform the proper procedures due to circumstances beyond their control e.g. they were appointed after the year end inventory verification was over and hence they cannot vouch for its accuracy and existence in any way.

circumstances beyond the control of the entity, e.g. the records of the entity have been destroyed and the auditor cannot verify the details from any other available means.

If the inability to obtain sufficient appropriate audit evidence is **material but not pervasive** (i.e. the limitation affects one area of the financial statements and is material, but does not render the whole financial statements misleading) then the auditor **issues a qualified opinion** in the following manner.

(ii) Sufficient appropriate audit evidence available, but misstatements in financial statements material although not pervasive

Material misstatement of the financial statements may arise in relation to:

the appropriateness of the selected accounting policies. For example, the valuation of inventories at cost instead of the lower of cost or net realisable value as prescribed by IAS 2, Inventories.

the application of the selected accounting policies. For example, the valuation of non-current assets is done using the cost model for one financial year, and in the next year the same assets are valued using the revaluation model. Furthermore, during the third year, the cost model is adopted to value the same non-current assets.

the appropriateness or adequacy of disclosures in the financial statements. For example the financial statements of a manufacturing company prepared under IFRS, do not include all of the disclosures relating to revenue recognition and non-current assets.

There may be a situation where the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in aggregate, are material, but not pervasive to the financial statements. At such times a qualified opinion is expressed.

(d) Disclaimer of opinion

In case the **auditor is unable to obtain sufficient appropriate audit evidence** on which to base their opinion, and the **limitation is pervasive enough to cause the financial statements to mislead** then the **auditor issues a disclaimer**.

A disclaimer of opinion is also made when under multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

This is under rare circumstances

(e) Adverse Opinion

An adverse opinion is expressed when **the auditor, after obtaining sufficient appropriate audit evidence, concludes that misstatements, individually or in aggregate, are both material and pervasive to the financial statements**. It means that the audit evidence indicates that the financial statements as a whole are not free from material misstatement

Test Yourself 9

Expenditures incurred by the government for which no goods or services have been rendered are:

A Nugatory Expenditures
B Non vouched expenditures
C Improperly vouched expenditures
D Properly vouched expenditures

Answers to Test Yourself

Answer to TY 1

The answer is **B**.

A Central Payment Office (CPO) was created at the Treasury under Central Payment System

Answer to TY 2

The answer is **C**.

At the Central Payment Office, the purchase document was put into the computer using COBOL language.

Answer to TY 3

The correct option is **B**.

The Accountant General is the Chief Accounting Officer of the receipts and payments of government money.

Answer to TY 4

All payments to outside parties shall be supported by the following documents like invoice, work order and goods received note.

Answer to TY 5

The correct option is **A**.

All payments generally should be made by crossed cheques.

Answer to TY 6

(i) The statement is false.

Payment vouchers shall be made in ink or ball point pens or indelible pencils or shall be type-written.

(ii) The statement is true

(iii) The statement is false.

Payment vouchers must be signed by the cashier.

(iv) The statement is false.

Use of correcting fluid is not allowed in a valid payment voucher.

(v) The statement is true

Answer to TY 7

The correct options are **A** and **D**.

Salary and telephone expense are revenue expenditure.

Answer to TY 8

The grantee needs to keep separate bank account for the grant money because if grant funds and operating funds are not kept in separate accounts, then there is danger that grant money may be spent on something that was not approved in the grant agreement.

Answer to TY 9

The correct option is **A**.

Expenditures incurred by the government for which no goods or services are rendered are called nugatory expenditures**.**

Self Examination Questions

Question 1

What are the general procedures of making payments? Who would be held responsible for making illegal payments?

Answers to Self Examination Questions

Answer to SEQ 1

The general procedures for all payments are:

1. All payments to outside parties would be made by crossed cheques in accordance with the Authority's procedures as given in the Public Finance Regulations 2001.

2. The date of record of the transaction in the accounts is governed by the date of payment of any amount.

3. All payments specially to the outside parties should be supported by invoice, work order or goods received note.

4. The Certificate of indemnity from the payee should support copy invoices and photostat invoices.

5. Enquiries on payment shall be made within cash office during working hours.

6. Payment vouchers must be complete in all respects such as detailing the authority, complete description and coding of the expenditure or reason for payment. There should be reference to the numbers of invoices so as to identify the payment in case the supporting documents are lost.

7. The approving and authorised persons must sign all alterations to the material particulars given in the application.
.
8. Both used and unused payment vouchers should be kept under maximum security.

9. It has to be ensured that the person claiming the payment is the person who is authorised to receive it or the authorised representative.

10. The original payment voucher should affix the authority by the payee to a nominee if there is one.

11. In case of lost cheques before presentation to bank, replacement cheques cannot be issued until:

    The non-presentation to the bank has been authenticated.
    A police report and a certificate of indemnity have been received from the payee.
    Instructions have been given to the bank to stop payment for the lost cheque by the authority.

12. The payment voucher and all the supporting documents shall be stamped with the date and with the words "PAID" by the paying officer after payment of voucher.

The responsibility of illegal payment lies on the following persons:

(a) Any employee making or directing a payment without proper authority shall be personally held responsible for the payment.

(b) The amount will be recovered from the defaulting person where the payment is made due to negligence or misconduct on the part of the employee.

(c) Any employee who is responsible to render accounts payments shall be held responsible for any inaccuracies in these accounts.

(d) The persons who check the accuracy and details of the payment would be held responsible for any loss that may arise from the payment in case any error or negligence is made.

SECTION A

ACCOUNTING FOR PUBLIC SECTOR

A10

STUDY GUIDE A10: NON-VOTE ACCOUNTS AND PUBLIC STORES

Get Through Intro

Non vote payment accounts are payments made out of public funds for the purpose not approved by the National Assembly. When affected, they are charged temporarily in the recurrent Vote account by using accommodation codes pending clearance, retirement and refund recovery.

This Study Guide discusses some of the non-vote accounts like suspense account, imprest accounts and advances. Furthermore it also explains various aspects of stores like procedures to handle stores, checks and condemnation of unserviceable stores Knowledge of this area is important as non-handling it appropriately can cause fraud and losses to an organisation.

Learning Outcomes

a) Explain the suspense accounts.
b) Explain the advances accounts and their types.
c) Explain the imprest account and their types.
d) Explain the deposit account.
e) Explain the special funds accounts.
f) Explain the importance, relevance and applicability of non – vote accounts in public sector.
g) Identify differences between the allocated and unallocated stores.
h) Explain the stores checks and condemnation of unserviceable stores.
i) Identify the procedures for handing and taking over of stores.

1. Explain the Suspense Accounts.
Explain the advances accounts and their types.
Explain the imprest Account and their types.
Explain the deposit Account.
Explain the special funds accounts.
Explain the importance, relevance and applicability of non - vote accounts in public sector.
[Learning Outcomes a, b, c, d, e and f]

Classification of non-vote accounts

Non vote payment accounts are payments made out of public funds for the purpose not approved by the National Assembly.

Examples of non-vote accounts are advances, suspense accounts and imprest accounts.

1.1 Suspense accounts

1. Meaning

According to The Local Government Finance Act 1982, a local government authority may make advances and operate deposit and suspense accounts.

Under the double entry book keeping system, we record the two effects of all transactions as debits and credits. Hence the trial balance totals of debits and credits are equal. Whenever the total of all debits and credits do not match, it means that there is an error in accounting.

A suspense account is a temporary account opened to accommodate differences or errors that cannot be immediately located. The account may also be opened to accommodate the trial balance differences or temporary errors while efforts to establish the cause is sought.

Case Study

The following is an extract of annual general report of the controller and auditor general, on the audit of the financial statements of the central government for the year ended 30th June, 2010

The system of accounting for revenue is not sound because, during the year returns from collection centres worth Shs.1,667,139,734.64 were not available for inspection.

In addition, there was unexplained difference of Shs.755,874,245.67 between the amount reported in the statement of revenue and the amount of Shs.3,316,898,398.78 recorded in the revenue collector's cashbook.

Further, the sources of collections adding to Shs.2,920,879,363.60 could not be identified because records were not recorded properly.

Nevertheless, the whole amount was put under the Miscellaneous Revenue code as opposed to the accounting procedures which require any unidentified amount to be accommodated under Suspense Account code pending adjustments.

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2. Errors leading to the creation of suspense account

The errors that can occur while preparing a trial balance can be summarised as follows:

(a) Casting error (i.e. errors of adding up)

Undercasting of the credit side
Undercasting of the debit side
Overcasting of the credit side
Overcasting of the debit side

(b) Posting error

Posting the wrong amount and transposition error
Omitting to post the debit or credit side of the transaction
Posting a transaction to the wrong side of the correct ledger account

(c) Figures incorrectly carried over to the trial balance

Example

The following is a summary of the transactions of a local government for the year ended 31 December 20X4

	Tshs'000
Local licenses, fees & rates	68,097.00
Local rates and taxes	54,738.00
Statutory allocation	459,162.00
Grants from State Government	253,672.50
Grants from Federal Government	190,060.50
Office of the Chairman	104,467.50
Office of the Secretary	353,932.50
Traditional Office Expenses	18,735.00
Primary Health Care	65,265.00
Rural Electrification Expenses	14,160.00
District Area Office Administration	324,787.50
Rent on Local Government Property	177,390.00
Miscellaneous Expenses	495.00
Planning and Budgeting Expenditure	7,951.50
Interest payments and dividends received	9,525.00
Earning from commercial undertakings	194,463.00
Legislative Deposits	54,462.00
Payee and union due balance	562.50
Advance Salaries to staff	1,444.50
Deposit for purchase of computer systems	36,195.00
Pension Balance	973.50
Bank Balance	181,159.50
Cash in Hand	3,162.00
Withholding Tax	20,490.00
Finance & Supply	79,800.00

Continued on the next page

Using the above information the following trial balance has been prepared:

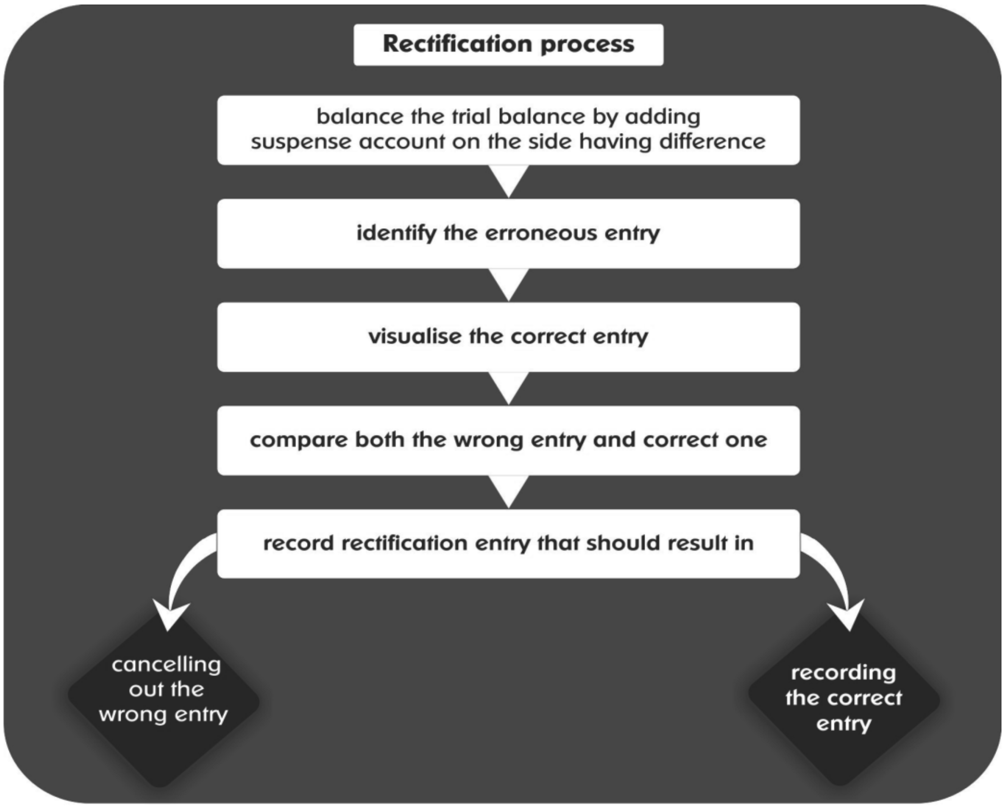
	Dr '000	**Cr '000**
District Area office Admin.	324,787.50	
Miscellaneous Expenses	495.00	
Planning and Budgeting Expenditure	7,951.50	
Interest payments and dividends received		9,525.00
Statutory allocation		459,162.00
Rent on Local Govt. property		177,390.00
Earnings from Commercial undertakings		194,463.00
Legislative deposits		54,462.00
Payee and Union Due Balance		562.50
Advance salaries to staff	1,444.50	
Deposit for purchase of Computer	36,195.00	
Pension Balance		973.50
Withholding Tax		20,490.00
Finance & Supply Department	79,800.00	
Local Licenses, Fees and Rates		68,097.00
Local Rates & Taxes		54,738.00
Grants from State Government		103,672.50
Grants from Federal Government		190,060.50
Office of the Chairman	254,467.50	
Office of the Secretary	353,932.50	
Traditional Office Expenses	18,735.00	
Primary health cave	65,265.00	
Rural electrification expenses	14,160.00	
Bank Balance Cash	181,159.50	
in Hand **Suspense**	3,162.00	
account		**7,959.00**
Total	**1,341,555.00**	**1,341,555.00**

As the total of the debit side of the trial balance exceeds the total of the credit side by Tshs 7,959, the accountant has created a suspense account to accommodate this difference.

3. Rectification process

Before we learn journal entries to rectify the errors causing the suspense account, let us visualise the process.

Diagram 1: Rectification process



Example

A local government has received a rent of Tshs 177,390. The amount recorded in the cash book is $177,930; however the correct amount is posted in the Rent income account.

Wrong **entry**

The following transaction was recorded as:

Dr	Cash account	$177,930	
Cr	Rent account		$177,390

Debit is not equal to credit.

Correct Entry

Dr Cash account $177,390
Cr Rent account $177,390

Correction entry

Dr	Suspense account	$540	
Cr	Cash account		$540

(Being rent received recorded as $177,930 in cash book instead of $177,390)

Test Yourself 1

You will credit the cash in the rectification entry for:

A the credit side of the cash book was undercast.
B the credit side of the cash book was overcast.
C the debit side of the cash book was undercast.
D None of the above

4. Purpose of suspense account

The purpose of the suspense account is to put the sum of all the errors in one visible place – in one account. The accountant can then concentrate on locating and rectifying these errors. It is important to ensure that the balance of the suspense account is reduced to zero i.e. all errors are identified and corrected before the financial statements are prepared.

Therefore, a **suspense account** is **temporarily included in** a **trial balance** to balance the debit and credit totals.

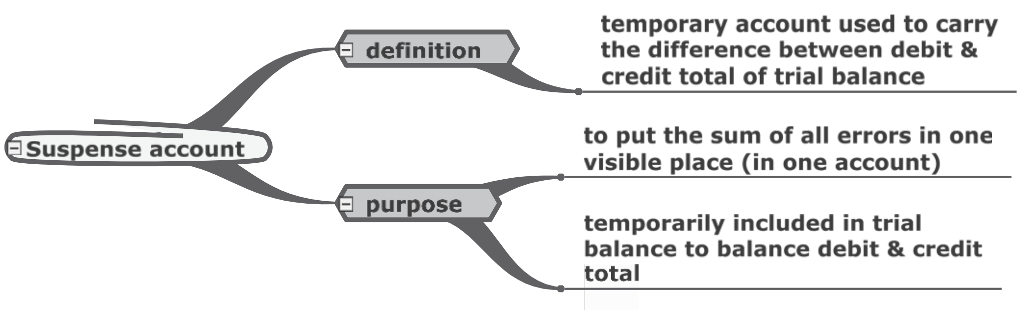
After opening a suspense account, all those errors that affect the agreement of a trial balance are rectified by either debiting or crediting the suspense account. **It is imperative that you investigate and eliminate the balance of the suspense account before proceeding to produce the financial statements.**

Once a suspense account is opened – it is essential to locate and rectify errors so that the account can be reduced to zero.

Tip

The next paragraph discusses how the balance of the suspense account is eliminated

SUMMARY



Tip

Remember that:

The creation of a suspense account is temporary.

The suspense account may contain more than one entry if a number of errors have been made during a period.

The balance in the suspense account has to be reconciled and reduced to zero before preparing the financial statements.

5. Classification of suspense account

Suspense account falls in the following categories:

(i) General suspense account- for pure suspense transactions

(ii) Warrant of funds (recurrent or development)

(iii) Stale cheques - for cheques issued but not presented for six months or more.

1.2 Advance accounts

Advances are short-term loans made to civil servants out of voted recurrent expenditure funds but which are subject to recovery either in full at the end of the month or by instalments from the employee's salary. Advances may be granted to cover job related expenditure, examination fees, tuition fees, etc. by the accounting officer.

1. Types of Advances

(a) Non Personal Advance

It is generally given to an officer for conducting his duties towards the organisation like tour advance or incurring work related expenditure. Non settlement of this kind of advance within a reasonable period of time will cause a deduction from the officer's salary.

(b) Personal advance

These are cash advances to individual officers in the public sector. They are grouped into six categories:

(i) Salary Advance

This advance is given to an employee under following circumstances:

- if he is on first appointment to the public sector
- if he is on transfer to an overseas office of the ministry of external affairs
- if he has been transferred to a new department outside his station
- the salary advance is payable within three months in instalments

(ii) Advance Salary

This is given to an officer who is to go on annual leave and is repayable en-bloc at the end of the same month.

(iii) Spectacle Advance

This is granted to an officer for procuring spectacles as prescribed by government medical officer.

(iv) Touring Advance

This is granted to officers with regards to transportation and hotel bills when they are on duty outside the station. This advance will not be granted to officers who have not repaid previous advance. If the same is not returned, it should be deducted en-bloc from the officer's salary.

(v) Motor vehicle Advance

It is given to the senior officers for the purchase of motor vehicles.

The following are the conditions for obtaining motor vehicle advance:

- Any officer who has been given motor vehicle advance once would be given another only after 3 years of the former. However, in case the vehicle has been completely written off and certified by the insurance, the same can be granted.
- Payments have to be made directly to the dealer.
- An agreement must be made that all outstandings on the advance shall be deducted from the salary or gratuity on retirement. Where this is not sufficient, the vehicle shall be returned.

(vi) Correspondence Advance

This is granted for taking correspondence course and is interest free.

The following are the conditions to be fulfilled for granting correspondence advance:

The officer must be competent.

The course must be relevant to his job.

The course must be taken in a recognised / reputed institution.

The course must improve his productivity and effectiveness.

1.3 Imprest accounts

The petty cash is usually maintained on the basis of the imprest system. An imprest system means a system where initially the petty cashier is given a fixed amount of cash and subsequently the amount of expenses is reimbursed.

1. Functioning of imprest system of petty cash

The petty cashier has to make all petty cash payments from the cash given to him. This amount of cash given to the cashier is called the "float". At the end of a pre-determined period or on the balance reaching a critical minimum, the amount of expenses are reimbursed or topped up so as to restore the balance to the imprest amount. The 'float' is decided in such a manner that it will cover average petty cash expenses during a given period, for example, a week.

This system provides better security as it minimises the amount of cash in the hands of the cashier.

Example

On 1 July 20X7, a petty cashier was given cash of Tshs500,000, being an imprest or a float. During the month of July 20X7, he spent Tshs350,000 on various accounts. On 31 July, a cheque for Tshs350,000 drawn on the company's bank account was handed over to him. He withdrew cash from the bank and put it into the cash box. The balance in his cash box was restored to Tshs500,000.

Cash is spent against petty cash vouchers. Once the amount is reimbursed to the petty cashier, he hands over the vouchers to the main cashier, in return for the reimbursement of the related vouchers. At any point of time, the cash in hand plus the total of vouchers not yet reimbursed must be equal to the imprest or float amount. In the example stated above, the situation before reimbursement is:

	Tshs
Cash in hand of petty cashier	150,000
Total of vouchers not reimbursed	350,000
Must be equal to the float or imprest	**500,000**

2. Types of imprest accounts

This represents money paid or entrusted to an officer or warrant holder in his official capacity to enable him/her to meet incidental and other petty expenses on Government official trips, or activities.

The imprest falls into the following categories:

(a) Standing imprest

It is granted to warrant holders or cashiers and is operated on reimbursement basis, subject to retirement at the end of the year. This is a general imprest which is in use from the start of the fiscal year to the end of that year. The same is reimbursed as and when required.

(b) Safari imprest

It is granted to officers proceeding on duty outside their normal duty stations. This is granted on the basis of subsistence allowance based on the rates applicable to respective officers.

(c) Special imprest

It is granted to public officers for the purpose of specific Government activities taking place at a particular point in time. It is subject to retirement by production of relevant documents describing how the money has been spent. It is generated for special purpose when the need arises and terminated i.e. all balances are retired immediately after the purpose for which it is set is achieved.

Example

From the following information, post the entries in the petty cash book using the non-imprest method:

	Tshs'000
01January 20X7 receipt of cash	100
02 January 20X7 postage	30
09 January 20X7 transport	15
10 January 20X7 cash receipt	50
13 January 20X7 transport	32
18 January 20X7 cash receipt	75
19 January 20X7 postage	22
23 January 20X7 postage	16
28 January 20X7 cash receipt	30
30 January 20X7 transport	11

Also show how the above transactions would reflect in the petty cash account.

Answer

Petty cash book

Receipts	Date	Particulars	Total	Postage	Transport
Tshs '000			Tshs'000	Tshs'000	Tshs'000
100	01/01/20X7	Cash			
	02/01/20X7	Postage	30	30	
	09/01/20X7	Transport	15		15
50	10/01/20X7	Cash			
	13/01/20X7	Transport	32		32
75	18/01/20X7	Cash			
	19/01/20X7	Postage	22	22	
	23/01/20X7	Postage	16	16	
30	28/01/20X7	Cash			
	30/01/20X7	Transport	11		11
255			126	68	58

Petty cash account

Date		Amount	Date		Amount
		Tshs'000			Tshs'000
01/01/20X7	Cash	100	31/01/20X7	Payments	126
10/01/20X7	Cash	50			
18/01/20X7	Cash	75			
28/01/20X7	Cash	30	31/01/20X7	Balance c/d	129
		255			255
01/02/20X7	Balance b/d	129			

1.4 Special fund accounts

According to section 36(1) of The Local Government Finances Act, 1982 the local government authority may, and where the Minister so directs shall, maintain such reserve, renewal or special funds for such purposes as the Minister may approve or direct.

Any special funds of a local government authority shall be deposited with the Board

Where the Minister considers that it is necessary or expedient that any special fund or any portion of it deposited by a local government authority pursuant to subsection. (2) should be returned to the authority which deposited it, he may direct that the Board to return the fund or the part of it to the authority concerned within such time as he may specify in that direction.

The purpose of these funds is to meet the expenditure on specified government activities for which the funds were respectively earmarked.

They include:

Civil contingencies fund,
Rewards and fines fund and sinking fund in the first schedule;
South African Relief Fund;
African Staff Housing Scheme Fund
Advance Funds and
Transport Maintenance Fund in the second schedule.

1.5 Deposit accounts

A deposit is a sum of money received and taken on charge by the accounting officer and held on behalf of an individual or institution for specific purpose or until it is ultimately repaid.

1.6 Relevance, importance and applicability of non-vote accounts

Non vote payment accounts are payments made out of public funds for the purpose not approved by the National Assembly.

As discussed in Study Guide A5 excess votes (i.e. any payments in excess of the budgets) and reallocation of funds, need to be approved by the assembly

However as non-vote payments are not sanctioned by the assembly. Such payments may be temporary payments and must be settled within a short period of time as discussed in paragraphs 1.1 to 1.3 under advances, suspense accounts and imprest accounts, above.

2. Identify differences between the allocated and unallocated stores.

[Learning Outcomes g]

Public Stores

Definition

Public stores include all moveable items purchased from public fund or otherwise acquired by the government.

Public stores are classified into two main types:

(a) Allocated Stores

The money for the procurement of allocated stores is already provided for or budgeted for in the approved estimates. The cost of allocated stores is charged to the sub-heading that is responsible for the expenditure of the stores. Allocated stores may be bought directly from outside or taken from the unallocated stores stock.

The purpose of the allocated stores is:

- To make provision of quality stores.
- To make them available always when required.
- To follow the policy of adhering to minimum stock
- To create the required space.
- To incur minimum costs regarding acquisition of stores

(b) Unallocated Stores

Unallocated stores are bought or ordered for the general stock. In case of unallocated stores, the sub-heading to be chargeable cannot be determined immediately when the stores are ordered. Their cost is chargeable to the unallocated stores sub-heading in the approved estimate of expenditure. They are charged to the relevant subhead as 'allocated stores', when issued.

Difference between allocated stores and unallocated stores

To summarise the allocated stores are those moveable items purchased from public fund which are approved through a budget, whereas unallocated stores are bought from general stock and cannot be charged immediately when ordered.

Furthermore, stores can be further classified on the basis of their life span:

(i) **Consumable stores**: These stores are used on the day to day basis. As soon as they are used up, demand is made for them immediately such as stationaries, postage etc.

(ii) **Expendable stores**: These stores have a life span of 2 to 5 years and are used for the daily activities of the organisation. They include computer, calculators etc.

(iii) **Non-expendable stores**: These stores can be used for a long period of time and have a life span of 5 years and more. They need regular maintenance such as plant and machinery, motor vehicles and building etc.

Test Yourself 2

Identify the purpose of the allocated stores.

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3. Explain the stores checks and condemnation of unserviceable stores.
[Learning Outcomes h]

3.1 Storekeeper's records

1. Documentation of stores

Store accounts are contained in the stock ledger accounts which are prepared from properly authorised vouchers.

The storekeeper is not responsible for the maintenance of the stock ledgers and should be given to the stock officer.

The stock officer needs to keep separate ledgers for different items of stores. All items of stores should be serially recorded and arranged.

All stores of same category should be recorded in the single ledger.

2. Maintenance of tally card or bin card

The bin cards record the movement of material (receipt, issue and balance of the inventory) **quantity wise,** and the stores ledger maintains the record of material movement in terms of **quantity as well as the cost** of the material.

The stores department maintains bin cards and the accounts department maintains the stores ledger.

The major differences between a bin card and a stores ledger are

A bin card is a quantity record of material, while the stores ledger is a record of quantity and value of material.

A bin card is maintained by the store keeper, while a stores ledger is maintained by the accounts department.

A bin card is kept inside the stores and the stores ledger is kept outside the stores.

Preparing the bin cards and the stores ledgers in parallel helps ensure there is an internal check over inventory to prevent pilferage or misappropriation.

This card needs to be kept by the storekeeper so as to ensure that all the items in the store at any point in time tally with the items contained in the store ledgers. The tally card must be marked with the ledger folio and must be checked and updated when time arises.

3. Sample of format of a bin card

Bin card

Description ____________________
Code no ________________

Bin no ____________
E.O.Q ____________
Maximum level ________
Minimum level ________
Reorder level ________

	Receipts		Issues		Balance	Remarks
Date	GRN no.	Quantity	MR no.	Quantity	Quantity	

4. Format of stores ledger

Stores ledger account

Material ________________ Code ________________ Maximum quantity
________________ Minimum quantity
____

Date	Receipts					Issues				Balance		
	GRN no./ MRN no.	Quantity	Invoice reference	Price per unit	Amount	Store req. no.	Quantity	Price per unit	Amount	Quantity	Price per unit	Amount

5. Procurement of stores

The Accounting Officer is responsible to determine the minimum level, maximum level and re-order level of the unallocated stores. When the minimum level is reached, he sends a purchase requisition to the Purchase department.

6. Receipt of stores

The authorised officer should ensure that the stores those are received must meet required specifications in terms of quantity and quality. The storekeeper must ensure that all received stores are entered in stores ledger and charged in the chargeable expenditure sub-head.

7. Issue of stores

When a store is needed in any department, a stores requisition form, duly completed and authorised, needs to be prepared by the authorised Officer of the department and send to the stores department.

The stocks need to be identified and selected in the storage area. A stores issue voucher will be prepared in duplicate while issuing stores. The storekeeper will update the records by posting in the tally card or bin card, the quantity and date of issue.

In case of scheduled issues to production, the production control function may undertake the authorisation. However, in certain emergencies and in case of items of comparatively small value, it is convenient to hand over stores based on verbal demand by a supervisor without presentation of any valid document.

Any requests made for stores should be duly signed by any officer who is authorised to incur expenditure or any person authorized in the departmental stores. Before authorisation the officer needs to ensure availability of funds to incur the expenditure. After authorisation, the demands should be made on prescribed stores requisition forms. The storekeeper will prepare stores issue vouchers in duplicate. After issue, the storekeeper will post his tally card at the actual time of issue.

8. Transfer of Stores

A situation can arise when one store in a department runs out of stock of a particular item and needs to be transferred from another store to that store. The transfer will take place by raising stores transfer requisition (STR) by the first store making the request. There will be two copies of STR and the original sent to the issuing store. The issuing store will then issue a stores issue voucher which will be prepared in duplicate, a copy of which will be send to the transferred store. The other copy will serve as a receipt voucher.

Sometimes the stores may be transferred from one warehouse to another. In such a case a stores transfer paper is raised by the requisitioning store in duplicate. One copy of the store transfer paper is forwarded to the issuing store and the other is retained. Further a stores issue voucher is also prepared in duplicate, one copy of which will be receipted and returned and the other retained.

9. Payment of Stores

The payment voucher for all items received must be supported by Local Purchase Order (LPO), invoices and copies of Stores Receipt Voucher (SRV). The SRV number must be clearly stated on the certificate issued by the storekeeper.

10. Loss of stores

In case it is established that the stores are lost, the accounting officer may authorise the write off of such loss. It is determined depending upon the factors surrounding the loss. The loss can be written off in case of following conditions:

The value of the items lost is not more than prescribed limits

There is no weakness in the internal control system.
There is no evidence of fraud or theft.
The los is not due to the negligence of the store keeper.

The procedure to be followed for the report of loss is as follows:

In the case of loss of stores found by the storekeeper, an official report must be made to the Head of Department who will forward the report to the Accounting Officer. The Accounting Officer looks into the materiality of the loss and if satisfied, completes the form and forwards it to the Accounting General or the Auditor General of the Federation.

The following actions are taken by these Officers in the event of loss of stores:

(a) Storekeeper

In case of fraud or theft, the storekeeper reports to the police. He completes a form and submits to the Head of Department.

(b) Head of department

He reports the loss of the Accounting Officer. In case he feels a Board of Enquiry needs to be constituted to investigate the loss, he recommends the same to the Accounting Officer.

(c) Accounting officer

In case of substantial loss, he is to ensure an independent investigation and also order for the Board of Enquiry.

(d) Accountant general

He is to ascertain that the Board of Enquiry is comprised of experienced, competent officers of proven integrity. He is to further see an Accounting Officer or an internal auditor who is well versed in public sector accounting is a member of the Board of Enquiry.

All the above officers need to see that the internal controls are proper and the loss is recovered by penalising the culprits.

3.2 Condemnation of unserviceable stock

When the life of stores has ended or these are rendered unserviceable for any reason or have become redundant through obsolescence, they must be kept until sufficient facts have gathered to merit the condemnation of some stock items in order to inspect them.

The Board needs to provide a written approval post which a store issue voucher will be required to remove such unserviceable store. This issue voucher needs to be duly authenticated.

Test Yourself 3

Identify three major differences between a bin card and a stores ledger

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4. Identify the procedures handing and taking over of stores.

[Learning Outcome i]

Procedure for handing and taking over stores

This situation may arise where an officer is re-deployed to another department or another station entirely. It could also be due to an officer taking annual or casual leave. The following procedure is to be followed in handover of stores:

(a) The officer taking over the stores must ensure that the record in the store ledger or bin card agrees with the. physical stock tally.

(b) If there are no differences between the physical stores and the store ledger records, the incoming and outgoing officer will sign a certificate of handover of stores to the incoming officer.

(c) In the absence of the outgoing Officer, a Stock Verifier or Board of Survey needs to check and do the handing over to the incoming Officer.

(d) The outgoing officer will be held responsible in case there are discrepancies resulting in loss of stores...

Test Yourself 4

Identify the circumstances under which **handing and taking over stores arises.**

Answers to Test Yourself

Answer to TY 1

The correct option is **A.**

Cash has a debit balance. When the credit side is undercast, it makes the closing balance of cash more than the actual. Therefore we need to credit the cash in the rectification entry.

Answer to TY 2

The purpose of allocated stores is as follows:

To make provision of quality stores.
To make them available always when required.
To follow the policy of adhering to minimum stock
To create the required space.
To incur minimum costs regarding acquisition of stores

Answer to TY 3

The major differences between a bin card and a stores ledger are

A bin card is a quantity record of material, while the stores ledger is a record of quantity and value of material.

A bin card is maintained by the store keeper, while a stores ledger is maintained by the accounts department.

A bin card is kept inside the stores and the stores ledger is kept outside the stores.

Preparing the bin cards and the stores ledgers in parallel helps ensure there is an internal check over inventory to prevent pilferage or misappropriation.

Answer to TY 4

The circumstances under which **handing and taking over stores arises,** may arise where an officer is re-deployed to another department or another station entirely. It could also be due to an officer taking annual or casual leave.

Self Examination Questions

Question 1

Explain the actions to be taken by the storekeeper, head of the department, Accounting Officer and Accountant General on discovery of the loss of stores?

Question 2

A non-expendable store is a:

A Stationary item
B Foodstuff item
C Shovel
D Motor vehicle
E Brush

Question 3

Stores purchased for general stock rather than for a particular service, for which the final vote of charge cannot be started at the time of purchase is called:

A Allocated store
B Non-expendable store
C Unallocated store
D Expendable store
E General store

Question 4

Briefly explain the stores handing over procedure.

Question 5

A ………………voucher is prepared while issuing stores.

Question 6

What is advance given to an officer who is to undertake correspondence courses called?

A Correspondence Advance
B Salary Advance
C Motor Vehicle Advance
D Touring Advance

Question 7

What are the different types of imprest account?

Answers to Self Examination Questions

Answer to SEQ 1

The actions to be taken by the storekeeper, head of the department, Accounting Officer and Accountant General on discovery of the loss of stores is as follows:

(a) Storekeeper

In case of fraud or theft, the storekeeper reports to the police. He completes a form and submits to the Head of Department.

(b) Head of Department

He reports the loss of the Accounting Officer. In case he feels a Board of Enquiry needs to be constituted to investigate the loss, he recommends the same to the Accounting Officer.

(c) Accounting Officer

In case of substantial loss, he is to ensure an independent investigation and also order for the Board of Enquiry.

(d) Accountant General

He is to ascertain that the Board of Enquiry is comprised of experienced, competent officers of proven integrity. He is to further see an Accounting Officer or an internal auditor who is well versed in public sector accounting is a member of the Board of Enquiry.

All the above officers need to confirm that the internal controls are proper and the loss is recovered by penalising the culprits.

Answer to SEQ 2

The correct option is **D.**

Motor vehicle is a non-expendable store.

Answer to SEQ 3

The correct option is **C.**

Stores purchased for general stock rather than for a particular service for which the final vote of charge cannot be started at the time of purchase is called unallocated store.

Answer to SEQ 4

The following procedure is to be observed in handover of stores:

(a) The officer taking over the stores must ensure that items in the store tally with the record in the store ledger or bin card.

(b) Where the out-going officer is not available, an appointment of a stock verifier is effected to hand-over the store to the in-coming one.

(c) Where there are no differences between the physical stores and the store ledger records, the incoming and outgoing officer will sign a certificate of handover on stores.

(d) Where there are differences resulting in loss of stores, the outgoing officer will be held responsible.

Answer to SEQ 5

A stores issue voucher is prepared while issuing stores.

Answer to SEQ 6

The correct option is **A**.

The advance given to an officer for undertaking correspondence courses is called correspondence advance.

Answer to SEQ 7

The different types of imprest accounts are:

(a) Standing imprest
(b) Safari imprest
(c) Special imprest

SECTION A

ACCOUNTING FOR PUBLIC SECTOR

A11

STUDY GUIDE A11: LOSSES OF GOVERNMENT MONEY AND PROPERTY

Get Through Intro

The government collects money in the form of taxes etc. and expends it to provide various services for the benefit of the people. So basically, on a financial level, it works like any other organisation in discharge of its duties. Therefore, like any other organisation, the government also suffers losses. These losses may be in the form of cash, stores, or through fraud, misappropriation, incorrect decisions leading to fruitless payments etc. It is very important to recognise and account for these losses, so that the general public can understand where their money is going.

In this Study Guide, we will learn all about government losses - the various types of government losses and how these losses are reported and accounted for.

Learning Outcomes

a) Identify the relevant provisions of the law relating to losses.
b) Identify and explain the types of losses in relation to Government money and property.
c) Explain large and unusual losses.
d) Identify the procedures used to report and account for losses.
e) Record accounting entries for losses.

1. Identify the relevant provisions of the law relating to losses.

[Learning Outcome a]

Loss of government money is a serious matter. Therefore, there are certain provisions in law to deal with such loss, relating to identification of the type of loss, ascertaining who is responsible for the loss, levying appropriate penalties on such a person, recording the loss in the books of accounts etc.

The Public Finance Act governs receipts and expenditure of public money. The various provisions in the Act regarding government losses are discussed below.

1.1 Relevant provisions of law relating to losses

According to Section 10 of the Public Finance Act, where there occurs a loss of or deficiency in public money or other money that has been advanced to or was under the control of a public officer or where a loss or destruction of or damage to public property or other property occurs while the property was in the care of a public officer and the Minister is satisfied after due enquiry that the negligence or misconduct of the officer caused or contributed to such loss or deficiency, then:

(a) the amount of such loss or deficiency; or

(b) the value of the property lost or destroyed; or

(c) the cost of replacing or repairing the damage to that property, as the case may be, shall be a debt due to the Government and may be recovered from the officer in accordance with the Public Officers (Recovery of Debts) Act, 1970.

Also, where the negligence or misconduct of a public officer was not the sole cause of any loss, deficiency damage or destruction resulting in an action under subsection (3), the amount recoverable from the officer may be restricted to so much only of the cost of, or the cost of replacing or repairing, the loss, deficiency, damage or destruction as the Minister considers, after due enquiry, to be just and equitable having regard to the contribution made by the officer to that loss, deficiency damage or destruction.

Example

Mr Mtajiju was a public officer working for the central government, in charge of postal services in the Tutafika District. He had received numerous complaints regarding the chief security officer, Mr Nitalipa, that the latter was careless and untrustworthy. However, Mr Mtajiju did not initiate any enquiry or action into the matter.

After the office hours were over one day, all the employees went home and the security personnel forgot to lock the premises of a post office securely. Moreover, the night watchman was sleeping on duty. There was a break-in and all postal stores such as stamps, stationery etc. worth Tshs100,00,000 as well as cash of Tshs540,00,000 were stolen by the thieves. Moreover, the thieves vandalised the office and damaged furniture and walls, which would cost Tshs1,100,000 to repair.

There was an enquiry and it was held that while the government property was in Mr Mtajiju's care, he had acted negligently and had caused the loss of public property. The cost of replacing the property / repairing the damage shall be recovered from Mr Mtajiju in accordance with the Public Officers (Recovery of Debts) Act, 1970.

According to Section 32 of the Public Finance Act, in the performance of his functions to audit and examine accounts, the Controller and Auditor-General may summon and examine on oath any person as he may determine in connection with the receipt or expenditure of public moneys or the receipt or issue of any public property affected by the provisions of this Act and in connection with any matter necessary for the proper performance of his functions.

Any expenditure made but disallowed by the Controller and Auditor General as per section 32 of the Public Finance Act of 2004 will be treated as a loss. Such loss will be investigated by the Standing Board of Enquiry nominated by the Pay Master General (PMG).

Also, if at any time it appears to the Controller and Auditor-General that:

(a) any payment has been made without due authority according to law;

(b) any irregularity has occurred in the receipt, custody, control, issue, transfer or delivery of any public property;

(c) any deficiency or loss occasioned by negligence, misconduct, fraud,

(d) Any failure to observe a policy of the highest thrift has or corruption has occurred; or

(e) any sum which ought to have been, has not been, brought to account; he shall:

(i) in the case of expenditure of or by the accounting officer, the
(ii) Judiciary or National Assembly, disallow the expenditure as a
(iii) charge on public funds; or
(iv) in any other case, call in question the sum concerned.

According to section 43 of the Public Finance Act, the National Assembly may, by resolution, authorise the Minister to the extent specified in the resolution to abandon and remit any claims by or on behalf of the Government or any service thereof and to write off losses of moneys or stores belonging to the Government or provided for the public service.

Test Yourself 1

Which of the following persons has the authority to disallow certain expenditure as a charge on public funds when the payment for the expenditure has been made without due authority according to the law?

A Pay Master General
B Controller and Auditor-General
C The officer in charge of the department that made the payment
D None of the above

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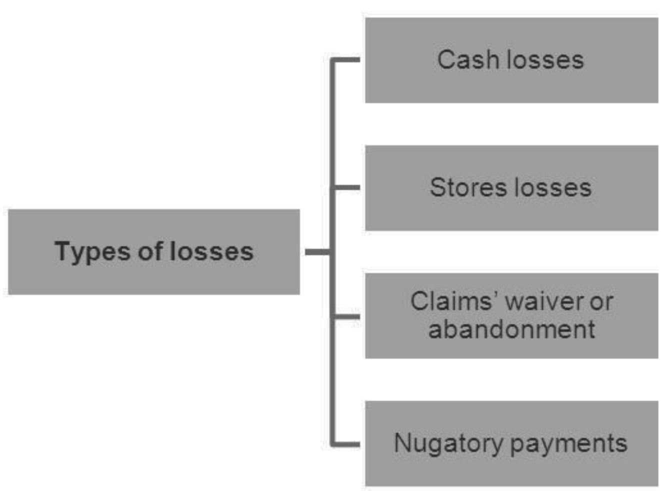
2. Identify and explain the types of losses in relation to Government money and property. Explain large and unusual losses.

[Learning Outcomes b and c]

2.1 Types of losses in relation to government money and property

The Government incurs various types of losses encountered in central and local Government accounting practices. For the purpose of ensuring that the National Assembly or any other person receives clear notification of all instances of losses, the losses are sub-divided into the following categories.

Diagram 1: Types of losses of government money/property



Let us discuss each of these categories in detail.

(a) Cash losses

Cash losses refer to losses which lead to depletion of the cash reserves of the government. These include losses of cash through:

fraud: fraud refers to embezzlement of money, i.e. deliberate misappropriation of government money by its officers. Unauthorized payments to government officials or outsiders also fall under this category.

theft: if appropriate safety measures are not adopted in relation to safeguarding of the cash stores, government money may be stolen, which will result in cash losses. There also may be instances of armed robbery, where a large amount of cash is stolen at a single time.

negligence: besides theft, if officers are careless when handling cash, cash can be lost.

natural calamities and unavoidable circumstances: incidents such as fire or earthquakes, floods etc. lead to cash losses.

overpayment: due to mistakes in calculation or fraud, certain emoluments such as pensions, bonuses etc. can be overpaid.

Example

Nakupenda lives in the Tutafika District and works for the local government. His duties include assisting the chief treasury officer in handling the cash expenses of the government. Nakupenda colluded with a supplier and, on a number of occasions, paid bills that were overcharged. This led to misappropriation of cash from the government treasury, resulting into cash losses for the government.

(b) Stores losses

The government holds certain goods in stores. Such government stores can be defined as all moveable items acquired by the government using public moneys or its own funds. These stores are only for official use by the government. They may be used for a specific purpose, i.e. allocated to a certain function or department of the government from the start, or be general stores held in stock for wide-ranging uses, which may be later allocated to some function or department.

There are permanent stores such as motor vehicles, furniture, plant and machinery etc., and non-permanent stores or expendable stores that are consumed and then cease to exist, such as stationery, cleaning materials etc. The purchases or transfers of these stores have to be authorised by the officer in charge of the stores. This officer is also responsible for any loss of stores in his control.

Losses of stores include:

Loss by fraud: deliberate misappropriation of government stores comes under this category. The stores may be embezzled and used for personal purposes by the staff or persons who have access to the stores, and accounting records can be falsified to cover up the misappropriation.

Loss by theft: government stores are liable to theft if appropriate safety measures are not set up and followed diligently.

Loss by natural causes: acts of God such as storms, fire, earthquakes, etc. can lead to losses of stores. In the case of certain stores such as spirit, petrol, acetone etc., the liquids evaporate when held in stock for a while, thus leading to decrease in quantity, finally translating to losses. Also, stores exposed to the weather for long durations go through natural wear and tear.

Loss by negligence: accidents may be caused due to unavoidable circumstances, or even due to negligence. Careless handling of stores also leads to damage and losses.

Loss by sabotage: stores may be deliberately destroyed by antisocial elements (i.e. people who intentionally destroy public property).

Example

Continuing the above example of Mr Mtajiju

Loss of stores of postal stamps, stationery etc. was **loss by negligence** of the security personnel and ultimately, the officer in charge, whereas loss of furniture was **loss by sabotage**.

(c) Losses through claims' waiver or abandonment

Sometimes, amounts of money owed to the government may become non recoverable due to certain reasons such as death or disability of the liable party, failure to make a claim as per contract, failure to receive an advance granted or collect revenue for service rendered. Sometimes, the government voluntarily decides to abandon its claim and not follow up to a liable third party.

Example

Mrs Sitojali was a single woman aged 98 years. She had no family, no significant assets, and no next of kin. She owed Tshs130,00,000 to the government towards arrears in utility bills. On 13 November, Mrs Sitojali died from old age. The amount of money that she owed to the government became non recoverable.

(d) Losses through nugatory payments

Nugatory payments are fruitless or unproductive payments, i.e. payments which are a waste of the government's resources. We have seen in Study Guide A9 that nugatory expenditures are expenditures incurred by the government for which goods or services have not been received. They are expenditures which include:

- over payments for materials and services made twice
- overpayments which are not recovered
- payments in excess of approved rates (without proper authority)
- irrecoverable overpayments

Example

The local government has rented a guest house for Tshs12,00,000 in Moshi town, which has a magnificent view of Mount Kilimanjaro. The guest house was supposed to be used to put up foreign dignitaries visiting the country and wishing to visit Mount Kilimanjaro. However, for the last five years, no foreign dignitary has come to stay in the guest house.

Hence the expense of Tshs12,00,000 is a nugatory expense, since it is an unproductive payment.

Test Yourself 2

Determine the type of loss of government money in the following scenarios:

(i) Embezzlement of cash from the government treasury.
(ii) Spilling of gasoline stored in a government warehouse.
(iii) Excess payment to a government supplier who provided sub-standard goods.
(iv) Unrecovered sum of money from a government officer who died during active service.

2.2 Large and unusual losses

Unusual losses are non-recurring, one-time losses. Such losses are a one-off occurrence, and the same type of loss may never be incurred again. These losses may be small and negligible, or large in amount and impact, which need to be investigated thoroughly, and steps taken to ensure the same type of loss is not incurred again.

These losses represent any expenditure made but disallowed by the Controller and Auditor General as per section 32 of the Public Finance Act of 2004. Such losses will be investigated by the Standing Board of Enquiry nominated by Pay Master General (PMG).

Example

On Independence day, official celebrations were planned in Dodoma and at the national stadium in Dar es Salaam. Tshs910,00,000 were authorised to be used for decorations and security. However, the actual amount expended for decorations alone turned out to be Tshs8,200,00,000.

This excess expenditure is large and a one-off case, i.e. non-recurring, and comes under 'large and unusual losses'. It was not authorised, and subsequently disallowed by the Controller and Auditor General. It will be investigated by the Standing Board of Enquiry nominated by the Pay Master General.

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3. Identify the procedures used to report and account for losses. Record accounting entries for losses.

[Learning Outcomes d & e]

In the earlier section, we saw how to identify the types of losses of government money. In this section we will learn how to report and account for these losses. It is very important to account for all government losses, whether big or small, so that the government knows where it is losing money. This also helps it to determine ways to minimise these losses, or, in some cases, to avoid the losses entirely.

Also, for transparency and to present a true and fair picture of the financial affairs of the government, these losses need to be ascertained and presented in the final accounts. For this purpose a 'Statement of losses of public money and stores', which contains funds and store losses that are written off, is drawn up and presented as a part of the National Consolidated Financial Statements. This contributes to a transparent and accountable government, because these financial statements are then audited by the Controller and Auditor General.

Example

Extract form the "Annual general report of the controller and auditor general" on the Audit of the Financial Statements of the Central Government for the Year ended 30th June, 2008:

Statement of losses of public money and stores

The statement of loss indicates that losses incurred by the Government has increased from Shs.2,370,688,000 during the year 2006/2007 to Shs.3,594,209,000 during year 2007/2008 being an increase of Shs.1,223,521,000 or 52%.

This indicates that internal controls over government assets have continued to deteriorate in such an alarming pace as more than 50% of public assets have been subjected to losses by more than 50%.This situation should not be acceptable, therefore all efforts should be exerted to substantially reduce or reverse this situation.

The government should take appropriate steps to strengthen its internal controls to reduce the reported big rise of losses of government money and stores.

3.1 Procedures used to report and account for losses

There are certain rules and procedures to be followed on the discovery of Government losses. Let us understand the procedures with the help of the example of Mr Mtajiju above (in the first section).

(i) Step 1, oral report: an oral report must be made to a senior officer by a person who has discovered the loss.

Example

Continuing the example of Mr Mtajiju above

The first person to discover the incident at the post office was Mr. Julius, a junior clerk, who was the first to arrive for work in the morning. He was taken aback by the condition of the post office. Nevertheless, he immediately called his supervisor, who then called Mr Mtajiju to make an oral report of the incident.

(ii) Step 2, written report: a written report to the accounting officer shall be made to cover:

the nature of loss
the amount of loss
the circumstance of the loss

Example

Continuing the example of Mr Mtajiju above

Mr Mtajiju came to the site where the incident took place. As soon as possible, he prepared a report in writing containing:

1. the nature of the loss, i.e. stores loss and cash loss resulting from theft and sabotage.

2. the total amount of the loss, i.e. Tshs651,00,000 (Stores loss Tshs100,00,000 + Tshs1,100,000 and cash loss Tshs540,00,000)

3. the circumstance of the loss, i.e. what happened before the loss occurred (the premises were not locked securely and the night watchman was sleeping on duty)

Mr Mtajiju duly submitted this report to the accounting officer.

(iii) Step 3, report to Accountant General, Controller and Auditor General and Pay Master General: the accounting officer shall prepare a preliminary report in writing and submit to the Accountant General and the Controller and Auditor General. Moreover, if the amount is significant, the accounting officer is also required to submit a report to the Pay Master General.

Example

Continuing the example of Mr Mtajiju above

The accounting officer studied the report submitted by Mr Mtajiju and added his own personal comments. Then the accounting officer submitted this preliminary report to the Accountant General and the Controller and Auditor General. However, as the amount was not significant, he did not submit a report to the Pay Master General.

(iv) **Step 4, investigation of loss**: the accounting officer will arrange for investigation of the loss and if misappropriation, theft or fraud seems to have taken place, then the accounting officer shall inform the Police.

Example

Continuing the example of Mr Mtajiju above

The accounting officer arranged for investigation of the matter. Theft and vandalism were involved, so the accounting officer informed the police and requested them to investigate the matter further.

(v) **Step 5, detailed report**: after the investigation, the accounting officer will submit a detailed report to the Accountant General. The same report will also be sent to the Permanent Secretary-Treasury and the Controller and Auditor General. This report should include:

The nature of loss or shortage
The amount of loss
The place and date of loss
The date and time of discovery
The exactly circumstance of loss
The name and designation of the person responsible
Whether that officer has made good the loss
Whether that officer should be interdicted
if the police were involved

Example

Continuing the example of Mr Mtajiju above

The investigation was complete, and the following information was included in the detailed report:

The nature of loss or shortage: i.e. stores loss and cash loss resulting from theft and sabotage

The amount of loss: i.e. Tshs651,00,000 (Stores loss Tshs100,00,000 + Tshs11,00,000 and cash loss Tshs540,00,000)

The place and date of loss: i.e. Tutafika District; 10 December 2013

The date and time of discovery: 11 December, 10:30 PM

The exact circumstance of loss: i.e. what happened before the loss occurred (the premises were not locked securely and the night watchman was sleeping on duty)

The name and designation of the person responsible: Mr Nitalipa, chief security officer was initially held responsible, but on further investigation, it was found that Mr Mtajiju had received reports of Mr Nitalipa being incompetent, but did not take the matter seriously, thus acting carelessly towards the government money and property entrusted in his hands)

Whether that officer has made good the loss: Yes, in accordance with the Public Officers (Recovery of Debts) Act, 1970

Whether that officer should be interdicted: No

If the police were involved: Yes

Test Yourself 3

A written report of the loss should be **first** submitted to:

A The Accountant General
B The Pay master General
C The accounting officer
D Controller and Auditor General

3.2 Recording of accounting entries for losses

Once proper reporting is done, the loss is then recorded in the books of accounts. The following accounting entries are recorded to accommodate the reported losses:

1. On receipt of the loss report the Accountant General will open an advance account in the name of the Accounting Officer. This advance account will be debited with the amount of loss. The amount will be credited to the officer responsible for the loss, who is expected to make good the loss.

Example

Continuing the example of Mr Mtajiju above

The accounting entry for the loss will be as follows:

Dr		Advance account (accounting officer)	Tshs651,00,000	
	Cr	To Mr Nitalipa		Tshs651,00,000

(Being loss to government money and property assigned to the responsible officer)

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2. If in case responsibility for the loss is subsequently transferred to another officer, then that officer's account will be credited with the loss and the innocent officer's account will be debited with the amount of loss.

Example

Continuing the example of Mr Mtajiju above

Subsequently, when the responsibility for the loss was transferred to another officer, the accounting entry will be:

Dr		Mr Nitalipa	Tshs651,00,000	
	Cr	To Mr Mtajiju		Tshs651,00,000

(Being responsibility of loss to government money and property transferred to another officer)

---

3. The advance account will remain open until the amount is cleared by the officer responsible for the loss. Once the officer clears the dues against him, cash/bank account will be debited and the officer's account will be credited.

Example

Continuing the example of Mr Mtajiju above

The accounting entry when Mr Mtajiju pays for the loss will be as follows:

Dr		Bank account	Tshs651,00,000	
	Cr	Advance account (accounting officer)		Tshs651,00,000

(Being loss of government money and property recovered and advance account closed)

As discussed earlier, according to Section 43 of the Public Finance Act, the National Assembly may, by resolution, authorise the Minister to the extent specified in the resolution to abandon and remit any claims by or on behalf of the Government or any service thereof and to write off losses of moneys or stores belonging to the Government or provided for the public service.

In such cases, a journal voucher duly authorised by the exercise of power to write off will be affected. Profit and Loss account will be debited with the amount of the loss and the asset destroyed will be credited.

Test Yourself 4

The accountant general receives a loss report for Tshs100,00,000. He will open an advance account and record which of the following entries?

A Debit advance account and credit accounting officer
B Debit accounting officer and credit advance account
C Debit cash account and credit accounting officer
D Debit accounting officer and credit cash account

Answers to Test Yourself

Answer to TY 1

The correct option is **B.**

The Controller and Auditor-General has the authority to disallow certain expenditure as a charge on public funds when the payment for the expenditure has been made without due authority according to the law.

Answer to TY 2

(i) Embezzlement of cash from the government treasury is a cash loss because physical cash reserves were depleted.

(ii) Spilling of gasoline stored in a government warehouse is a stores loss because government stores were wasted.

(iii) Excess payment to a government supplier who provided sub-standard goods is a nugatory payment because the government did not receive the intended benefit from the expenditure.

(iv) Unrecovered sum of money from a government officer who died during active service is loss through claims' waiver, because the government would waive the claim under the circumstances.

Answer to TY 3

The correct option is **C**.

A report of the loss should be first submitted to the accounting officer.

Answer to TY 4

The correct option is **A**.

Advance account is debited and accounting officer account is credited.

Self Examination Questions

Question 1

The Accounting Officer in the Local Government has prepared a workshop to discuss changes in the Public Finance Act and its Regulations, Revised 2004. During the discussion, it was revealed that most of the participants did not understand the categories of losses elaborated in the Regulations.

Required:

Mention four classifications of losses encountered in Central and Local Government accounting practices.

May 2012

Question 2
Briefly explain the procedures used to report and account for losses.

Answers to Self Examination Questions

Answer to SEQ 1

Classifications of losses encountered in central and local Government accounting practices. For the purpose of ensuring that the National Assembly or any other person receives clear notification of all instances of loss, the losses are sub-divided into:

(i) Cash losses
(ii) Stores losses
(iii) Loss through claim waivers or abandonment
(iv) Losses through fruitless or Nugatory expenditures

Answer to SEQ 2

Procedures used to report and account for losses

There are certain rules and procedures to be followed on the discovery of Government losses. Let us understand the procedures with the help of the example of Mr Mtajiju above (in the first section).

(i) Step 1: Oral report

An oral report must be made to a senior officer by a person who has discovered the loss.

(ii) Step 2: Written report

A written report to the accounting officer shall be made to cover:

the nature of loss
the amount of loss
the circumstance of the loss

(iii) Step 3: Report to Accountant General, Controller and Auditor General and Pay Master General

The accounting officer shall prepare a preliminary report in writing and submit to the Accountant General and the Controller and Auditor General. Moreover, if the amount is significant, the accounting officer is also required to submit a report to the Pay Master General.

(iv) Step 4: Investigation of loss
The accounting officer will arrange for investigation of the loss and if misappropriation, theft or fraud seems to have taken place, then the accounting officer shall inform the Police.

(v) Step 5: Detailed report
After the investigation, the accounting officer will submit a detailed report to the Accountant General. The same report will also be sent to the Permanent Secretary-Treasury and the Controller and Auditor General. This report should include:

The nature of loss or shortage
The amount of loss
The place and date of loss
The date and time of discovery
The exactly circumstance of loss
The name and designation of the person responsible
Whether that officer has made good the loss
Whether that officer should be interdicted
if the police were involved

SECTION A

ACCOUNTING FOR PUBLIC SECTOR

A12

STUDY GUIDE A12: ANNUAL FINANCIAL STATEMENTS AND ACCOUNTS – UNDER IPSAS AND PUBLIC FINANCE ACT

Get Through Intro

Cooking food well is a job half done. The food will not serve its true purpose unless it is well laid out, to make it appear appetising. Similarly, performing day to day accounting well is a job half done. It will not serve its purpose, unless the results are presented in a proper format, with the required content.

The end result of the accounting process is financial reporting. Unless the report contains true and fair information, and its structure and presentation is understandable and consistent, its utility to the users will be substantially reduced.

Accounting is said to be the language of business. The person receiving the information should understand the statements in the manner the person giving the information intended it to. Similarly, the presenter of the information should give information that is sufficient for the user to make informed decisions.

Unless there are some standards, there may be intentional or unintentional errors in the financial statements. Misleading information will lead to wrong decisions. For example investors may wrongly decide to buy or sell their investments; management may take wrong decisions involving the future of the business.

In future, you will be responsible for ensuring compliance with IPSAS / IFRSs, therefore it is essential for you to master the principles.

Learning Outcomes

a) Identify the relevant provisions of the law and applicable accounting standards.
b) Explain the cut-off procedures and the year-end accounting activities.
c) Identify the final accounts prepared by Accounting Officers.
d) Identify the final accounts and reports prepared by Accountant General.
e) Identify the final accounts prepared by the Local Government Authorities.
f) Explain the preparation & presentation of financial statements – IPSASs 1
   i. General purpose financial statement
   ii. Identify a complete set of financial statements
   iii. State the components of each set of financial statement.
g) Apply accounting principles, techniques and standards in the preparation of the key financial statements (including any necessary consolidation) for public sector organisations.

1. Identify the relevant provisions of the law and applicable accounting standards. [Learning Outcome a]

1.1 Definitions

Definition

Financial year means in relation to:

(a) the Government, other than local government authority, a period of twelve months ending on 30th June of each year;

(b) a local government authority, - Provisions are covered under the local Government Finances Act, 1982. For the purposes of this Act the financial year of each local government authority shall be twelve months ending, on and including the thirty-first day of December of each calendar year,

(c) a public authority or other body, the period specified by or under the relevant law or instrument relating to that authority or body or as determined by the competent authority of that authority or body;

Definition

Generally Accepted Accounting Practice means accounting practices and procedures recognised by accounting profession authorities as appropriate for reporting financial information relating to government, a ministry or department, a Fund, an Agency or other reporting unit being practices and procedures that are consistent with this Act and any relevant Appropriation, Act;

1.2 Provisions of law and accounting standards

All accounts submitted by the Accounting Officers, Accountant General and the Local Government Authorities, under the Public Finance Act 2001 (revised 2004) shall

(a) be prepared in accordance with generally accepted accounting practice and in accordance with any instructions approved by the Permanent Secretary and issued by the Accountant-General and

(b) state the basis of accounting used in their preparation and identify any significant departures there from and the reason for that departure.

In July 2004, National Board of Accountants and Auditors (NBAA) joined the International Professional Organisation and agreed to adhere with the requirements of producing financial statements which reflect true and fair view of all material aspects.

In that regard, the Government agreed to prepare its financial statements which comply with these standards namely:

“International Financial Reporting Standards (IFRS)” – For Government Business Enterprises and Profit making Organisations

“International Public Sector Accounting Standards (IPSAs)” – for Public Sectors e.g. Ministries, Departments, Agencies, Local Government Authorities and Regional Secretariats

These standards are issued by “International Federation of Accountants (IFAC)” of which Tanzania is a member via NBAA

In order to comply with these standards, the Central Government in 2007 - 2008 started preparing and presenting its financial statements on IPSAS Cash Basis. Since IPSAS Cash Basis was a stepping stone towards adoption of Accruals Basis IPSAS, therefore the Central Government is in the process of migrating to IPSAS Accruals Basis.

In order to understand the current status of adoption of IPSAS in Tanzania, refer to Study Guide A16, Learning Outcome 1.

Test Yourself 1

Financial year in relation to local government authority means:

A A period of twelve months ending on 31 March of each year
B A period of twelve months ending on 30 June of each year
C A period of twelve months ending on 30 September of each year
D A period of twelve months ending on 31 December of each year

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2. Identify the final accounts prepared by Accounting Officers.

[Learning Outcome c]

2.1 Final accounts and reports prepared by the Accounting Officers

In accordance with Section 25(2) of the Public Finance Act, each accounting officer shall prepare and transmit to the Controller and Auditor General in respect of the past financial year and in respect, of the votes, revenues and moneys for which he is responsible:

(a) an **appropriation account** signed by the accounting officer showing the services for which the moneys expended were voted, the sums actually expended on each service, and the state of each vote compared with the amount appropriated for that vote by the National Assembly;

(b) a statement signed by the accounting officer and in such form as the Accountant General may direct containing the **amount of commitments outstanding for the supply and goods** and services at the end of the financial year and such other information as the Minister may require;

(c) a **statement of revenues** received signed by the accounting officer and in such form as the Accounting-General may direct showing the amount contained in the estimates of revenue for each source of revenue and the amount actually collected, and containing an explanation, for any variation, between the revenues actually collected and the amount estimated;

(d) a **statement of arrears of revenue** signed by the accounting officer showing the amount outstanding at the end of the financial year for each source of revenue and containing such information and in such form as the Accountant-General may direct, a nil return should be submitted if appropriate;

(e) a **statement of assets** signed by the accounting officer containing details and values of all unallocated stores under his control at the end of the financial year together with the details and values of such other classes of assets under the control of the accounting officer as the Accountant-General may from time to time determine.

(f) a **statement of performance** in providing each class of outputs provided during the year signed by the accounting officer, being a statement that-

compares that performance with the forecast of the performance contained in the Estimates laid before the National Assembly

gives particulars of the extent to which the performance criteria specified in that Estimates in relation to the Provision of those outputs were satisfied.

2.2 Cut-off for preparation of accounts by the Accounting Officers

The Accounting Officers shall submit the above accounts within a period of four months after the end of each financial year.

Test Yourself 2

In accordance with the Public Finance Act, the accounting officer shall prepare and transmit an Appropriation Account to the:

A Controller and Auditor General
B National Assembly
C Annual Accounts Minister
D Public Sector Accounting Board

3. Identify the final accounts and reports prepared by Accountant General.
[Learning Outcome d]

3.1 Final accounts and reports prepared by the Accountant General

In accordance with Section 25(1) of the Public Finance Act, the Accountant General shall prepare and transmit to the Annual Accounts Minister and to the Controller and Auditor-General:

(a) a **balance sheet** showing the assets and liabilities of the consolidated fund;

(b) a **statement of the source and application of funds** for the consolidated fund showing the revenues, expenditures and financing of the Fund for the year;

(c) a **summary statement of revenue and expenditure**, being a summary of all the statements signed by accounting officers

(d) a **statement of the amounts outstanding** at the end of the year in respect of the Public Debt;

(e) a **statement of the amounts guaranteed by the government** at the end of the financial year m respect of bank overdrafts, loans, public loan issues and other contingent liabilities;

(f) a **statement of the amount outstanding** at the end of the year in respect of loans issued by the Government

(g) a **summary statement of arrears of revenue** for each revenue head being a summary of the Statements of Arrears of Revenue signed by accounting officers

(h) a **summary statement of commitments outstanding** for the supply of goods and services for each Vote at the end of the financial year being a summary of the amount included for such commitments in the statement signed by such accounting officers

(i) a **summary statement of stores and other assets** for each Vote being a summary of the Statement of assets signed by accounting officers

(j) such other statements and m such form as the National Assembly may from time to time require.

3.2 Cut-off for preparation of accounts by the Accountant General

The Accountant General shall submit the above accounts within a period of six months after the end of each financial year. If this will take longer than six months this needs to be approved by a resolution of the National Assembly.

Test Yourself 3

In accordance with the Public Finance Act, the Accountant General shall prepare and transmit a balance sheet showing the assets and liabilities of the consolidated fund to the:

A Controller and Auditor General
B National Assembly
C Annual Accounts Minister
D Both Controller and Auditor General and Annual Accounts Minister

4. Identify the final accounts prepared by the Local Government Authorities.
[Learning Outcome e]

4.1 Final accounts and reports prepared by local government bodies

Subject to the provisions of Local Government Finance Act 1982 every local government authority shall cause to be provided, kept and maintained books of accounts and records with respect to:

(a) the receipt and expenditure of moneys by, and other financial transactions of, the authority;

(b) the assets and liabilities of the authority, and shall cause to be made out for every financial year a balance sheet showing details of the income and expenditure of the authority and all its assets and liabilities.

All books of accounts and records of all local government authorities shall, for the purpose of enabling comparative statements of revenue, expenditure and costs in different local government authorities to be prepared and to secure general uniformity in their accounts, be kept and maintained in such form and manner as may be prescribed in financial memoranda. The financial memoranda are written instructions issued by the Minister, for better control and management of the financial business of local government authorities. The local authorities are required to abide by such orders.

4.2 Publishing final accounts

Under the provisions of Local Government Finance Act 1982, every local government authority shall at its own offices and in such other manner as may be directed by the Regional Commissioner publish within its area:

(a) the annual balance sheet and statement of abstract; and

(b) any report on the accounts made and signed by the auditor, within six months after the close of the financial year to which the accounts relate or within six months of the receipt of the report of the auditor, as the case may be

Case Study

The following is an extract from the Annual General Report of the Controller and Auditor General on the Audit of Local Government Authorities (LGAs) for the financial year ended 30 June, 2013:

The submitted financial statements of the LGAs were prepared in compliance with IPSASs-accrual basis of accounting and Part (iv) of the LGFA No. 9 of 1982 (revised 2000), and in accordance with the provisions of Order 31 (4) of LGFM, 2009 as the applicable reporting framework for LGAs. A complete set of financial statements prepared according to IPSASs–accrual basis of accounting, which is supposed to be submitted by all LGAs for audit, includes the following:

a) A statement of financial position
b) A statement of financial performance
c) A statement of changes in net assets/equity
d) Cash flow statement
e) Statement of comparison of budget Vs actual amount by nature
f) A statement of comparison of budget Vs actual amount by function
g) Notes to the financial statements

Test Yourself 4

What is the time period of publish the auditor's report by every local government authority?

A Within six months after the close of the financial year to which the accounts relate
B Within six months of the receipt of the report of the auditor
C Within 4 months of the receipt of the report of the auditor
D Within six months after the close of the financial year to which the accounts relate or within six months of the receipt of the report of the auditor, as the case maybe

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5. Explain the cut-off procedures and the year-end accounting activities.
[Learning Outcome b]

5.1 Cut-off procedures

Cut-off procedures ensure transactions and events have been recorded in the correct accounting period. In other words, the transactions that are recorded in the current financial year do not include any transactions relating to any other year.

Example

If title to the goods is not transferred to a customer before period end, the sale of goods is not recognised in the current year. The relevant goods are shown as inventory, at cost.

Normally cut-off date for the year end accounting activities should be considered as 30 June each year for public sector entities in Tanzania. The accountant should perform cut-off procedures on purchase transactions in order to ascertain the inventory on the reporting date. This in turn enables determination of the cut-off of accounts payable too. In other words, the year-end cut-off procedures must assure the auditor that liabilities recorded for any goods received on the last day of the year are included in the physical inventory. Otherwise, income would be overstated by the full amount of the omitted invoice

Type of transaction	Procedures
Cut-off for revenue Transaction	To ensure all revenue transactions are recorded in the correct period. Check the cut-off procedures that ensure that the revenue are recorded in the correct period. This requires that the physical movements of goods and the accounting entries are fully synchronised. Verify the despatch notes for goods dispatched before the year end and confirm that they have been invoiced and are included in revenue, i.e. inspect the dates of the invoices with the dates of the despatch notes. Choose a sample of items in the inventory list and confirm that they have not been included under revenue.
Cut-off for purchase Transaction	To ensure that the purchase and purchase returns are recorded in the correct period. Verify that the challans relating to goods received before the year end have been invoiced and are included in purchases and goods received after the year end (and the inventory count) have been included in the purchases of the next accounting period. Enquire if any transactions represent goods received on consignment, and if so, whether they have been excluded from purchases as well as inventory. See if, after the reporting period, there are entries with large amounts reversing purchases recorded in the current period. This may be the result of manipulations made at the reporting period just to increase purchases. Choose a sample of items in the inventory list and confirm that they have been included under purchases.
Cash and bank transactions	To ensure that the cash transactions recorded in the cash book relate to the current accounting period only. Usually cash transactions are recorded immediately and the physical cash balance is verified with the balance according to the cash book. Therefore, there will normally not be any problems on the cut-off related to cash transactions. However, bank transactions immediately before and after the year end are verified to see if any entries to manipulate the records have been entered. Bank reconciliation is checked for subsequent clearance of the items.

6. Explain the preparation & presentation of financial statements – IPSASs 1
i. General purpose financial statements
ii. Identify a complete set of financial statements
iii. State the components of each set of financial statement.
[Learning Outcome f]

IPSAS 1 Presentation of Financial Statements deals with the format and content of financial statements prepared under IPSAS. This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 1 (Revised 2003), "Presentation of Financial Statements," published by the International Accounting Standards Board (IASB).

IPSAS 1 applies to all public sector entities other than Government Business Enterprises.

6.1 General purpose financial statements

IPSAS 1 shall be applied to all general purpose financial statements prepared and presented under the accrual basis of accounting in accordance with IPSASs.

General purpose financial statements are those intended to meet the needs of users who are not in a position to demand reports tailored to meet their particular information needs. General purpose financial statements include those that are presented separately or within another public document, such as an annual report.

Example

Users of general purpose financial statements include taxpayers and ratepayers, members of the legislature, creditors, suppliers, the media, and employees.

6.2 Complete sets of financial statements

Definition

A complete set of financial statements comprises:

(a) A statement of financial position;

(b) A statement of financial performance;

(c) A statement of changes in net assets/equity;

(d) A cash flow statement;

(e) When the entity makes publicly available its approved budget, a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the financial statements; and

(f) Notes, comprising a summary of significant accounting policies and other explanatory notes.

IPSAS 1, Para 21

An entity whose financial statements comply with IPSAS shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with IPSAS unless they comply with all the requirements of IPSAS.

6.3 Components of financial statements

Public Sector Entity—Statement of Financial Position as at 31 December 20X2 ((in thousands of currency units)

	20X2	**20X1**
Assets		
Current assets		
Cash and cash equivalents	X	X
Receivables	X	X
Inventories	X	X
Prepayments	X	X
Other current assets	X	X
	X	**X**
Non-current assets		
Receivables	X	X
Investments in associates Other	X	X
financial assets Infrastructure,	X	X
plant and equipment Land and	X	X
buildings	X	X
Intangible assets	X	X
Other non-financial assets	X	X
	X	**X**
Total assets	**X**	**X**
Liabilities		
Current liabilities		
Payables	X	X
Short-term borrowings	X	X
Current portion of long-term borrowings	X	X
Short-term provisions	X	X
Employee benefits	X	X
Superannuation	X	X
	X	**X**
Non-current liabilities		
Payables	X	X
Long-term borrowings	X	X
Long-term provisions	X	X
Employee benefits	X	X
Superannuation	X	X
	X	**X**
Total liabilities		
Net assets		
Net Assets/Equity		
Capital contributed by	X	X
Other government entities	X	X
Reserves	X	X
Accumulated surpluses/(deficits)	X	X
Minority interest	X	X
Total net assets/equity	**X**	**X**

Public Sector Entity—Statement of Financial Performance for the year ended 31 December 20X2

(Illustrating the Classification of Expenses by Function)

	20X2	20X1
Revenue	X	X
Taxes	X	X
Fees, fines, penalties, and licenses	X	X
Revenue from exchange transactions	X	X
Transfers from other government entities	X	X
Other revenue	X	X
Total revenue	**X**	**X**
Expenses		
General public services	(X)	(X)
Defence	(X)	(X)
Public order and safety	(X)	(X)
Education	(X)	(X)
Health	(X)	(X)
Social protection	(X)	(X)
Housing and community amenities	(X)	(X)
Recreational, cultural, and religion	(X)	(X)
Economic affairs	(X)	(X)
Environmental protection	(X)	(X)
Other expenses	(X)	(X)
Finance costs	(X)	(X)
Total expenses	**(X)**	**(X)**
Share of surplus of associates	(X)	(X)
Surplus/(deficit) for the period	**X**	**X**
Attributable to:		
Owners of the controlling entity	X	X
Minority interests	X	X
	X	**X**

Public Sector Entity—Statement of Financial Performance for the year ended 31 December 20X2

(Illustrating the Classification of Expenses by Nature)

	20X1	20X2
Revenue		
Taxes	X	X
Fees, fines, penalties, and licenses	X	X
Revenue from exchange transactions	X	X
Transfers from other government entities	X	X
Other revenue	X	X
Total Revenue	**X**	**X**
Expenses		
Wages, salaries, and employee benefits	(X)	(X)
Grants and other transfer payments	(X)	(X)
Supplies and consumables used	(X)	(X)
Depreciation and amortization expense	(X)	(X)
Impairment of property, plant, and equipment	(X)	(X)
Other expenses	(X)	(X)
Finance costs	(X)	(X)
Total Expenses	**(X)**	**(X)**
Share of surplus of associates	X	X
Surplus/(deficit) for the period	**X**	**X**
Attributable to:		
Owners of the controlling entity	X	X
Minority interest	X	X
	X	**X**

Public Sector Entity—Statement of Changes in Net Assets/Equity for the Year Ended December 31, 20X1

	Contributed capital	Other Reserves	Translation reserve	Accumulated surpluses/ (Deficit)	Total	Minority	Total net assets / equity
	Tshs	Tshs	Tshs	Tshs	Tshs	Tshs	Tshs
Balance at December 31, 20X1 brought forward	X	X	(X)	X	X	X	X
Changes in net assets/equity for 20X2							
Loss on property revaluation		(X)			(X)	(X)	(X)
Gain on revaluation of investments		X			X	X	X
Exchange differences on translating foreign operations			(X)		(X)	(X)	(X)
Net revenue recognized directly in net assets/equity		(X)	(X)		(X)	(X)	(X)
Deficit for the period				(X)		(X)	(X)
Total recognized revenue and expense for the period		(X)	(X)	(X)	(X)	(X)	(X)
Balance at December 31, 20X2	**X**	**X**	**(X)**	**X**	**(X)**	**X**	**X**

Note: IPSAS 1 requires a comparative statement of changes in equity to be prepared each year which accompanies the financial statements.

IPSAS have generally been based on IFRSs which are adopted to address the needs of the public sector. Some of the key differences between the two sets of accounting standards include:

	IPSASs	IASs / IFRSs
Presentation of financial statements	It always refers to sales as "Revenue". IPSAS does not incorporate the concept of comprehensive income.	It uses the terminology "Sales".
Extraordinary items	IPSAS 1 does not explicitly preclude the presentation of items of revenue and expense as extraordinary items either on the face of the statement of financial performance or in the notes.	IAS 1 prohibits any items of income and expense to be presented as extraordinary items either on the face of the statement of profit or loss or notes.
Financial instruments	IPSAS 28,29 and 30 **are** modelled on IAS 32 and 39 – Financial assets and liabilities are classified based on IAS 39 principles.	IAS 39 has been revised by the IASB and a new standard - IFRS 9 - has replaced most of the IAS 39 requirements.
Income taxes	IPSAS presumes that entities that operate within the public sector are generally exempt from income taxes and therefore does not cater to the accounting of income taxes.	IAS 12 deals with accounting for current tax and deferred tax.

Continued on the next page

Consolidation	IPSAS are still based on IAS 27 Consolidated and Separate Financial Statements, IAS 28 Investments in Associates and IAS 31 Interest in Joint Ventures. The definition of control is limited and needs to be revised.	IFRS 10 Consolidated Financial Statements, IFRS 11 Joint Arrangements and IFRS 12 Disclosures of Interests in Other Entities deals with consolidated financial statements. The definition of control is elaborate in these standards.
Construction contracts	IPSAS 11 covers only non-commercial contracts. A deficit does not have to be recognized on a contract when contract costs exceed total contract revenues, if the intention at the inception of the contract was not to fully recover contract costs of the parties to that contract.	It covers all commercial and non-commercial contracts. A loss on a construction contract has to be recognised immediately in the statement of profit or loss.
Provisions, Contingent Liabilities And Contingent Assets	Obligations arising from social benefits provided by an entity are excluded from the scope.	A provision has to be made if there is a probable outflow of resources.
Borrowing costs	IPSAS 5 requires borrowing costs to be recognized as an expense in the period in which they are incurred.	IAS 26 requires capitalisation of borrowing costs for qualifying assets.
Public sector specific guidance	IPSAS 21—Impairment of Non–Cash-Generating Assets IPSAS 22—Disclosure of Information about the General Government Sector IPSAS 23—Revenue from Non-Exchange Transactions (Taxes and Transfers) IPSAS 24—Presentation of Budget Information in Financial Statements	No such guidance is available under IASs / IFRSs.

Test Yourself 5

Which IPSAS deals with presentation of financial statement?

A IPSAS 1
B IPSAS 3
C IPSAS 5
D IPSAS 10

7. Apply accounting principles, techniques and standards in the preparation of the key financial statements (including any necessary consolidation) for public sector organisations.

[Learning outcome g]

The following ledger balances were extracted from the books of Mbeya District Council for the year ended 30th June, 2010 with some balances for the year ended 30th June 2009.

	2009	2010
	Tshs	Tshs
Cash in hand	1,220,000	2,460,000
Equipment's and tools	4,850,000	13,563,000
Cash at bank	10,500,000	18,661,000
Debtors	29,476,000	71,000,000
Land and buildings	233,800,000	575,226,000
Other capital reserve	671,000,000	665,000,000
Furniture and fittings	6,567,000	7,605,000
Capital grant applied	331,770,000	585,000,000
Deposits	2,725,000	8,150,000
Capital reserves	290,000,000	291,560,000
Long term capital	176,600,000	165,050,000
Plant and Motor vehicles	56,530,000	85,110,000
Creditors	100,652,000	109,460,000
Revenue contribution to capital	62,153,000	64,950,000
Basket fund	14,512,177	27,500,000
Capital grant un-applied	7,095,000	7,270,000
Revaluation reserves	316,660,000	316,600,000
Unpaid LAPF	-	4,800,000
Unclaimed salary	-	9,340,000

Required:

Prepare Mbeya District Council consolidated statement of financial position as at 30 June 2010.

Paper T08, May 2011

Mbeya District Council Consolidated statement of financial position as at 30 June 2010

	30/06/2009	30/06/2010
	Tshs	Tshs
Non-current Assets		
Land and building	233,800,000	516,226,000
Plant and Motor vehicles	56,530,000	85,110,000
Other Capital reserves	671,000,000	665,000,000
Tools and Equipment	4,850,000	15,563,000
Long Term Capital	176,600,000	165,000,000
Furniture and Fittings	6,567,000	7,605,000
Total Non-current assets (A)	**1,149,347,000**	**1,513,504,000**
Current Assets		
Cash in Hand	1,220,000	2,460,000
Cash at Bank	10,500,000	18,661,000
Debtors	29,476,000	71,000,000
Total Current Assets (B)	**41,196,000**	**92,121,000**
Less: Current Liabilities		
Creditors	100,652,000	109,460,000
Deposits Unpaid	2,725,000	8,150,000
LAPF Unclaimed	-	4,800,000
salary	-	9,340,000
Total current liability (C)	**103,377,000**	**131,750,000**
Working capital (D = B – C)	(62,181,000)	(39,629,000)
Net Assets (A – D)	**1,087,166,000**	**1,473,875,000**
Represented by:		
Capital grant applied	331,770,000	585,000,000
Revenue contribution to capital	62,153,000	64,950,000
Revaluation reserves	316,600,000	316,600,000
Capital reserve	290,000,000	291,560,000
Capital grant un applied	7,095,000	7,270,000
Basket Fund	14,512,171	27,500,000
Surplus (deficit) Account (balancing figure)	65,035,829	180,995,000
	1,087,166,000	**1,473,875,000**

District Director ……………… Chairman/Mayor ……………

Answers to Test Yourself

Answer to TY 1

The correct option is **B**.

Financial year means in relation to the Government, other than local government authority, a period of twelve months ending on 30 June of each year.

Answer to TY 2

The correct option is **A.**

In accordance with Section 25(2) of the Public Finance Act, each accounting officer shall prepare and transmit an Appropriation Account to the Controller and Auditor General.

Answer to TY 3

The correct option is **D.**

In accordance with Section 25(2) of the Public Finance Act, each accounting officer shall prepare and transmit an Appropriation Account to the Controller and Auditor General.

Answer to TY 4

The correct option is **D.**

Each local government authority shall publish the auditor report within six months after the close of the financial year to which the accounts relate or within six months of the receipt of the report of the auditor, as the case maybe

Answer to TY 5

The correct option is **A**.

IPSAS 1 Presentation of Financial Statements deals with the format and content of financial statements prepared under IPSAS.

Self-Examination Questions

Question 1

Which act requires the Accountant General to prepare and transmit balance sheet and other financial statements to the Annual Accounts Minsiter?

A Public Finance Act 2001
B Public Procurement Act 2004
C Public servant code of conduct
D Public Service (Amendment) Act 2007

Question 2

Which IPSAS deals with the treatment of borrowing costs?

A IPSAS 1
B IPSAS 2
C IPSAS 3
D IPSAS 5

Question 3

The following are the details of receipt and payments of Leo Club for the year ended 31 December 20X3.

Receipts and Payments account for the year ended 31 December 20X3

Receipts		Tshs'000	Payments	Tshs'000
Cash balance b/f		4,500	Salaries (11 months)	1,100
Subscriptions:			Tournament expenses	1,600
20X2	100,000		Investments	1,000
20X3	2,400,000		Furniture	400
20X4	200,000	2,700	Stationery	1,200
Sale of old furniture (Original cost Tshs200,000)		140	Sports expenses	15,000
Tournament receipts		2,000	Newspapers and magazines	200
Sports fund		10,000	Rent paid up to February 20X4	1,400
Donations for sports		3,000	Cash in hand	440
		22,340		**22,340**

Other information

(1) The club has 300 members each paying an annual subscription of Tshs10,000. Tshs70,000 is still outstanding for the year 20X2. In 20X2, 10 members had paid their subscription for 20X3 in advance.

(2) Stock of stationery as on 31 December 20X2 was Tshs100,000 and as on 31 December 20X3 was Tshs140,000.

(3) On 1 January 20X3, the club owned Land & Building valued at Tshs20 million and furniture worth Tshs1.3 million. Interest accrued on investment at the rate of 6% per annum for 3 months.

Required:

Prepare Income and Expenditure account and Statement of financial position of Leo Club for the year ended 31 December 20X3

Answers to Self Examination Questions

Answer to SEQ 1

The correct option is **A**.

In accordance with Section 25(1) of the Public Finance Act, the Accountant General shall prepare and transmit to the Annual Accounts Minister and to the Controller and Auditor-General the balance sheet and other financial statements.

Answer to SEQ 2

The correct option is **D**.

IPSAS 5 deals with the treatment of borrowing costs.

Answer to SEQ 3

Income and Expenditure account of Leo Club for the year ended 31 December 20X3

	Tshs'000		Tshs'000
Salaries (W3)	1,200	Subscriptions (W1)	3,000
Tournament expenses	1,600	Tournament receipts	2,000
Sports expenses	15,000	Interest on investments (W5)	15
Newspapers and magazines	200	Donation for sports	3,000
Rent (W4)	1,200	Sports fund	10,000
Stationery consumed (W6)	1,160	Deficit	2,405
Loss on sale of furniture (Tshs200,000 – Tshs140,000)	60		
	20,420		**20,420**

Statement of financial position as on 31 December 20X3

	Tshs'000

Non-current assets	
Land and building	20,000
Furniture (W8)	1,500
Investments	1,000
Current assets	
Stock of stationery	140
Subscription outstanding	570
Prepaid rent	200
Accrued interest on investments	15
Cash	440
Total assets	**23,865**
Current liabilities	
Subscriptions received in advance	200
Outstanding salaries	100
Reserves	
Capital fund less deficit (Tshs25,970,000 – Tshs2,405,000) (W7)	23,565
Total liabilities	**23,865**

Workings

W1 Subscriptions amount to be credited to Income and Expenditure account

	Tshs'000	Tshs'000
Subscriptions received during the year		2,700
Add: Subscriptions outstanding as on 31 December 20X3 (W2)	500	
Subscriptions received in advance as on 31 December 20X2 (10 x Tshs10,000)	100	600
		3,300
Less: Subscriptions received in advance as on 31 December 20X3	200	
Subscriptions outstanding in 20X2 and received in 20X3	100	(300)
Subscription amount to be shown in Income and Expenditure account		**3,000**

W2 Subscription outstanding as on 31 December 20X3

	Tshs'000
Total subscription expected during the year 20X3 (300 members xTshs10,000)	3,000
Less: Subscription received in advance for 20X3 during the previous year (10 members x Tshs10,000)	(100)
Total subscription due from the members for the current year 20X3	**2,900**
Less: Subscription received during the year 20X3 (from Receipts and Payments account)	(2,400)
Subscription outstanding as on 31 December 20X3	**500**

W3 Salaries

Salaries paid by the club for 11 months are Tshs1,100,000 according to Receipts and Payments account. The figure in the Income and Expenditure account is considered on the basis of accrual principle. Therefore, the salaries to be debited to Income and Expenditure account for 12 months will be calculated as follows:

Tshs1,100,000 X 12 months/11 months = Tshs1,200,000

The salaries for one month which have not been paid are outstanding liabilities for the club and therefore will be shown on the liabilities side of the statement of financial position of the club.

W4 Rent

Rent is paid by the club up to February 20X4 during the current year 20X3, i.e. for 14 months.

According to the accrual principle, only the rent paid for the current year will be considered in Income and Expenditure account which will be calculated as follows:

Tshs1,400,000 X 12 months/14 months = Tshs1,200,000

The rent paid for January 20X4 and February 20X4 is a prepaid rent and hence the amount of Tshs 200,000 (Tshs1,400,000 – Tshs1,200,000) will be shown on the assets side of the statement of financial position.

W5 Interest on investments
Accrued interest on investments for 3 months at the rate of 6%:

Tshs1,000,000 x 6% x 3/12 = Tshs15,000

It will be credited to Income and Expenditure account and will be shown on the assets side of the balance sheet.

W6 Cost of stationery consumed

	Tshs'000
Opening stock of stationery	100
Add: Purchases	1,200
	1,300
Less: Closing stock of stationery	(140)
Cost of stationery consumed to be charged to Income and Expenditure account	**1,160**

W7 Opening capital fund

	Tshs'000
Non-current assets	
Land and building	20,000
Furniture	1,300
Current assets	
Stock of stationery	100
Subscription outstanding	170
Cash	4,500
Total assets	**26,070**
Current liabilities	
Subscriptions received in advance	100
Reserves	
Capital fund (Balancing figure)	25,970
Total liabilities	**26,070**

Dr Furniture account Cr

	Tshs '000		Tshs'000
Balance b/f	1,300	Sale of furniture	200
Purchases	400	Balance c/d	1,500
	1,700		1,700

STUDY GUIDE A13: PERIODIC STATEMENTS AND REPORTS

Get Through Intro

The people of Tanzania have a right to excellent public services from the government. In order to ensure such public services, the government should be made accountable to the citizens for its actions and decisions by periodically reporting on the public services provided by the government. The quality of public services can only be accurately measured with the help of various types of reports and statements.

The reporting activities of the Tanzanian Government include generating financial as well as performance reports for all its programmes and undertakings which are financed by public money. In principle, these reports should be produced routinely by the government, based on carefully set performance indicators which show the achievements of the particular area of reporting. Moreover, information in the reports should be structured in a clear and understandable manner to enable easy interpretation by the stakeholders. This helps gain inputs from these stakeholders and corrective action can be initiated where necessary.

In this Study Guide, we will learn about the types of reports generated by central and local government and the information disclosed in these report.

Knowledge of this Study Guide will help you not just pass your exams but also in your career as an auditor or an employee in a government establishment.

Learning Outcomes

a) Identify the types of reports which are to be found in both central and local government.
b) Identify the information disclosed in the financial and performance reports.
c) Apply accounting principles, techniques, standards and regulations in preparation of periodic reports in public sector.

1. Identify the types of reports which are to be found in both central and local government. Identify the information disclosed in the financial and performance reports.
[Learning Outcomes a & b]

The working of the local government is not very different from the workings of the central government, just that the local governments have a smaller area under their jurisdiction compared to the central government. Therefore, the types of reports that both governments generate are more or less similar in nature.

Government reports can be broadly classified into two categories; financial reports and performance reports.

1.1 Financial reports

As the name suggests, financial reports relate to the monetary aspects of the activities of the government, and include cash flow statements, budgets, income statement, statement of financial position etc. These reports are discussed in detail in the following Study Guides:

Type of reports	Study Guide Numbe
Budgets: Statement of comparison of budget and actual amounts	A5
Cash flow statement	A8
Financial statements: Statement of Financial Performance Statement of Changes in Net Assets/Equity Statement of financial position	A12

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1.2 Performance reports

As the name suggests, performance reports of the government show the performance of a particular sector or activity undertaken by the government. Financial reports only state the figures of income, expenditure, cash flow etc. But performance reports do more than that, they use these figures and comment on how the government has performed in that particular area.

Auditing an area of government activity gives a clear picture of the performance of the government in that area / sector. The Comptroller and Auditor General carries out various audits in a number of areas of government activity.

Example

The Government of Tanzania established the Occupational Safety and Health Authority (OSHA) under the Ministry of Labour and Employment (MOLE) and charged it with the responsibility of ensuring safe and healthy working conditions in all workplaces, by setting and enforcing laws and standards that will be observed by employers in every workplace.

OSHA has prepared the following performance report on the 'Fatality Rate by Sector'

Table 3.3: Fatality Rate by Sector

Sector	Total Employed	Number of Fatal injuries[13]	Fatality rate in %
Agriculture, forestry, fishing	13,890,054	16	0.12
Mining & quarrying	29,223	6	20.53
Commerce & Distribution	2,486,818	12	0.48
Manufacturing	245,449	28	11.41
Construction/building	151,690	36	23.73
Transport	111,571	23	20.61
Total	**16,914,805**	**121**	

Source: OSHA report on Occupational Accidents by sector[14]

The above report indicates that the fatality rate is high in construction/building sector followed by transport and mining sector. This implies that the level of risk in relation to occupational accidents sector-wise is also different.

Source: A performance audit report on the management of occupational health and safety in Tanzania: A report of the Controller and Auditor General of the United Republic of Tanzania, January 2013)

Some examples of such reports are:

(a) Management of occupational health and safety in Tanzania

(b) Management of fisheries activities in the lake Victoria

(c) Management of procurement of ICT equipment in public sector

(d) Road Works

(e) Cost control in public procurement

(f) Management of food inspection

(g) Management of inspection of imported goods

(h) Management of most vulnerable children

(i) Management of wildlife in game reserve

(j) Management of traffic inspections and speed limits

(k) Management of forest harvesting

(l) Management of water distribution in urban areas

(m) Management of outsourced revenue collection function by local government authorities

(n) Maternal health care

Let us see how such reports look like:

Example

The following is an extract of a performance audit report on the management of occupational health and safety in Tanzania: A report of the Controller and Auditor General of the United Republic of Tanzania, January 2013

A review of the tools/equipment available in the central zone reveals the following:

Table 3.6: Analysis of the available against required inspection tool

Type of tool required	2009/2010		2010/2011		2011/2012	
	Required	Available	Required	Available	Required	Available
Electrical inspection	4	0	4	0	4	0
Industrial hygiene measurement	4	0	4	0	3	4

Source: Zone resource database (Fixed Asset Registers)

Table 3.6 shows that the central zone had limited electrical and hygiene inspections equipment though the team managed to inspect 146 workplaces in 25 days. These tools were supposed to be supplied by OSHA HQ. According to interviews held with OSHA officials, inspection tools were not provided due to limited financial resources.

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Example

Extract of National Synthesis Report (April 2007) on annual assessment of minimum conditions and performance measures for local councils under the local system for FY2007/08 published by The Prime Minister's Office Regional Administration and Local Government

Table 1 below summarizes the performance of the LGAs under Minimum conditions for all the grants.

Out of the 121 LGAs which were assessed for funding in FY 2007/08, 63 councils (52%) met all the Minimum Conditions compared to 62 councils (51%) which qualified to access CDG during FY 2006/07.

Out of the 121 LGAs assessed only 106 councils (88%) directly met Minimum Conditions to access CBG in FY 2007/08 compared to 121 councils (100%) in financial year 2006/07.

Results for accessing DADG show that 62 councils (51%) directly met the Minimum Conditions to access funding in FY 2007/08 compared to 49 councils (40.5%) in FY 2006/07.

Table 1: Summary performance results for LGAs assessed under MCs

Grant	Met	%	Provisional	%	Not Met	%
CDG	63	52%	46	38%	12	10%
CBG	106	88%	15	12%	0	0%
DADG	62	51%	45	37%	14	12%
UDEMG	28	23%	10	8%	83	69%
UDEM-CBG	41	34%	80	66%	0	0%

Box 1) Major Reasons for Failure of MCs

- CDG
  (Primary)
  - Weak Internal Audit Units (6 LGAs)
  - Failure to prepare financial reports (8 LGAs)
  - M&E progress reports (2 LGAs)
  - Financial irregularities (3 LGAs)
  - Council minutes (4LGAs)
  - Adverse Audit Reports (4LGAS)

  (Secondary)
  - Weak Fiscal Capacity (42 LGAs)
  - Failure to present internal audit reports to FPC (18 LGAs)
  - Failure to prepare bank reconciliation statements (14 LGAs)
- DADG
  - Failure to meet MCs for accessing CDG (12)
- UDEMG
  - UDEM not functional in most councils
- UDEM-CBG (Secondary)
  - Lack of approved Capacity building plans (79)

Table 2: Summary Comparison of Assessment Results under MCs for FYs 2006/07 & 2007/08

	CDG		DADG		CBG	
Status	06/07	07/08	06/07	07/08	06/07	07/08
Met	62	63	49	62	121	106
Provisional	22	46	29	45	0	15
Not Met	37	12	43	14	0	0

Test Yourself 1

The report 'cost control in public procurement' falls under which of the following types of reports?

A Financial report
B Performance report
C Management report
D None of the above

2. Apply accounting principles, techniques, standards and regulations in preparation of periodic reports in public sector.

[Learning Outcome c]

This topic has been discussed in detail in Study Guide A12.

Answer to Test Yourself

Answer to TY 1

The correct option is **B.**

'Cost control in public procurement' is a performance report. Financial reports only state the figures of income, expenditure, cash flow etc. But performance reports use these figures and comment on how the government has performed in that particular area. 'Cost control in public procurement is not just about how much cost is saved, but about how the government has fared in this area and the how the costs were controlled.

Self Examination Questions

Question 1

The following is the information of transactions for the year ended 31 December 20X4 prepared by a local government:

	Tshs'000
Local licenses, fees & rates	68,097.00
Local rates and taxes	54,738.00
Statutory allocation	459,162.00
Grants from State Government	253,672.50
Grants from Federal Government	190,060.50
Office of the Chairman	104,467.50
Office of the Secretary	353,932.50
Traditional Office Expenses	18,735.00
Primary Health Care	65,265.00
Rural Electrification Expenses	14,160.00
District Area Office Administration	324,787.50
Rent on Local Government Property	177,390.00
Miscellaneous Expenses	495.00
Planning and Budgeting Expenditure	7,951.50
Interest payments and dividends received	9,525.00
Earning from commercial undertakings	194,463.00
Legislative Deposits	54,462.00
Payee and union due balance	562.50
Advance Salaries to staff	1,444.50
Deposit for purchase of computer systems	36,195.00
Pension Balance	973.50
Revenue brought forward	7,959.00
Bank Balance	181,159.50
Cash in Hand	3,162.00
Withholding Tax	20,490.00
Finance & Supply	79800.00

Required:

(a) Prepare the trial balance of the local government for the year ended 31 December 20X4.
(b) Prepare the Statement of Income and Expenditure as at that date.
(c) Prepare the Statement of Assets and Liabilities as at that date.

Answers to Self Examination Questions

Answer to SEQ 1

(a) Trial balance as at 31st December 20X4

	Dr '000	Cr '000
District Area office Admin.	324,787.50	
Miscellaneous Expenses	495.00	
Planning and Budgeting Expenditure	7,951.50	
Interest payments and dividends received		9,525.00
Statutory allocation		459,162.00
Rent on Local Govt. property		177,390.00
Earnings from Commercial undertakings		194,463.00
Legislative deposits		54,462.00
Payee and Union Due Balance		562.50
Advance salaries to staff	1,444.50	
Deposit for purchase of Computer	36,195.00	
Pension Balance		973.50
Withholding Tax		20,490.00
Finance & Supply Department	79,800.00	
Local Licenses, Fees and Rates		68,097.00
Local Rates & Taxes		54,738.00
Grants from State Government		103,672.50
Grants from Federal Government		190,060.50
Office of the Chairman	254,467.50	
Office of the Secretary	353,932.50	
Traditional Office Expenses	18,735.00	
Primary health cave	65,265.00	
Rural electrification expenses	14,160.00	
Bank Balance	181,159.50	
Cash in Hand	3,162.00	
Revenue brought forward		7,959.00
Total	**1341555.00**	**1341555.00**

(b) Local Government Statement of Income & Expenditure for the year ended 31st December, 20X4

	Tshs 000	
Income		
Statutory Allocation	459,162.00	
Grants from Federal Govt.	190,060.50	
Grants from State Govt.	103,672.50	
Local Licenses, fees & rates	68,097.00	
Local rate and taxes	54,738.00	
Interest payments and dividends received	9,525.00	
Rent on Local Govt. property	177,390.00	
Earnings from Commercial undertakings	194,463.00	**1,257,108.00**
Less: Expenditure Office		
of the Chairman Office of	254,467.50	
the Secretary Traditional	353,932.50	
office expenses Primary	18,735.00	
Health Care	65,265.00	
Rural electrification	14,160.00	
District Area office. Admin	324,787.50	
Miscellaneous expenses	495.00	
Planning & Budgeting Expenditure	7,951.50	
Finance & Supply Department	79,800.00	**1,119,594.00**
Excess of Income over Expenditure for the year		**137,514.00**
Revenue brought forward		7,959.00
Revenue carried forward		**145,473.00**

(c) Statement of assets and liabilities for the year ended 31st December, 20X4

	Tshs 000
Assets	
Deposit for purchase of computer	36,195.00
Advance salaries to staff	1,444.50
Bank balance	181,159.50
Cash in Hand	3,162.00
Total	**221,961.00**
Liabilities	
Legislative Deposit	54,462.00
P.A.Y.E & Union due balance	562.50
Pension Balance	973.50
Withholding Tax	20,490.00
Revenue balance	145,473.00
Total	**221,961.00**

SECTION A

ACCOUNTING FOR PUBLIC SECTOR

A14

STUDY GUIDE A14: INTRODUCTION TO PUBLIC SERVICES REGULATION

Get Through Intro

Many companies have codes of ethics and many companies publish their codes of ethics but many companies still face critics who question attitudes and practice in employment, market competition abuse, transparency of reporting, social and environmental responsibilities and the sale of ethically unacceptable products. Some even question whether making profits can ever be ethical.

Codes are designed to set rules or give guidance so that ethical behaviour is not merely cultural but subject to systems and controls. Accountants play a significant role in corporate governance and reporting and are involved with ethical codes in companies. Accountants are also professionals and subject to their own codes and controls.

In a public services entity, administrators and bureaucrats are responsible for making numerous decisions and in doing so they should attempt to make ethical decisions. Sometimes the powers are discretionary in nature that go beyond the job descriptions, orders, manuals and legal framework pertaining to their position and duties. In such situation professional ethics will have to come in as guidelines, in addition to the formal regulations.

In this Study Guide we will understand the need to adhere to the fundamental principles of the code of ethics. We will also understand the application of the ethical codes in the public services.

Learning Outcomes

a) Explain code of ethics and conduct for public servants.
b) Identify examples public servants offences.
c) Identify penalties imposed upon public servants.

1. Explain the code of ethics and conduct for public servants.
[Learning Outcome a]

1.1 Meaning of public Interest

Definition

The **public interest** refers to the general well-being of public.

Therefore 'acting in public interest' means

- Acting in the interest / welfare of the public.
- Taking decisions which serve the interest of the maximum number of persons.
- Upholding human rights.

Fundamentally, public interest is 'contextual'; i.e. it is in the context of the work that accountants perform. In essence, this means that accountants are not required professionally to look out for the 'welfare' of the public. However, they do need to consider whether a 'public' interest exists in relation to their work, and whether it should override the interests of their client or employer.

Important

This Learning Outcome has been explained in the context of the United Republic of Tanzania (Code of ethics and conduct for the public service Tanzania)

1.2 Meaning of ethics

The term "ethics" comes from the Greek word "ethikos". Ethikos literally translated means theory of living. This definition has evolved over time and now refers to abiding by a set of written and unwritten rules based on both **legality and morality**.

Definition

Ethics can be defined as abiding by a set of written and unwritten rules based on both legality and morality:

- Legality, because ethics involves obeying the laws of a country,
- Morality, because ethics involves doing what a society believes is just and correct. It includes non-legal regulatory compliances like obeying the rules of the work place.

Ethics also involves having a **permanent commitment** to abiding by these rules. A person cannot claim to be ethical by just having ethics in some situations, but not in others.

Example

Sam is an honest employee and a law abiding citizen. However, if Sam lies about the condition of a car he is selling he becomes unethical, despite his ethical behaviour in other situations.

Very broadly speaking, ethics involves doing **what is right and what will not harm the interest of others**. Having a system of ethics is very important to people on both an individual and collective level.

1.3 Meaning of business ethics

Ethics also has a very important place in commerce. Remember that the business world comprises and is run by people. Even the world's largest organisations and governments are all ultimately controlled by individuals. Therefore, how ethical an organisation or government is, will depend upon how ethical its employees and public servants are.

Definition

Business ethics can be defined as the branch of ethics that examines rules and principles within a commercial context.

The original view regarding organisations was that their only ethical responsibility was to maximise profits for their owners or shareholders. The standing belief was that profitability should be the only criteria used to evaluate decisions. For a public sector organisation the ethical responsibility is to provide basic amenities to the general public at an affordable price.

This view later changed to the belief that organisations also have an **ethical responsibility towards their various stakeholders** (e.g. their employees, suppliers, customers and society at large).

Decisions needed to be considered in terms of both profitability and also whether it would detrimentally affect the interests of any of its stakeholder groups. Decisions that would hurt the interests of any stakeholder group would be **unethical** despite the level of profits it would bring to the firm.

Example

It would be unethical for an organisation to exaggerate or lie about the features of one of its products, regardless of how heavily this tactic would increase sales.

According to Crane & Matten right and wrong may be seen in terms of morally right and wrong as opposed to economically right or wrong. For example, a pharmaceutical company may decide to launch a new product with only limited testing. This may be economically right However, it may be ethically wrong.

Therefore business ethics focuses on rights and wrongs in relation to business activities, situations and decisions.

1.4 Importance of ethics for an organisation

Today organisations are expected to have an ethical responsibility to their **shareholders and stakeholders, as well as to society at large**. Organisations are expected not to take decisions or engage in activities that will hurt the interests of any of these groups. In addition, organisations are expected to "**give back**" to society through donations or by sponsoring welfare activities.

It should be noted that **there is also a strong economic justification for organisations to behave ethically**. Experience has shown that being ethical makes good business sense for the organisation in the long run. For example, suppliers are more willing to deal with organisations that have an established reputation for being ethical in their dealings.

Research has also shown that **people are more willing to work for or buy products from an ethical organisation**. Having ethical behaviour across all levels will promote the overall efficiency of both the organisation and society as a whole.

Example

The purchase managers of Kigogo have a well-earned reputation for not accepting bribes. Therefore, the organisation's suppliers offer this bribe amount as a legitimate discount to the organisation instead.

Kigogo also follows a very strict policy of not discriminating against candidates on any level when recruiting. Over the years, this has led the organisation to have great success in hiring the most suitable candidates for its job openings.

Kigogo has also followed a policy of not giving bribes to win Government contracts. By following this policy they have earned themselves credibility with both the Government and the public, which has led to them being awarded several large construction projects.

Lastly and most importantly **in today's world, organisations have to be ethical**. Society and Governments no longer tolerate unethical behaviour from firms.

Although an organisation may "get away" with unethical practices in the short run, in the long run it will see its sales, profitability and share price decline because of this type of behaviour.

Example

The sudden resignation of former Boeing Chairman and CEO Philip M. Condit on Dec 1, 2003 was largely due to the highly publicised ethical scandals that took place under his command.

Boeing had damaged its relationship with one of its most important customers, the US Government. The organisation had offered an Air Force procurement officer a position with the company whilst negotiating for a Tshs18 billion tanker order. In addition, Boeing was also found to have confidential information belonging to its competitor, the Lockheed Martin Corporation that related to a Tshs1billion rocket contract that both businesses were applying for.

Furthermore a class action suit had been brought against the organisation that accused Boeing of underpaying and under-promoting female employees.

Along with Condit's resignation, these ethical violations also led to the organisation losing both the airplane tanker and rocket contract. During this time Boeing's share price also fell by 6.5%.

Condit's successors made restoring creditability with the US Government and the public their top priority. Recently, current CEO Jim McNerney made a public apology to Congress. McNerney stated that these ethical violations had "brought dishonour on a great company and caused harm to the U.S. Government and its taxpayers".

McNerney also agreed to pay a Tshs615 million fine and stated that ethics would be woven "into the fabric" of the organisation.

1.5 Code of ethics for public servants in Tanzania

In order for the public service to be efficient and respected, public servants must behave and conduct themselves in a manner as stipulated below

1. Respect all human rights and be courteous;
2. Perform diligently and in a disciplined manner;
3. Promote team work;
4. Pursue excellence in service;
5. Exercise responsibility and good stewardship;
6. Promote transparency and accountability;
7. Discharge duties with integrity, and
8. Maintain political neutrality.

This code explains each of these expectations in more detail.

1. Respecting human rights and being courteous

(a) Democratic rights: a public servant has the right of being a member of any political party and can vote both for his/her political party and in the general elections.

(b) Religion: a public servant can become a member of any religious sect provided that he/she does not contravene the existing laws. However, since the government has no religion, religious beliefs should not be advocated in Public Service Offices.

(c) Discrimination: a public service shall not discriminate or harass a member of the public or a fellow employee on grounds of sex, tribe, religion, nationality, ethnicity, marital status or disability.

(d) Courtesy to all: a public servant shall be courteous to senior and fellow employees as well as to all clients and particularly the clients being served. If a public servant is requested to clarify or to provide direction on issues arising from laws, regulations and procedures, the employee will do so with clarity and promptness.

(e) Respect for all: a public servant will respect other employees and their rights, including their right to privacy, especially when handling private and personal information.

(f) Sexual harassment: a public servant shall refrain from having sexual relationships at the workplace. Likewise he/she will avoid all types of conduct which may constitute sexual harassment

2. Discipline and Diligence

(a) Diligent: for efficient performance, a public servant will perform his/her duties diligently and with a high degree of discipline. An employee shall therefore use the time, skills and expertise possessed so as to attain the expected goals.

(b) Discipline: public servants are expected to

(i) obey the law: decisions should not be biased because of religion, ethnicity, sex, personal interests or any relationship;

(ii) obey and effect lawful directives;

(iii) carry out assigned duties efficiently: where a public servant considers that he/she is being asked to act improperly he/she shall report the matter to his/her superiors in accordance with the laid down procedures;

(iv) be ready to work at any duty station;

(v) refrain from any conduct which might impair one's work performance;

(vi) be punctual with respect to hours of arrival at work, at all official appointments or engagements and not absent oneself from duty without proper authorization or reasonable cause;

(vii) avoid the use of rude and abusive language; and

(viii) finish assigned duties within required time and standards.

(c) Attire: an employee will maintain personal hygiene and dress in respectable attire, in accordance with the acceptable norms of the office as stipulated in staff circulars.

(d) Private life: while out of office, an employee will conduct his/her personal life in such a manner that it does not affect his/her services or bring the public service into disrepute. He/she is therefore required to refrain from becoming drunk, using narcotic drugs and indulging in any other unacceptable behaviour.

(e) Secrecy and confidentiality: a public servant shall not, without due permission, disclose secret and confidential or official information which has been communicated to him or which has been uncovered while discharging official duties. An employee shall continue to maintain secrecy and confidentiality of official information even after he leaves the public service.

(f) Disclosure of information

(i) A public servant shall not use for personal ends any official disclosure of a document or photocopy any information or any document obtained in the course of discharging his/ her duties.

(ii) Public servants shall not communicate with the media on issues related to work or official policies without due permission.

(iii) Official information will be released to the media only by officials who have been authorised to do so according to the laid down procedures.

3. Team work

Public servants will strive to promote team work by offering help to co-employees whenever the need arises.

Team work will be achieved by public servants by observing the following

(a) giving instructions which are clear and undistorted;

(b) giving due weight and consideration to official views submitted by fellow employees and subordinates;

(c) ensuring that subordinates clearly understand the scope of their work and encouraging them to enhance their competence and skills;

(d) giving credit to an employee with outstanding performance and not seeking personal credit at the employee's expense;

(e) avoiding malicious actions or words intended to ridicule either subordinates or superiors; and

(f) reporting on his/her subordinates fairly and without any fear.

4. Pursuing of excellence in service

Since the public service is geared towards provision of excellent services, public servants will do the following

(a) Strive to achieve the highest standards of performance.

(b) Members of professional bodies (e.g. doctors, teachers, pharmacists, engineers, lawyers etc.) should adhere to their respective professional Code of Conduct.

(c) Strive to acquire new knowledge and skills continuously and use them effectively.

(d) Recognise the need for training and strive to get such training.

5. Exercise responsibility and good stewardship

(a) Exercising responsibilities: a public servant shall act within the boundaries of the authority and responsibilities delegated to him/her. In doing so, he/she shall

(i) make decisions in line with authorised standards and procedures; and

(ii) discharge duties effectively and be accountable for one's own actions.

(b) Public property

(i) A public servant shall safeguard public funds and other properties of the public, including properties entrusted to him/her, and shall ensure that no damage, loss or misappropriation occurs to the funds or public property.

(ii) A public servant will use such resources for public use only. Public property includes office supplies, telephones, computers, copiers, buildings and other properties purchased with Government funds or donated to the Government. Expenses met by Government or service such as telephone, water and electricity are also part of public property.

6. Transparency and accountability

A public servant will adhere to and practice meritocratic principles in appointments, promotions and while delivering any service. He/she will be accountable both for actions and inactions through normal tiers of authority.

(a) A public servant shall conduct meetings for the purpose of promoting efficiency and shall not use meetings as a way of avoiding being responsible for the decision he/she is supposed to have made on her/ his own.

(b) A public servant shall not engage in unofficial activities or projects during official hours or conduct such activities or projects within the office premises or by using public property.

(c) A public servant shall be ready to declare his/her property or that of his/her spouse when required to do so.

7. Loyalty to the Government

A public servant shall be loyal to the duly constituted Government of the day and will therefore, implement policies and decisions made by a Minister or any other Government leader.

8. Discharge duties with integrity

(a) Adherence to laws: a public servant shall not fear to abide by Laws, Regulations and Procedures when discharging his/her duties.

(b) Corruption: a public servant shall not solicit, force or accept bribes from a person whom he/she is serving, has already served or will be serving either by doing so in person or by using another person.

(c) Gifts

(i) A public servant or any member of his/her family shall not receive presents in form of money, entertainments or any service from a person that may be regarded as geared towards compromising his/her integrity.

(ii) A public servant may accept or give nominal gifts such as pens, calendars and diaries in small amounts.

(iii) A public servant will return to the donor any other gift or hand the gift over to the government, in which case a receipt will be issued.

(d) Conflict of interest: a public servant shall perform his/her duties honestly and impartially to avoid circumstances that may lead to conflict of interest. If conflict of interest arises, he/she shall inform his/her superiors who will decide upon the best course of action to resolve it.

(e) Pecuniary embarrassment: a public servant shall not borrow to the extent of not being able to repay the debts as this will discredit the public service as well as affect his/her ability to make unbiased decisions.

9. Political neutrality

(a) Political participation: a public servant can participate in politics provided that when doing so, he/she observes the following limitations – he/she

(i) shall not conduct or engage in political activities during official hours or at work premises;

(ii) shall not take part in political activity which will compromise or be seen to compromise his/her loyalty to the Government;

(iii) shall not provide services with bias due to his/her political affiliation;

(iv) shall not pass information or documents availed through his/her position in the service to his/her political party.

(b) Political influence: although public servants have a right to communicate with their political representatives; they

(i) shall not use such influence to intervene on matters affecting him/her which are in dispute between the government and him/her;

(ii) shall not use such influence for furthering personal ends which are not part of the Government policy.

Conclusion

The Code of Ethics and Conduct has been issued pursuant to the Public Service Act. A breach of the Code has been dealt with under the Public Service Act, National Security Act, Prevention of Corruption Act or any other relevant law.

On its part, the government has the obligation to provide the following

establish meritocratic principles and procedures to be used in appointments, promotions and in all other service delivery activities;

establish a system which specifies the authority, responsibilities and expected actions of each public servant which can then be assessed after a specific time;

effect an appraisal system, which will enable a public employee to participate in assessing his/her performance;

ensure that safe working conditions prevail which will enable the public employee to discharge his/her duties without undue risk or fear; and

remunerate public servants on the basis of skills, responsibilities and working conditions.

For efficient, effective and courteous delivery of services to the public, all public servants must observe this Code.

Test Yourself 1

What is meant by public interest in a professional accountants' context?

A Taking decisions which serve the interest of the maximum number of persons
B Acting in the interest / welfare of the public
C Upholding human rights
D All of the above

**2. Identify examples public servants offences.
Identify penalties imposed upon public servants.**

[Learning Outcomes b and c]

2.1 Public servants

Public servants include public officer. Public officer is defined under The Public Procurement Act 2004 as follows:

Definition

Public officer means:

i. Any person holding or acting in an office of emolument in the services of Government;
ii. A person holding or acting in then office of Minister in the Government
iii. An employee of any body corporate such as is referred to in the definition of public body or public authority
iv. Any person conducting negotiations, for or in relation to a public contracts, or a prospective public contracts on behalf of a public body or public authority,
v. A person who is a consultant to a public body or a public authority

Public Procurement Act 2004

2.2 Examples of public servant offences

The two main examples of public servants offences include: Bribery and Corruption.

1. **Bribery** is said to have taken place when a financial or another advantage:

   is provided / offered to another person to perform a function / activity inappropriately
   is provided (directly / through a third person) to a public official to obtain a business advantage
   is received by a person to perform a function / activity inappropriately. For example, a public servant may be paid some money (by a construction company) in order to be awarded the contract to build a bridge.

2. **Corruption** means misuse of power by various individuals like:

   public servants; when they accept bribes
   officials from companies; when they pay bribes to government officials for securing orders or for not penalising them for not following the civic rules, etc.

2.3 Adverse effect of bribery and corruption on financial information

Corruption and bribery are illegal. So, when public servants receive bribes or undertake any corrupt practices, such transactions cannot be reported honestly by them. Therefore these transactions are not reported and disguised through creative accounting. This may also involve misuse of public resources. This in turn affects the accuracy of the financial information provided to the users of financial statements.

Indulging in bribery and corrupt practices is not just illegal but also unethical. For example, in the Tanzania a legislation on bribery and corruption is contained in 'The prevention and combating of corruption Act 2007. This legislation discourages acts of bribery by Tanzania companies and its nationals**. In this way, the Tanzanian government encourages good corporate governance practices like honesty and openness.**

2.4 Best practice measures for reducing and combating bribery and corruption

Following are certain bribery avoidance procedures which can be established:

(a) Efforts to combat corruption should start from the government. For this, the government could penalise organisations (by charging them of criminal liability) as well as individuals involved in bribery and corruption.

(b) Entities can establish a corporate code of ethics, which would include measures to combat corruption. For example, the code should prohibit employees from accepting hospitality and gifts, prohibition of donations to political parties, etc.

(c) Entities can imbibe values, ethics and culture within the entity as ethically sound decisions form the basis of good corporate governance practices. For this, it is important that the top management is totally committed to following the code of ethics and not indulging in bribery and corruption.

(d) Entities can include training programmes for staff where the ills of bribery and corruption and the penalties imposed on employees indulging in such practices are clarified.

(e) Periodic anti-bribery audits can be conducted by the internal auditors.

(f) Establishment of bureau for combating corruption.

2.5 Prevention and Combating of Corruption Act, 2007

The Prevention of Corruption Act, 1971 of Tanzania was repealed and replaced by the now operative Prevention and Combating of Corruption Act of 2007 which came into effect on 20 June 2007.

The Prevention and Combating of Corruption Act, 2007 is a law against corruption and has taken into account both preventive and enforcement measures against corruption. It provides a legal framework to combat corruption.

Corruption in procurement involves several actors from both private and public sectors who take decisions based on their own rather than public interests.

Actors involved include public officials responsible for procurement management, politicians, bidders, supplies, contractors, and intermediaries who represent bidders. Corruption in procurement decreases the benefits that could have been delivered to citizens and thus hindering socio-economic development and growth, lowers trust and confidence in Government.

Sections 15 to 39 of the Act give various examples of corruption and related offences. Some offences under the act along with their penalties are discussed below.

Sr. No	List of offences	Penalties
1.	**Corrupt transactions (Section 15)** Any person who corruptly by himself or in conjunction with any other person solicits, accepts or obtains, or attempts to obtain, from any person for himself or any other person, any advantage as an inducement commits an offence.	Liable to a fine of not less than five hundred thousand shillings but not more than one million shillings or to imprisonment for a term of not less than three years but not more than five years or to both.
2	**Corrupt transactions in contract (Section 16)** Any public official who solicits or accepts any advantage as an inducement to or reward for or otherwise on account of his giving assistance or using influence in, or having given assistance or used influence to assist in the promotion, execution or procuring of the payment of the price, consideration or other moneys stipulated or otherwise provided for in any contract commits an offence.	Liable to a fine of not less than one million shillings but not more than three million shillings or to imprisonment for a term of not less than three years but not more than five years or to both.

Continued on the next page

3	**Corrupt transactions in procurement (Section 17)** A public servant commits an offence if he: offers any advantage to another person as an inducement for or a reward for or otherwise on account of the withdrawal of a tender, or refraining from inviting a tender, for any contract with a public or private body for the performance of any work, the supply of service, the doing of anything or the supplying of any article, material of substance solicits or accepts any advantage as an inducement for or a reward for or otherwise on account of the withdrawal of a tender, or refraining from inviting a tender, for such a contract	Liable to a fine not exceeding fifteen million shillings or to imprisonment for a term not exceeding seven years or to both.
4	**Corrupt transactions in auctions (Section 18)** A public servant commits an offence if: offers any advantage to another person as an inducement to or reward for or otherwise on account of that other person's refraining or having refrained from bidding at an auction conducted by or on behalf of any public or private body; or solicits or accepts any advantage as an inducement to or reward for or otherwise on account of his refraining or having refrained from bidding at any auction conducted by or on behalf of any public or private body	Liable to a fine of not exceeding fifteen million shillings or to imprisonment for a term not exceeding seven years or to both.
5	**Corrupt transactions in employment (Section 20)** Any person who offers an advantage to another person as an inducement to or reward for or otherwise on account of such another person's giving assistance or using influence in or having given assistance or used influence to assist in obtaining employment, promotion or any other matter relating to employment commits an offence of corruption	Liable to a fine not exceeding five million or to imprisonment for a term not exceeding three years or to both.
6	**Bribery of foreign public official (Section 21)** Any foreign public official or an official of a public international organisation who intentionally solicits or accepts, directly or indirectly an undue advantage, for himself or another person or entity in order that he acts or refrains from acting in the exercise of his official duties, commits an offence.	Liable on conviction to a fine not exceeding ten million shillings or to imprisonment for a term not exceeding seven years or to both.
7	**Person obtaining advantage (Section 23)** A person who solicits, accepts or obtains or agrees to accept or attempts to obtain for himself or for any other person, any advantage without lawful consideration or for a lawful consideration which he knows or has reason to believe to be inadequate.	Liable on conviction to a fine not exceeding ten million shillings or to imprisonment for a term not exceeding seven years or to both.
8	**Sexual or any other favours (Section 25)** Any person being in a position of power or authority, who in the exercise of his authority, demands or imposes sexual favours or any other favour on any person as a condition for giving employment, a promotion, a right, a privilege or any preferential treatment, commits an offence.	liable on conviction to a fine not exceeding five million shillings or to imprisonment for a term not exceeding three years or to both.

Continued on the next page

9	**Public officials to give accounts of properties (Section 26)** Public official are required to give, within a specified time and in a specified manner, a full and true account of all or any class of properties which such public official or his agent possess or which he or his agent had in possession at any time during which the public official held any public office. If he does not give this in writing to the officer in Bureau, he commits an offence.	Liable on conviction to a fine not exceeding five million shillings or to imprisonment for a term not exceeding three years or to both.
10	**Possession of unexplained property (Section 27)** A person commits an offence who, being or having been a public official: maintains a standard of living above that which is commensurate with his present or past lawful income; owns property disproportionate to his present or past lawful income, unless he gives a satisfactory explanation to the court as to how he was able to maintain such a standard of living or how such property came under his ownership.	Liable on conviction to a fine not exceeding ten million shillings or to imprisonment for a term not exceeding seven years or to both. The court shall, in addition to the penalty order the confiscation of any pecuniary gain or property.
11	**Embezzlement and misappropriation (Section 28)** A person being a public official who dishonestly or fraudulently misappropriates or otherwise converts for his own use any property entrusted to him or under his control as a public official or allows any other person to do so, commits an offence.	Liable on conviction to a fine not exceeding ten million shillings or to imprisonment for a term not exceeding seven years or to both. The court shall, in addition to the penalty order the confiscation of any pecuniary gain or property.
12	**Diversion (Section 29)** Any person being a public official or not who diverts, for the purposes unrelated to those for which they were intended, for his or her own benefit or that of a third party any property belonging to the Government or its agencies to an independent agent, or to an individual, which property that official has received by virtue of his position, commits an offence.	Liable on conviction to a fine not exceeding two million shillings or to imprisonment for a term not exceeding two years or to both.
13	**Abuse of position (Section 31)** Any person who intentionally abuses his position in the performance or failure to perform an act, in violation of law, in the discharge of his functions or use of position for the purpose of obtaining an undue advantage for himself or for another person or entity, commits an offence.	Liable on conviction to a fine not exceeding five million shillings or to imprisonment for a term not exceeding three years or to both.
14	**Trading in influence (Section 33)** Any public official or any other person who directly or indirectly solicits or accepts an undue advantage for himself or for another person in order that such public official or the other person abuse his real or supposed influence with a view to obtaining from an administration or a public authority an undue advantage, commits an offence.	Liable on conviction to a fine not exceeding three million shillings or to imprisonment for a term not exceeding two years or to both.

2.6 Public procurement Act 2004

The Public Procurement Regulatory Authority (PPRA) is a regulatory body established under the Public Procurement Act 2004.The Authority is charged with regulatory functions and vested with oversight powers and responsibilities on all public procurement activities carried by all public bodies in the mainland Tanzania.

The objectives of PPRA are to ensure the application of fair, competitive, transparent, non-discriminatory and value for money procurement standards and practices; harmonize the procurement systems in Tanzania between the local and central governments; set standards for the public procurement systems in Tanzania; monitor compliance of procuring entities; and build procurement capacity in the country.

The public procurement Act 2004 prohibits public entities and public officials from certain activities which detriment the public interest. These prohibitions are discussed:

> No procuring entity, member of an approving authority or any public officer or other Government authority shall accept a gratuity in any form, any offer of employment or any other thing, service or value as an inducement with respect to an act or decision of, or procedure followed by, the procuring entity or by the approving authority in connection with any procurement proceedings or tender;, and a procuring entity shall promptly reject a tender of any supplier, contractor or consultant who gives, agrees to give or offers, directly or indirectly, any such inducement.
>
> Procurement shall not be made from a public officer or associate of a public officer acting in a private capacity, either alone or as a partner in a partnership or as an officer of a company.
>
> Any member of an approving authority or a member of its staff or of a procuring entity or member of staff of a procuring entity shall declare any interest that he may have in any supplier, contractor or consultant, and shall take no part, nor seek to influence in any way, procurement proceedings in which that supplier, contractor or consultant is involved or liable to become involved

Penalty

If any public servant connives or colludes to commit a fraudulent act is liable to a fine not exceeding five hundred thousand shillings or to imprisonment for a term not exceeding three years or to both fine and imprisonment.

Test Yourself 2

Which of the following statements is incorrect with reference to the code of ethics and conduct for public services?

(i) A public servant shall be courteous to senior and fellow employees as well as to all clients, and particularly to the clients being served.

(ii) An employee will maintain personal hygiene, dress in respectable attire in accordance with the acceptable norms of the office as stipulated in staff circulars.

A Only (i)
B Only (ii)
C Both (i) and (ii)
D Neither (i) nor (ii)

Answers to Test Yourself

Answer to TY 1

The correct option is **D**.

'Acting in the public interest' means

taking decisions which serve the interest of the maximum number of persons
acting in the interest/welfare of the public
upholding human rights.

Answer to TY 2

The correct option is **D.**

Both the statements are correct with reference to the code of ethics and conduct for public service in Tanzania.

Self Examination Questions

Question 1

Which of the following incidences are not in public interest?

i. A senior employee reports serious weakness in the control systems of the company to the board of directors.
ii. An accountant discloses confidential information relating to the company to his friend.
iii. An auditor disclosed the fraud in the financial statement
iv. The financial statements prepared by an accountant are not in accordance with the local GAAP.
v. An employee reports the malpractices carried out in the purchase department of the organisation to the HR manager.
vi. The board of directors does not disclose the rights issue (issue of new shares for cash; offered to the existing shareholders as a right) to the shareholders in the AGM
vii. An employee who acted as a whistleblower is terminated from his job.
viii. An employee employed in the mining industry reports certain hazardous practices within the entity, to the press.

A (i), (ii) ,(iii) and (iv)
B (ii), (iv), (vi) ,and (vii)
C (i), (iii), (vi) and (vii)
D (v), (vi) , (vii) and (viii)

Question 2

Define the following terms in brief:

(i) Public interest
(ii) Ethics

Question 3

Which of the following is not stipulated in Code of ethics and conduct for the public service Tanzania?

A Respect all human rights and be courteous
B Perform diligently and in a disciplined manner
C Promote team work
D Promote government services over private services

Answers to Self Examination Questions

Answer to SEQ 1

The correct option is **B**.

Points mentioned under (ii), (iv), (vi) and (viii) are not in the public interest as

(ii) Relates to disclosing confidential information about the entity
(iv) Involves not adhering to the accounting standards
(vi) and (vii) relate to the failure to disclose information which would cause damage or losses to the public.

Answer to SEQ 2

(i) Public interest

The public interest refers to the general well-being of public.

Therefore 'acting in public interest' means

Acting in the interest / welfare of the public.

Taking decisions which serve the interest of the maximum number of persons.

Upholding human rights.

(ii) Ethics

Ethics can be defined as abiding by a set of written and unwritten rules based on both legality and morality:

Legality, because ethics involves obeying the laws of a country,
Morality, because ethics involves doing what a society believes is just and correct. It includes non-legal regulatory compliances like obeying the rules of the work place.

Answer to SEQ 3

The correct option is **D.**

Except option D, all other options are included in code of conduct for public services in Tanzania.

SECTION A

ACCOUNTING FOR PUBLIC SECTOR

A15

STUDY GUIDE A15: TERMINAL BENEFITS AND PENSION CALCULATIONS

Get Through Intro

Employers offer benefits that can be enjoyed by employees during the period commencing from the completion of the employee's service. These benefits are offered as a part of the remuneration package.

Both public and private servants have the obligation to contribute to defined pension funds so that upon termination of their employment, on retirement (voluntary) after qualifying years of service, on compulsory retirement, on health grounds ,on total or permanent disability or for Public interest, may be compensated for the well-being for the rest of their lives.

In this Study Guide, we shall discuss the pension funds operating in Tanzania, relevant regulations and the different categories of employment benefits.

Learning Outcomes

a) Explain terminal benefits and pensions.
b) State relevant pensions in Tanzania.
c) Explain the acts, rules and regulations governing employment benefits in Tanzania and their applicability.
d) Identify types of the pensions funds in Tanzania.
e) Explain the functions and services of pensions funds.
f) Explain the pension management and procedures.
g) j) Explain the challenges facing pensions funds management in Tanzania.
k) Explain the role of Social Security Regulatory Authority (SSRA) in sorting out pension fund challenges in Tanzania.
k) Explain scope, relevance and applicability of IPSASs 25 – (Employment Benefits) in Tanzania.
l) Explain the categories of employment benefits and their relevance in Tanzania environment.

1. Explain terminal benefits and pensions.
State relevant pensions in Tanzania.
[Learning Outcomes a and b]

1.1 Terminal benefits

Definition

Terminal benefits are the payments which the employee is entitled to on account of termination of the employment contract.

The termination of the contract may be due to various reasons such as

(a) entity's decision to terminate an employment on account of disciplinary or other reasons
(b) employee's decision to accept voluntary redundancy in exchange for some benefits
(c) early retirement on medical grounds etc.

Section 44 of the Employment and Labour Relations Act, 2004 provides for payment of the following by the employer to the employee upon termination of the employment contract

(a) Remuneration for work done before termination
(b) Annual leave pay due to an employee for leave that employee has not taken
(c) Annual leave pay accrued during any incomplete leave cycle
(d) Any notice pay due
(e) Any severance pays due if an employee qualifies for this
(f) Transport allowance that may be due

On termination, the employer shall issue to an employee a prescribed certificate of service.

Example

Mr.Mashaka is employed with MDHInc. and has 10 years of service left for retirement. On medical grounds he has requested the organisation to relieve him of his duties with immediate effect.

Mr.Mashaka is entitled to all accrued benefits i.e. terminal benefits up to the date of service.

1.2 Pension

Definition

Pension is a statutory payment to be made to retired servants who prior to retirement were serving on permanent and pensionable terms with the Government of the United Republic of Tanzania.

Government pays pension on the basis of the Public Service Retirement Benefit Act No 2 of 1999.

1.3 Relevant Pensions in Tanzania

Funds are responsible for the payment of eight kinds of benefits to its beneficiaries as shown below:

(a) Old age benefits
(b) Survivor benefits
(c) Death gratuity
(d) Sickness benefits
(e) Invalidity benefits
(f) Withdraw (due to marriage, maternity, and giving birth)
(g) Withdraw (due to Emigration/unemployment)
(h) Funeral benefits

The laws applicable to each type of pension fund specify the benefits payable by the fund.

The local authorities pension fund established under The Local Authorities Pension Fund Act, 2006 provides for the following classes benefits which shall be payable under the fund:

(a) Retirement pension
(b) Survivorship benefits
(c) Invalidity pension
(d) Withdrawal in respect of marriage
(e) Withdrawal in respect of emigration or unemployment
(f) Maternity benefits
(g) Sickness benefit
(h) Funeral grant
(i) Education grant

Test Yourself 1

Mr. Simba is opting for a voluntary retirement package of his

employer. Will he be entitled to any benefits?

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2. Explain the acts, rules and regulations governing employment benefits in Tanzania and their applicability.

[Learning Outcome c]

2.1 Chronological development of pension funds

Tanzania had several social security funds towards the end of 2019. These included: the Government Employees Provident Fund (GEPF), the National Social Security Fund (NSSF), the Local Authorities Pension Fund (LAPF), PPF Pension Fund, and the Public Service Pension Fund (PSPF). In 2018, the government enacted a new law, the Public Service Social Security (PSSS) Act 2018, which joined all pension funds in Tanzania into two entities. The established entities are; the Public Service Social Security Fund (PSSSF) and the National Social Security Fund (NSSF) which are meant to serve all employees in the public and private sectors respectively.

Year	Establishment
1942	Government Employee Provident Fund (GEPF) - to provide for the benefits of government employees who are not eligible for pension. Such employees include those working under contracts and under operational service for the central government, independent government departments, executive agencies and donor financed government projects
1944	Local Authority Provident Fund (LAPF) - to create a single fund for all local authorities' employees in the then colonial Tanganyika.
1954	Civil Service Pension Scheme under the Pension Fund Ordinance CAP 371
1964	National Provident Fund (NPF) - by an Act of Parliament no. 36 of 1964 as a mandatory savings scheme to provide retirement income to private sector workers.
1978	(Parastatals Pension Fund) PPF - by an Act of Parliament with a purpose of providing pensions and other social security benefits to its members (Parastatals Organisations)
1997	The National Social Security Fund (NSSF) - by the National Social Security Fund Act No. 28 of 1997 after the transformation of the National Provident Fund (NPF). Its functions are to register employers and employees, collect contributions, account for the money collected, invest and pay out benefits to members, according to the provisions of the Act.
1999	Changing Civil Service Pension Scheme from non-contributory to contributory- formation of Public service Pension Fund (PSPF)
2002	Amendment in PPF to cover also private sector.
2003	The Social Security Policy is endorsed
2006	Formation of the Local Authorities Pension fund (LAPF)
2008	Enactment of the Social Security (Regulatory Authority) Act
2018	The Public Service Social Security (PSSS) Act

2.2 Acts rules and regulations governing employment benefits in Tanzania

1. Social Security (Regulatory Authority) Act No.8 of 2008

(a) This Act is intended to implement the National Social Security Policy of 2003.
(b) Generally, the Act deals with established mandatory schemes, and establishment of supplementary and private schemes. It introduces competition amongst mandatory schemes and mechanisms for the establishment of minimum benefits.
(c) The Act also introduces the indexation of benefits, portability of benefit rights of a member from one scheme to another and reviews of taxation policies after consultation with the Minister for Finance.

2. The Public Service Social Security (PSSS) Act, 2018

(a) The enactment of the PSSS Act 2018, repeals the Acts of all merged schemes, namely; the PPF Pension Fund, Public Service Pension Fund (PSPF), Local Authorities Pension Fund (LAPF) and Government Employees Provident Fund (GEPF) were repealed.
(b) The PSSS Fund takes over all the assets and liabilities, powers, rights, privileges, duties or obligations, as well as all the investments and legal entities incorporated under the former schemes. This includes the legal proceedings pending before any court or tribunal.
(c) The creates uniform set of rules, regulations and standards for the administration and payments of retirement pension's benefits for public service employees and private service employees on the other hand.
(d) Employees who move from the public sector to the private sector will have their pension membership changed to the National Social Security Fund (NSSF) while employees who are members of NSSF working in the public sector will move to the Public Service Social Security Fund (PSSSF).
(e) The Act has introduced survivor and unemployment benefits, a new provision that was not in the former pension funds.

3. The National Social Security Fund (NSSF)

(a) Pension scheme covering employees in the private sector.
(b) Some of the previous provident fund conditions were carried forward to the pension scheme and a member can still withdraw his/her contributions and accumulated interest, in case of unemployment.
(c) In terms of membership and income revenue, NSSF is the largest pension scheme in Tanzania; it has been extended to cover employees in the private sector (informal economy) on a voluntary membership basis. The contribution rate is 20 percent of gross salary, shared equally between employee and employer.

4. National Social Security Policy - 2003

In 2003, the Government developed the National Social Security Policy.

The policy identified the following three shortcomings in the current social security system:

(a) Fragmentation and lack of coordination; as a result, contribution rates, benefit structures, qualifying conditions as well as plans and priorities differ from one institution to another.

(b) Lack of Mechanism for Portability of Benefit Rights; there is no established mechanism that can allow benefit rights of a member to be transferred from one scheme to another.

(c) Inadequacy of benefits paid (number and meaningfulness); the number of benefits offered by most of the existing schemes fall below the ILO Minimum Standards in terms of number, quality and indexation to the current levels of earnings.

The objectives of the policy are:

(a) To widen the scope and coverage of social security services to all citizens.

(b) To harmonize social security schemes so as to eliminate the current fragmentation by rationalizing contribution rates and benefit structures.

(c) To reduce poverty through improved quality and quantity of benefits offered.

(d) To institute mechanisms for good governance and sustainability of social security institutions through establishment of a regulatory body.

(e) To establish social security structure that is consistent with ILO standards but with due regard to the socio-economic situation in the country.

(f) To ensure more transparency and involvement of social partners in decision making with respect to social security institutions.

Test Yourself 2

Match the following

S no.	Column A	S no.	Column B
1	National Social Security Fund (NSSF)	A	Serve all employees in the public sector
2	Public Service Social Security Fund (PSSSF)	B	Repealed the PPF Pensions Fund Act Cap 372; Public Service Retirement Benefit Act Cap 371; the GEPF Retirement Benefits Fund Act Cap 51; and the LAPF Pensions Fund Act Cap 407
3	The PSSS Act	C	Serve all employees in the private sector

3. Identify types of pension funds in Tanzania.
Explain the functions and services of pension funds.
[Learning Outcomes d and e]

3.1 Types of pension funds

Type of fund	Act and year of establishment	Membership	Benefits
Public Service Social Security Fund (PSSSF)	Act No. 2 of 2018	Employees & Employers From public sector	Retirement Pension Benefit, Survivors' Benefit, Invalidity Benefit, Maternity Benefit, Unemployment Benefit, Sickness Benefit, and Death Gratuity
National Social Security Fund (NSSF)	Act No. 28 of 1997	Employees & Employers From the private sector, self -employed, foreigners employed in Mainland Tanzania, international organization based in Mainland Tanzania, and any other category of persons that the Minister responsible for social security matters	Retirement Pension Benefit, Survivors' Benefit, Invalidity Benefit, Maternity Benefit, Unemployment Benefit, Sickness Benefit, and Death Gratuity

3.2 Functions and services of pension funds

Pension funds are the primary stakeholder(s) in the process of providing terminal benefits in Tanzania. The key functions include

1. Capturing of all the information/data of employees

The data required to join the schemes is obtained and recorded systematically. This information includes

cheque number
date of birth

date of first appointment
date of confirmation
date of admission to pensionable terms
indicative date of termination etc.

2. Assessment of the information/documents submitted

After the retirement forms/data sheet have been submitted to the Fund by an employer, then the operation officers start to scrutinize that information to see whether what was presented is correct and appropriate.

The scrutiny of the information submitted normally aims at checking if all relevant information are in place and sufficient to enable the Fund grant terminal benefits to the retiree.

If all the information submitted are correct and complete, preparations of the terminal benefits start right away. However, if some information is lacking queries will be raised which force the operation officer to communicate back with the Employer.

The employer is then required to submit that information so as to allow Terminal Benefits process to continue. Depending on the nature of the query, the terminal benefits will not be processed pending query reply.

3. Preparation of terminal benefits payment

The preparation of terminal benefits is done, when the employee's required information is complete and submitted. The computation result on the amount of lump sum (Commuted Pension Gratuity) payable soon after retirement and Monthly pension collected after every three months (i.e. collected 4 times a year) up to the date of death of a pensioner. Normally, the computations pass through internal checks within the fund before the cheque is prepared.

4. Processing of payment

When a retirement benefit cheque is ready, the Fund informs the employer and his/her official goes to the Fund to collect the cheque. Only this official is allowed to collect the cheque from the Fund. The cheque is then sent to the employer's office for the collection by the retiree.

5. To ensure that all contributors are fully registered

It is the function of the fund to ensure that all contributors are fully registered in terms of all information required by the statute.

Test Yourself 3

The traditional pension scheme (PPS) covers

A Gratuity
B Old age pension
C Education
D All of above

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4. Explain the pension management and procedures.

[Learning outcome f]

4.1 Participants in the pension management process

The various parties involved in the pension management process are

Government authorities in terms of enacting and administering laws and regulations
Pension funds
Employer - responsibility of reminding an employee on the date of retirement
Employees – should understand his terms of service and give notification to employer as required
Treasury
President's office – public service management

4.2 Pension management process

The steps involved in the pension management procedure are detailed below:

1. The employer is required to notify the employer six months before the retirement date through a written notification letter. The employer acknowledges the same.

2. The process of payment of terminal benefits starts with the expected retiree filling the forms and the employer submits them to PSPF/LAPF three months before the date of retirement.

3. The employer has to ensure that Retirement Benefits Application Forms have been filled correctly and appropriately, that is to ensure that all required information have been reported on the application form. Also, the employer has to ensure that all information is supported by documentary evidence.

4. The employer’s concerned personnel have to co-ordinate with the Pension Fund to ensure that all expected retirees’ payments are done. In case of any missing or improper filling of data sheets, this information is communicated to the concerned personnel.

5. On satisfactory scrutiny of documents by the fund, the terminal benefit payments are effected. There is through check by the Fund as explained in the preceding learning outcome.

6. When the retirement benefit cheque is ready, the employer is informed, the cheque collected and sent to the employer’s office for the collection by the retiree

7. The retiree is then informed about the cheque. He / she collects it and the payment cycle is complete.

4.3 Fund management by the pension fund

1. The sources of fund for a pension fund is from the

(a) Employer’s contribution

(b) Employee’s contribution

(c) moneys accrued from investments;

(d) such sums as may be given out by the Government for the purposes of the Fund;

(e) any sums borrowed by the Board in accordance with the provisions of this Act; and

(f) moneys from other sources such as grants and donations.

The employee’s contribution is deducted from the monthly salary / wages and for the employer part there is direct remittance by the Treasury. Further investment income accrues on the funds deployed.

2. The contributions to a pension scheme are employer – 15% and employee – 5% of the monthly salary. Both the contributions are to be remitted within 30 days after the end of each month.

3. The uses of the funds shall be for

(a) payment of benefits;

(b) investments of the Fund;

(c) administration of the Fund; and

(d) other uses as may be allowed for better administration of the Act

4. The funds so collected are invested by the fund according to the investment approved by the Board which it considers appropriate having regard to the economic and commercial viability.

Test Yourself 4

The contributions to PSSSF and NSSF are:

A Employer 15% of the monthly salary.
B Employee – 5% of the monthly salary
C Both a and b
D 10% by each

5. Explain the challenges facing pensions funds management in Tanzania.
Explain the role of Social Security Regulatory Authority (SSRA) in sorting out pension fund challenges in Tanzania.

[Learning Outcomes i and j]

5.1 Challenges facing pension fund management in Tanzania

There are several challenges encountered in the domain of pension fund management in Tanzania.

1. Fragmented legal and regulatory framework

The administration of each pension scheme in Tanzania was controlled by the respective Board of Directors. There was no uniform pension regulation in Tanzania Mainland. Schemes reported to different ministries: GEPF, PPF and PSPF report to the Ministry of Finance, NSSF to the Ministry of Labour, Employment and Youth Development and LAPF reports to the Prime Minister’s Office Regional Administration and Local Government. The establishment of the new Act was meant to address some of these challenges.

2. Excessive state intervention

In Tanzania it is well known that there are clear indications of excessive state intervention or interference. The government often controls the composition and appointment of governing boards, as well as public pension fund administrations, the management of funds and investment decisions.

3. Low social security coverage

The coverage of social security is shared between five public pension schemes, each providing for a specific population group. The national pension system in Tanzania has very limited coverage only 6.5% of the working population. This low coverage can partly be explained not only by major proportion of persons working in the informal economy, but also by low compliance and limited legislative coverage of some occupations in the informal economy.

4. Lack of equity in benefit formulas

The range of benefits provided varied from one scheme to another in the pension system (some schemes also offer short-term benefits not related to pensions) and there is no portability of benefits.

5. Problem of transferability of benefits across schemes

Due to lack of transferability of benefits across schemes there is adverse impact on workforce mobility especially in the context of a globalized work environment. In the present scenario, it is reasonable to expect a person to be covered by more than one pension scheme during his/her active life. If a beneficiary has moved between employment and thus pension schemes over his/her working life, this lack of portability of benefit rights results in him/her being eligible on retirement only to a number of low pension benefits, rather than the higher benefit that would have been available if the individual had remained in one scheme throughout. This problem get multiplied by the prevailing practice of allowing withdrawals of contributions when unemployed, that would lead to lesser or no pension entitlements at retirement.

6. Absence of indexation of benefits leading to the erosion of the purchasing power of pensioners

The social security schemes do not provide protection against erosion of purchasing power due to inflation.

Example

Mr. Fimbo retired 15 years ago. The current purchasing power is more than 60% lesser than what is was then. This leads to reduced purchasing power in the hands of the pensioner.

Indexing of pensions would provide workers with confidence in the benefits of the retirement component of the social security system. It acts as a shield against inflation. Without indexation, pensioners become poorer with age owing to the declining value of their fixed-income pensions. Preference for lump sums at retirement could also be partially explained by the lack of indexation.

7. Low awareness of social security services

The awareness of the benefits provided by social security schemes in Tanzania is low due to limited marketing efforts by the social security funds, the Government and the social partners. The members of the social security schemes are not fully aware of their pension rights especially regarding employment injury insurance and other forms of short-term benefits. Public education is essential. Schemes should formally notify members on a regular basis about their current status, contributions paid and their potential benefits

8. Lack of reliable data

Monitoring of the social security system effectively is not possible without adequate data about the contributors, pensioners and financial status of the social security schemes. The access to data is difficult in terms of availability, format and standardization. Data is frequently incomplete and has to be specially generated. Resources should be deployed to improve the quality of and access to data, to enable improved policy decisions, better investment outcomes and service delivery to beneficiaries through accurate and timely information.

9. Absence of uniform investments guidelines

The pension funds are established for different employment categories and have different government departmental regulators. Due to this, there are different regulatory conditions in each case and different investment guidelines

10. High operational costs

The administrative expenses were much higher in Tanzania as compared to other countries outside

Africa. Scheme Ratio of expenses to contributions

NSSF	20.3%
LAPF	18.8%
PPF	14.5%
PSPF	4.1%
GEPF	9.8%

5.2 Role of Social Security Regulatory Authority (SSRA) in sorting out pension fund challenges

With a view to address the challenges discussed earlier, SSRA has developed a medium term strategic plan with five objectives

1. Development of a conducive legal and regulatory framework to foster development of social security in the country

With a view to harmonise the legal and regulatory framework as well as identifying gaps and/or potential snags that could affect effective operationalization of reforms in the sector, during 2010-11 , the Authority embarked on reviewing the Social (Regulatory Authority) Act, No.8 of 2008 together with the five Acts that established the mandatory Social Schemes in mainland Tanzania. Currently the amendments are shared with stakeholders, Trade Unions, Employee Associations, Social Security Funds and the Government.

2. Increase social security coverage for the formal and informal sector

SSRA is working towards widening the scope and coverage of social security to cover both formal and informal sector.

3. Risk management and governance

SSRA's approach to risk is founded on robust corporate governance practices and a risk management culture, which guides all employees' behaviour and decisions. The Authority uses an Enterprise-wide Risk Management (ERM) framework for the identification, assessment, measurement and management of risk as articulated in its risk policy. The Authority's risk governance structure is comprised of the Board of Directors and it's Board Committees; the risk committee of the management; and the internal audit unit. During the period under review, the Board approved the Authority's risk management policy and risk management framework

4. Promotion of public relations and awareness to the stakeholders and the public at large

The Authority organized and conducted a number of awareness programs through TV and Radio programs. SSRA had opportunities to participate in members' conferences, Sabasaba, Nanenane, Public Service Week, and the 4th Trade Union Congress during which SSRA leveraged its expertise to offer clarification on social security matters.

5. Enhancing and harmonizing of members' benefits

The Authority in collaboration with the BOT, commissioned a comprehensive actuarial valuation of five mandatory schemes namely, GEPF, LAPF, NSSF, PPF and PSPF. The purpose of the valuation is to harmonize and improve the benefits structure to members of the Schemes as well as increase sustainability of the Social Security Funds.

Test Yourself 7

SSRA uses which approach framework for identification, assessment, measurement and management of risk as articulated in its risk policy.

A Balanced approach
B Enterprise-wide Risk Management (ERM)
C Socialistic approach
D Comprehensive

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7. Explain the categories of employment benefits and their relevance in Tanzania environment.
Explain scope, relevance and applicability of IPSASs 25 – (Employment Benefits) in Tanzania.

[Learning Outcomes k and l]

8.1 Categories of employment benefits and their relevance in Tanzania

Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees.

Employee benefits include:

1. Short-term employee benefits
2. Post-employment benefits
3. Other long-term employee benefits
4. Termination benefits

1. Short-term employee benefits

These are employee benefits (other than termination benefits) that are due to be settled within twelve months after the end of the period in which the employees render the related service.

Short-term employee benefits include

Wages, salaries, and social security contributions;

Short-term compensated absences (such as paid annual leave and paid sick leave) where the compensation for the absences is due to be settled within twelve months after the end of the period in which the employees render the related employee service;

Performance related bonuses and profit-sharing payable within twelve months after the end of the period in which the employees render the related service

Non-monetary benefits (such as medical care, housing, cars, and free or subsidized goods or services) for current employees

2. Post-employment benefits

Arrangements whereby an entity provides post-employment benefits are post-employment benefit plans. Post-employment benefits include

Retirement benefits, such as pensions

Other post-employment benefits, such as post-employment life insurance, and post-employment medical care

Post-employment benefit plans are either

(a) Defined contribution plans or
(b) Defined benefit plans

(a) Defined contribution plans

Definition

These are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

IAS 19 Para 8

Under a defined contribution plan the amount of liability of the entity towards post-retirement benefit is restricted to the fixed contributions to a separate entity or fund.

Example

Kitinga Ltd has a defined contribution plan with First Insurance Co. According to the terms of the scheme, Kitinga Ltd has to pay a monthly fixed amount of Tshs320,000 per employee per month to First Insurance Co. First Insurance will then invest this in assets which it hopes will increase the value of the overall plan in the future. The liability of Kitinga Ltd is still restricted to a fixed amount – Tshs320,000 per month. This is a defined contribution scheme.

Furthermore, the amount of post-employment benefits received by the employee depends on the contributions paid by the entity and the employee (if any) to a post-employment benefit plan or to an insurance company, together with any investment returns arising from the contributions made.

Example

Continuing from the above example of Kitinga Ltd

After seven years of operation of the scheme, Mr. Victor retires. The amount of post-employment benefit received by him is related to the value of the fund created by the contributions made by Kitinga Ltd on his behalf, plus the returns on investments (if any) made by First Insurance Co.

Therefore the actuarial risk and investment risks rest fully with the employee.

(b) Defined benefit plan

Under defined benefit plans:

The entity's obligation is to provide the agreed benefits to current and former employees

Actuarial risk and investment risk fall, in substance, on the entity. If actuarial or investment experience is worse than expected, the entity's obligation may be increased.

Generally, the amount of retirement benefits is calculated as a formula using

The earnings of the employee and

The number of years of service of the employee

Example

Zanaki Ltd has a defined benefit plan, to offer post-retirement benefits to its employees. According to the arrangement, the amount of post-retirement benefit offered is Tshs120,000 per month for each year of completed service. If Mr. Mjanja retires after 30 years of service, the pension payable to him would be Tshs3,600,000 per month for his lifetime.

To ensure that the pre-determined amount is offered at the time of retirement, the amount of contribution Zanaki makes to the fund will not be fixed. It will change depending on the present value of the postretirement benefit fund.

Here the actual return on investments of the fund will have no bearing on the pension paid to Mr. Mjanja. Even if the fund has received a poor return on its investments Zanaki Ltd will still be bound to pay the pre-determined amount to Mr. Jengo. This will be done by Moonlight having to make additional contributions to the fund.

The amount of promised retirement benefits depend on

The financial position of the plan (the value of the assets in the plan or fund)

Ability of contributors to make future contributions

Investment performance and efficiency of the plan

The periodic advice of an actuary will be needed to assess the financial condition of the plan, review the assumptions and recommend future contribution levels.

3. Other long-term employee benefits

Other long-term employee benefits may include, for example

Long-term compensated absences such as long service or sabbatical leave

Jubilee or other long service benefits

Long-term disability benefits

Bonuses and profit sharing payable twelve months or more after the end of the period in which the employees render the related service

Deferred compensation paid twelve months or more after the end of the period in which it is earned

Compensation payable by the entity until an individual enters new employment.

4. Termination benefits

These are employee benefits payable as a result of either an entity's decision to terminate an employee's employment before the normal retirement date; or an employee's decision to accept voluntary redundancy in exchange for those benefits.

The event which gives rise to an obligation is the termination rather than employee service. Therefore, an entity should recognize termination benefits when, and only when, the entity is demonstrably committed to either:

(a) Terminate the employment of an employee or group of employees before the normal retirement date; or

(b) Provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

An entity is demonstrably committed to a termination when, and only when, the entity has a detailed formal plan (with specified minimum contents) for the termination and is without realistic possibility of withdrawal.

Where termination benefits fall due more than 12 months after the reporting date, they should be discounted. In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits should be based on the number of employees expected to accept the offer.

8.2 Scope, Relevance and applicability of IPSAS 25

International Public Sector Accounting Standard (IPSAS) - 25 on Employee Benefits is based on International Accounting Standard (IAS) – 19. The objective of this Standard is to prescribe the accounting and disclosure for employee benefits.

1. Scope and applicability

This Standard applies to all public sector entities other than Government Business Enterprises.

(a) The standard is to be applied by an employer in accounting for all employee benefit costs except share based transactions. An employee may provide services to an entity on a full-time, part-time, permanent, casual, or temporary basis. For the purpose of this Standard, employees include key management personnel

(b) It does not deal with reporting by employee retirement benefit plans and benefits provided by composite social security programs that are not consideration in exchange for service rendered by employees or past employees of public sector entities.

(c) The employee benefits to which this Standard applies include those provided

Under formal plans or other formal agreements between an entity and individual employees, groups of employees, or their representatives

Under legislative requirements, or through industry arrangements, whereby entities are required to contribute to national, state, industry, or other multi-employer plans, or where entities are required to contribute to the composite social security program; or by those informal practices that give rise to a constructive obligation.

2. Recognition and summary of provisions

(a) The standard requires an entity to **recognise**

A liability when an employee has provided service in exchange for employee benefits to be paid in the future

An expense when the entity consumes the economic benefits or service potential arising from service provided by an employee in exchange for employee benefits

(b) The principle of the standard centers around the requirement to recognize the cost of providing employee benefits in the period in which the benefit is earned by the employee, rather than when it is paid or payable.

(c) Current service cost is the increase in the present value of the defined benefit obligation resulting from employee service in the current period.

(d) An entity shall measure the expected cost of accumulating compensated absences as the additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the reporting date.

(e) Bonus payments and profit-sharing payments are to be recognised only when the entity has a legal or constructive obligation to pay them and the obligation can be reliably estimated.

(f) Post-retirement benefits

(i) Defined contribution plans - expenses are recognised in the period the contribution is payable. Accrued expenses, after deducting any contribution already paid, are recognised as a liability.

(ii) Defined benefit plans, a liability is recognised in the statement of financial position equal to the net total of:

The present value of the defined benefit obligation (the present value of expected future payments required to settle the obligation resulting from employee service in the current and prior periods)

Plus any deferred actuarial gains minus any deferred actuarial losses minus any deferred past service costs

Minus the fair value of any plan assets at the reporting date

(g) Actuarial gains and losses may be (a) recognised immediately in surplus or deficit, (b) deferred up to a maximum, with any excess amortised in surplus or deficit (the “corridor approach”), or (c) recognised immediately directly in net assets/equity (in the statement of changes in net assets/equity).

(h) Gains or losses on the curtailment or settlement of a defined benefit plan may be recognized when the curtailment or settlement occurs. However, before determining the effect of a curtailment or settlement, an entity shall re-measure the obligation using current actuarial assumptions.

(i) Plan assets include assets held by a long-term employee benefit fund and qualifying insurance policies.

(j) For group plans, the net cost is recognised in the separate financial statements of the entity that is legally the sponsoring employer unless a contractual agreement or stated policy for allocating the cost exists.

(k) Long-term employee benefits shall be recognised and measured the same way as post-employment benefits under a defined benefit plan. Unlike defined benefit plans, actuarial gains or losses and past service costs must always be recognised immediately in earnings.

(l) Termination benefits shall be recognised as a liability and an expense when the entity is demonstrably committed to terminate the employment of one or more employees before the normal retirement date or to provide termination benefits as a result of an offer made to encourage voluntary redundancy.

(m) An entity may pay insurance premiums to fund a post-employment benefit plan. The entity shall treat such a plan as a defined contribution plan unless the entity will have (either directly or indirectly through the plan) a legal or constructive obligation to either

Pay the employee benefits directly when they fall due

Pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods

(n) If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan.

(o) On first adopting this IPSAS

(i) An entity shall determine its initial liability for defined benefit plans at that date as

The present value of the obligations at the date of adoption

Minus the fair value, at the date of adoption, of plan assets out of which the obligations are to be settled directly

Minus any past service cost that shall be recognised in later periods

(ii) The entity shall not split the cumulative actuarial gains and losses. All cumulative actuarial gains and losses shall be recognised in opening accumulated surpluses or deficits.

Test Yourself 8

Post-Retirement benefits include

A Pension
B Post-employment medical care
C Long service benefits
D A and B

Answers to Test Yourself

Answer to TY 1

Yes, Mr. Simba is entitled to terminal benefits that all the entitlements that pertain to his period of service.

Answer to TY 2

1. C
2. A
3. B

Answer to TY 3

The correct option is **D**.

Answer to TY 4

The correct option is **C**.

Answer to TY 5

The correct option is **B**.

Answer to TY 6

The correct option is **D**.

Self Examination Questions

Question 1

Fill in the blank space

______________________________ is the increase in the present value of the defined benefit obligation resulting from employee service in the current period.

Question 2

What are the challenges facing pension management in Tanzania?

Answers to Self Examination Question

Answer to SEQ 1

1. Current service cost

Answer to SEQ 2

Pension management in Tanzania is faced with multiple challenges, while some originate from the state and related regulations, others are caused by local problems and fund features.

1. Lack of uniform pension regulation in Tanzania with different schemes report to different ministries

2. There is excessive state intervention with control by government on composition, management etc.

3. The coverage of social security is shared between five public pension schemes, each providing for a specific population group. The national pension system in Tanzania has very limited coverage only 6.5% of the working population.

4. There is a constraint on transferability of benefits across schemes, due to which there is an adverse impact on workforce mobility especially in the context of a globalized work environment.

5. Absence of indexation of benefits leading to the erosion of the purchasing power of pensioners.

6. The awareness of the benefits provided by social security schemes in Tanzania is low due to limited marketing efforts by the social security funds, the Government and the social partners. The members of the social security schemes are not fully aware of their pension rights especially regarding employment injury insurance and other forms of short-term benefits.

7. Due to in complete and unreliable data it is not possible to effectively supervise the social security system.

8. The investment guidelines vary from fund to fund

9. High operational costs as compared to other countries outside Africa

STUDY GUIDE A16: PRACTICAL ISSUES/CASE STUDIES ON ADOPTION OF IPSASS IN TANZANIA

Get Through Intro

Tanzania migrated to IFRSs, IPSASs and ISAs with effect from 1 July 2004 and therefore, every entity in the country, whether small or large, was required to prepare its financial statements in accordance with the IFRSs or IPSASs as the case may be. Public sector entities mostly use IPSAS in preparation of its financial statements.

IPSAS aim to improve the quality of general purpose financial reporting by public sector entities, leading to better informed assessments of the resource allocation decisions made by governments, thereby increasing transparency and accountability.

In this Study Guide we will look into application of some IPSAS at the local and central government level. This knowledge is essential in preparing the financial statements of a public sector entity.

Learning Outcomes

a) Overview of current status of adoption of IPSASs in Tanzania.
b) Apply IPSASs knowledge to explain the level of application of IPSASs in local government.
c) Apply accounting theory and practices to discuss level of applicability of IPSASs in central government.
d) Explain the challenges on valuation and convergence process
   i. Property, plant and equipment – as per IPSAS requirements
   ii. Inventories – as per IPSAS requirements
   iii. Accounting software and packages.

1. Overview of current status of adoption of IPSASs in Tanzania.
Apply IPSASs knowledge to explain the level of application of IPSASs in local government.
Apply accounting theory and practices to discuss level of applicability of IPSASs in central government.

[Learning Outcomes a, b and c]

1.1 Formulation of IPSAS's by Public Sector Committee

The Public Sector Committee (PSC) of the International Federation of Accountants formulates IPSAS. The preface to IPSAS explains:

(a) IPSAS are intended for national, regional and local governments and related government entities such as agencies, boards and commissions.

(b) At present such entities have diverse reporting practices and there are no authoritative international standards.

(c) IPSAS are authoritative requirements established by PSC to improve the quality of financial reporting in the public sector around the world.

(d) PSC addresses governmental needs by issuing and promoting benchmark guidance supported by education, research and dissemination.

(e) PSC's primary focus is ensuring that its pronouncements are consistent with those of the International Accounting Standards Committee.

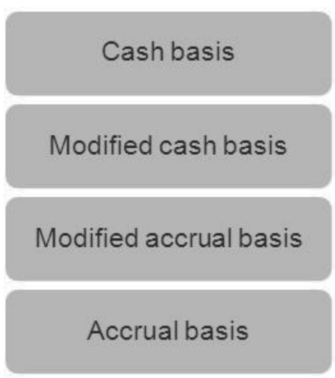
(f) PSC is concerned with "general purpose financial statements".

(g) IPSAS apply to the published financial statements of public sector entities except for government business entities which are to follow International Accounting Standards (IASs).

(h) IPSAS issued by the PSC do not over-ride statutory or other jurisdictional requirements, but PSC encourages governments and national standard-setters to adopt IPSAS.

PSC started work on the basis of four alternative accounting bases:

Diagram 1: Four bases on which PSC promulgated the standards



The cash and modified cash bases were defined as being practically the same (the only difference being that under the modified basis the books were left open for a period of months after the year end for the settlement of bills). The modified accrual and accrual basis differ principally in that the latter requires the capitalisation of fixed assets and their depreciation. PSC assumed that countries would evolve along a continuum between cash and full accruals.

However, support for the two modified bases was judged to be inadequate and the focus was shifted to two bases: cash and full accruals. Thus to comply with IPSAS a government must either use the cash or the full accruals basis for its principal general-purpose financial statements. Using the full accruals basis implies financial statements similar to those produced by large corporations.

PSC has produced one standard for the cash basis and other standards are based on accrual basis. The focus of PSC has been mainly on the accrual based IPSAS. For a government entity to be compliant with IPSAS its general-purpose financial statements are required to select either accrual based IPSAS or Cash based IPSAS and they must consolidate all the entities controlled by that entity.

1.2 Overview of current status of adoption of IPSASs in Tanzania

International Public Sector Accounting Standards (IPSAS) are accounting standards issued by IPSASB for application by national governments, regional (e.g., state, provincial, territorial) governments, local (e.g., city, town) governments and related governmental entities (e.g., agencies, boards and commissions). IPSAS standards are widely used by inter-governmental organisations. It should be noted that IPSAS do not apply to government business enterprises.

Tanzania migrated to IFRSs, IPSASs and ISAs with effect from 1st July, 2004 and therefore, every entity in the country, whether small or large, was required to prepare its financial statements in accordance with the IFRSs or IPSASs as the case may be.

The non-business enterprises including the Central Government - Ministries, Departments and Agencies (MDAs) and the Local Government Authorities (LGAs) adopted the International Public Sector Accounting Standards (IPSASs) from 2006 and 2009 respectively. Most of the MDAs used IPSAS- modified cash-basis while the LGAs used IPSASs accrual basis. In order to encourage adoption of accrual basis IPSAS for all the MDA’s, efforts were made since the financial year 2011-2012.

Diagram 2: Status of adoption of IPSAS in Tanzania

2004	• Tanzania migrated to IFRSs, IPSASs and ISAs
2006	• Ministries, Departments and Agencies (MDAs) adopted modified cash basis IPSAS
2009	• Local Government Authorities (LGAs) adopted accrual basis IPSAS
2011	• Efforts being made to encourage MDA's to adopt accrual basis IPSAS

1.3 Applicability of accounting theory and IPSAS in Central and Local Government in Tanzania

The Central Government of Tanzania, under the Accountant General (ACCGEN) has migrated to accrual based IPSAS for the year ended 30 June 2013. That means the Government financial statements are prepared on accrual basis. It is on the basis of such decision external audit of the financial statements for that period is conducted. Local Government Authorities and Government Business Enterprises are already complying with accrual based IPSAS.

The plan set by the Government of Tanzania is to be able to consolidate the Local Government Authorities and Government Business Enterprises from year 2015.

Test Yourself 1

Which body is responsible for the formulation of IPSAS?

A IFAC
B IASB
C CPA
D ACCA

2. Explain the challenges on valuation and convergence process
i. Property, plant and equipment – IPSAS 17
ii. Inventories – IPSAS 12
iii. Accounting software and packages.

[Learning Outcome d]

2.1 IPSAS 17: Property plant and equipment

IPSAS 17 applies to all public sector entities other than Government Business Enterprises (GBE's). GBE apply IFRS issued by IASB.

1. Heritage Assets

IPSAS 17 does not require an entity to recognise heritage assets that would otherwise meet the definition of, and recognition criteria for, property, plant, and equipment. If an entity does recognise heritage assets, it must apply the disclosure requirements of IPSAS 17 and may, but is not required to, apply the measurement requirements of this Standard.

Some assets are described as heritage assets because of their cultural, environmental, or historical significance.

Example

Examples of heritage assets include historical buildings and monuments, archaeological sites, conservation areas and nature reserves, and works of art

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Characteristics of heritage assets

(a) Their value in cultural, environmental, educational, and historical terms is unlikely to be fully reflected in a financial value based purely on a market price;

(b) Legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;

(c) They are often irreplaceable and their value may increase over time, even if their physical condition deteriorates; and

(d) It may be difficult to estimate their useful lives, which in some cases could be several hundred years.

Some heritage assets have future economic benefits or service potential other than their heritage value,

Example

For example a historic building being used for office accommodation will be treated as a heritage asset. In this case, it may be recognised and measured on the same basis as other items of property, plant, and equipment.

For other heritage assets, their future economic benefit or service potential is limited to their heritage characteristics,

Example

Examples of heritage assets include monuments and ruins. The existence of both future economic benefits and service potential can affect the choice of measurement base.

Disclosure of heritage assets

Entities that recognise heritage assets are required to disclose in respect of those assets such matters as, for example:

(a) The measurement basis used;

(b) The depreciation method used, if any;

(c) The gross carrying amount;

(d) The accumulated depreciation at the end of the period, if any; and

(e) A reconciliation of the carrying amount at the beginning and end of the period showing certain components thereof.

2. Infrastructure assets

Some assets are commonly described as infrastructure assets. While there is no universally accepted definition of infrastructure assets, these assets usually display some or all of the following characteristics:

(a) They are part of a system or network;
(b) They are specialised in nature and do not have alternative uses;
(c) They are immovable; and
(d) They may be subject to constraints on disposal

Although ownership of infrastructure assets is not confined to entities in the public sector, significant infrastructure assets are frequently found in the public sector. Infrastructure assets meet the definition of property, plant and equipment and should be accounted for in accordance with this Standard. Examples of infrastructure assets include road networks, sewer systems, water and power supply systems and communication networks.

Tip

Accounting for property, plant and equipment (PPE) is also covered under IAS 16. The principles given in IAS 16 apply to accounting for PPE under IPSAS 17. There is not much difference between IAS 16 and IPSAS 17. Students are advised to read Section F in Paper T05 to understand accounting for PPE.

3. Comparison of IPSAS 17 and IAS 16

The comparison between IPSAS 17 and IAS 16 will help you understand the areas where these two standards differ. The following are the differences between the two standards:

(a) IPSAS 17 does not require or prohibit the recognition of heritage assets. An entity that recognises heritage assets is required to comply with the disclosure requirements of this Standard with respect to those heritage assets that have been recognised and may, but is not required to comply with other requirements of this Standard in respect of those heritage assets. IAS 16 does not have a similar exclusion.

(b) IAS 16 requires items of property, plant, and equipment to be initially measured at cost. IPSAS 17 states that where an item is acquired at no cost, or for a nominal cost, its cost is its fair value as at the date it is acquired.

(c) IAS 16 requires, where an enterprise adopts the revaluation model and carries items of property, plant, and equipment at revalued amounts, the equivalent historical cost amounts to be disclosed. This requirement is not included in IPSAS 17.

(d) Under IAS 16, revaluation increases and decreases may only be matched on an individual item basis. Under IPSAS 17, revaluation increases and decreases are offset on a class of asset basis.

(e) IPSAS 17 contains definitions of “impairment loss of a non-cash-generating asset” and “recoverable service amount.” IAS 16 does not contain these definitions.

(f) IPSAS 17 does not use the term “income,” which in IAS 16 has a broader meaning than the term “revenue.”

(g) IPSAS 17 contains Implementation Guidance on the frequency of revaluation of property, plant, and equipment. IAS 16 does not contain similar guidance.

4. Challenges faced on adoption of IPSAS 17

The major challenges faced on adoption of IPSAS 17 include:

(a) A lot of accounting data needs to be maintained for revaluation and impairment of assets. This will increase the complexity in accounting and will be time consuming.

(b) A regular physical verification exercise needs to be carried out and documented. This will be a time consuming process and difficult to do regularly at a country level.

(c) Depreciation rates and useful lives are required to be reviewed regularly. If this is not done this will lead to a large number of assets being fully depreciated but still in use.

(d) Asset register will require reconciliation to the general ledger. This is complex reconciliation and will require a lot of resources to undertake this reconciliation.

2.2 IPSAS 12: Inventory

IPSAS 12 applies to all public sector entities other than Government Business Enterprises (GBE’s). GBE’s apply IFRS issued by IASB.

1. Definition

Inventories encompass goods purchased and held for resale including, for example, merchandise purchased by an entity and held for resale, or land and other property held for sale. Inventories also encompass finished goods produced, or work-in-progress being produced, by the entity.

Inventories also include:

(a) materials and supplies awaiting use in the production process, and

(b) goods purchased or produced by an entity, which are for distribution to other parties for no charge or for a nominal charge, for example, educational books produced by a health authority for donation to schools.

2. Cost of Inventories of a service provider

In many public sector entities, inventories will relate to the provision of services rather than goods purchased and held for resale or goods manufactured for sale. In the case of a service provider, inventories include the costs of the service for which the entity has not yet recognised the related revenue.

(a) These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel and attributable overheads.

(b) The costs of labour not engaged in providing the service are not included.

(c) Labour and other costs relating to sales and general administrative personnel are not included, but are recognised as expenses in the period in which they are incurred.

(d) The cost of inventories of a service provider does not include surplus margins or non-attributable overheads that are often factored into prices charged by service providers

Example

Inventories in the public sector may include:

(a) Ammunition;
(b) Consumable stores;
(c) Maintenance materials;
(d) Spare parts for plant and equipment, other than those dealt with in standards on Property, Plant and Equipment;
(e) Strategic stockpiles (for example, energy reserves);
(f) Stocks of unissued currency;
(g) Postal service supplies held for sale (for example, stamps);
(h) Work-in-progress, including:
Educational/training course materials; and
Client services (for example, auditing services), where those services are sold at arm’s length prices; and
(i) Land/property held for sale

When a government maintains strategic stockpiles of various reserves, such as energy reserves (for example, oil), for use in emergency or other situations (for example, natural disasters or other civil defence emergencies), these stockpiles are recognised as inventories under IPSAS 12 and treated accordingly

3. Measurement of inventories under IPSAS 12

Inventories shall be measured at the lower of cost and net realisable value, except in the below two circumstances:

(a) Where inventories are acquired through a non-exchange transaction, their cost shall be measured at their fair value as at the date of acquisition.

(b) Inventories shall be measured at the lower of cost and current replacement cost where they are held for:

Distribution at no charge or for a nominal charge; or
Consumption in the production process of goods to be distributed at no charge or for a nominal charge.

4. Comparison between IPSAS 12 and IAS 2

IPSAS 12, Inventories is drawn primarily from IAS 2, Inventories (revised 2003). The main differences between IPSAS 12 and IAS 2 are as follows:

(a) IPSAS 12 uses a different definition from IAS 2; the difference recognises that in the public sector some inventories are distributed at no charge or for a nominal charge.

(b) IPSAS 12 clarifies that work-in-progress of services that are to be distributed for no or nominal consideration directly in return from the recipients is excluded from the scope of the Standard.

(c) A definition of current replacement cost, which is additional to the definitions in IAS 2, has been included in IPSAS 12.

(d) IPSAS 12 requires that where inventories are acquired through a non-exchange transaction, their cost is their fair value as at the date of acquisition.

(e) IPSAS 12 requires that where inventories are provided at no charge or for a nominal charge, they are to be valued at the lower of cost and current replacement cost.

(f) Commentary additional to that in IAS 2 has been included in IPSAS 12 to clarify the applicability of the standards to accounting by public sector entities.

(g) IPSAS 12 uses different terminology, in certain instances, from IAS 2. The most significant example is the use of the terms “statement of financial performance” in IPSAS 12. The equivalent term in IAS 2 is “income statement.”

(h) IPSAS 12 does not use the term “income,” which in IAS 2 has a broader meaning than the term “revenue.”

5. Challenges faced on adoption of IPSAS 12

(a) It is difficult to assess net realisable value or current replacement cost where services are distributed at nominal cost or no charge. Many times such services are valued at cost leading to incorrect valuation.

(b) Inventories face valuation choices and in some cases the cost of inventories is not clearly determinable.

(c) The volume of transactions and the quantity of inventory held by public sector enterprises are huge. This creates challenge in physical inspection and valuation.

(d) There is no single cost formula which can be applied and will change based on the nature of inventory being valued.

(e) Record keeping may be challenging at times as public enterprises carry large quantity of inventory.

2.3 Accounting software and packages

The implementation of IPSAS at central and local government will have the most significant impact on the accounting and financial reporting functions. This will further impact changes in people, processes and technology. We will focus on the impact of accounting software and packages that will be required to implement IPSAS and the challenges that will be faced in convergence. The extent of changes required to the existing accounting software and packages will depend on size and complexity of operations, the strategy for responding to IPSAS, existing infrastructure and the method of collecting financial data into the accounting system.

The challenges on valuation and convergence process due to the accounting software and packages chosen can be described as follows:

For IPSAS to be adopted in their right spirit, the accounting software will require extensive and detailed data to be recorded for proper accounting under IPSAS. This also means that the data recorded is properly valued.

Example

For example the property, plant and equipment needs to value per the market prices in case revaluation model is adopted.

It will be difficult to get tailor made software that suit requirements of the public sector entities and will require a lot of programming and changes in the rules engine to function effectively.

Availability of trained resources to implement the IPSAS in the new accounting system and to use it effectively is yet another challenge.

Changes to the chart of accounts based upon the differences between IPSAS and local GAAP. Also various templates used to record data will require changes in order to capture accounting data required to implement IPSAS.

Test Yourself 2

Under IPSAS 12, when inventories are distributed at no charge or for a nominal charge, inventories shall be measured at:

A lower of cost and net realisable value
B higher of cost and net realisable value
C lower of cost and current replacement cost
D higher of cost and current replacement cost

Answers to Test Yourself

Answer to TY 1

The correct option is **A**.

The Public Sector Committee (PSC) of the International Federation of Accountants formulates IPSAS.

Answer to TY 2

The correct option is **C**.

Under IPSAS 12, when inventories are distributed at no charge or for a nominal charge, inventories shall be measured at lower of cost and current replacement cost.

Self-Examination Questions

Question 1

Tanzania migrated to IPSAS, IFRS and ISA's in the year ______________.

A 2004
B 2006
C 2009
D 2011

Question 2

Which IPSAS deal with measurement of heritage assets?

A IPSAS 1
B IPSAS 2
C IPSAS 12
D IPSAS 17

Question 3

Explain in brief the characteristics of infrastructure assets.

Answers to Self Examination Questions

Answer to SEQ 1

The correct option is **A**.

Tanzania migrated to IPSAS, IFRS and ISA's in the year 2011.

Answer to SEQ 2

The correct option is **D**.

Heritage assets are required to be measured under IPSAS 17.

Answer to SEQ 3

Infrastructure assets usually display some or all of the following characteristics:

(a) They are part of a system or network;
(b) They are specialised in nature and do not have alternative uses;
(c) They are immovable; and
(d) They may be subject to constraints on disposal

SECTION A

ACCOUNTING FOR PUBLIC SECTOR

A17

STUDY GUIDE A17: CONCEPT OF PERFORMANCE MEASUREMENTS IN PUBLIC SECTOR

Get Through Intro

Performance measurement has become increasingly important in public sector organisations. These organisations are established for the purpose of working towards the welfare of the society and not for earning profits. A major part of the objectives of a public sector entity cannot be quantified in monetary terms. Their performance is measured on the basis of how well and efficiently they are able to achieve their objectives with the limited funds that are available to them.

This Study Guide explores the problems of having non-quantifiable objectives in performance measurement and discusses 'Value for Money' as a public sector objective. By studying this Study Guide, you will be able to understand the most appropriate performance measures for public sector organisations. The knowledge of these techniques will help you to appraise a public sector.

Learning Outcomes

a) Explain how performance is measured in public sector organisations and briefly discuss the difficulties of having non-quantifiable objectives in performance management.
b) Discuss the problems associated with the evaluation of performance of public sector organisations.
c) Explain how governmental regulations can affect the performance of public sector organisations.
d) Explain the Value for Money (VFM) as an objective of public sector.

1. Explain how performance is measured in public sector organisation and briefly discuss the difficulties of having non quantifiable objectives in performance management.
[Learning Outcome a]

1.1 Measurement of performance in public sector organisations

Performance measurement is an instrument for assessing progress against stated programme goals and objectives. The underlying assumption is that the strategic objectives are known and quantified.

In the case of profit-seeking organisations, the most common performance measurements are based on profitability such as return on capital employed, gross profit margin ratio and earnings per share. This is because the primary objective of profit-seeking organisations is to make profit and maximise the shareholders' wealth.

Public sector organisations, such as government departments, differ from commercial business organisations because their main objective is not to earn profit or maximise profit. The main objective of these organisations depends on the purpose for which it exists. For a government department the objective is to administer the country, for state run schools the objective is to provide best quality education, for a government hospital the objective is to provide medical services.

Since public sector organisations lack profit maximising objective, the financial performance measurements cannot be effectively used to measure their. However, the performance measurements for public sector organisations can be classified along the same lines, for example:

financial performance indicators such as cost per patient, cost per arrest (in case of police services)

non-financial performance indicators such as number of complaints received, number of operations carried out, mortality rate

qualitative performance indicators such as the behaviour of the employees of public sector companies, quality of service provided

In addition to these, the following measures can be used to evaluate the performance of public sector organisations:

1. Objective-based measures

In the case of public sector organisations, the primary objective of performance evaluation is to determine how well the organisation is fulfilling its objectives. Taking this into consideration, the criteria for measuring the performance of public sector organisations could be:

number of patients served (in a government hospital)
number of students using the service (in a government school)
quality of the service provided etc. (in a public sector bank)

Example

Examples of the objectives and performance measurements for a government run school are as follows:

Objectives	Measures
to provide education to the maximum number of students	number of students studying in the school
to offer a variety of courses / provide a broad education	number of courses offered
to educate students about information technology	number of computers made available
to have an impact on society	
to provide high quality education	number of students newly joined
to produce competent graduates	pass rate with grades
	number of graduates finding jobs and performing well, pass rate

Pass rate will show how well the objective of imparting education is served.

In order for these measures to be meaningful, they must be compared with similar internal or external activities, the results of similar organisations and with targets or trends over time.

Limited and uncontrollable funds are made available to public sector organisations and, as far as possible; they need to achieve their objectives using the available funds. Therefore optimum utilisation of resources is crucial for such organisations.

As a result, how well the resources are used to achieve the objectives can also be used as a measure for evaluating performance.

2. Input / output-based measures

Input, i.e. resources utilised, can be used as a measure for evaluating performance.

Example

The number of teachers recruited, the number of computers available, the variety of books available in the school library etc. can be used to measure the performance of a school.

Sometimes, output is used to measure performance.

Example

The pass rate and grades achieved, the number of graduates finding jobs etc.

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3. Stakeholders' satisfaction

Stakeholders' satisfaction should be one of the criteria for evaluating the performance of an organisation, whether or not it is profit-seeking.

In the case of public sector organisations, there are two main stakeholders whose satisfaction is given most importance in assessing the performance. These are:

- those receiving the benefits
- those providing the funds

Those receiving the benefits should be satisfied because this is the ultimate aim of the organisation. However, those who are providing funds (tax payers) are also important. This is because if they are not satisfied with the work of the organisation, they may stop providing finance. Therefore, in order to ensure that finance will continue to be provided or even increase, those providing the finance should be keep satisfied.

4. Balanced scorecard

Since in public sector organisations, the emphasis is on long-term value creation, a balanced scorecard is an appropriate measure for evaluating performance.

A balanced scorecard begins by defining the mission, outlining the strategies to achieve the mission, understanding the core customer requirements, defining the internal business process and assessing the organisational infrastructure needed to achieve the objectives.

The main concept behind the balanced scorecard is that no one measure can properly evaluate an organisation's progress to strategic success. Rather, multiple measures typically grouped in the following four key areas provide the desired comprehensive evaluation of the organisation's performance:

- customer satisfaction
- financial performance
- internal business process
- learning and growth

5. Value for money

This is discussed in detail in learning outcome (d). It is concerned with the three E's i.e. economy, efficiency and effectiveness. Economy refers to how wisely the funds are utilised, efficiency refers to how wisely the resources are used, i.e. maximising output input ratio, and effectiveness refers to how well the objectives are achieved.

6. Measures suggested by Anthony and Young

In their book, "Management Control in Non-profit Organisations", 6th Edition (Homewood, IL, Irwin, 1999), Richard Anthony and David Young, suggested that the performance public sector organisations can be assessed on the basis of the following three measures:

social indicators: assessing the impact of an organisation on the society as a whole
result measures: how well objectives are achieved (this is the same as the output-based method)
process / productivity measures: with reference to the activity carried out by the organisation e.g. the number of operations carried out (in the case of a hospital)

Example

The government of Tanzania has set up an organisation responsible for serving the health and educational needs of impoverished children in the country. While assessing the performance of the organisation, the following criteria can be used:

Social indicators: impact on society i.e. assessing whether the organisation's programmes are making a positive, measurable difference to the lives of children and their communities around the country e.g. providing health educating to the society.

Result measures: achieving the objectives i.e. how well the funds are utilised towards achieving the objectives and implementing the organisation's programmes e.g. a decrease in mortality rate.

Process / productivity measures: number of activities carried out to achieve the objectives i.e. how many programmes are conducted to create awareness about the health and education of children e.g. number of vaccination programmes carried out during the year.

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7. League table

A league table is a chart or list which is used to rank sports teams, institutions or companies in order of ability or achievement and facilitates comparison.

Example

School league tables are used to compare the academic achievements of different schools.

This is a modern technique used for evaluating the performance of public sector organisations.

8. Profitability ratios

Although performance measurements based on profitability are not so suitable for public sector organisations, to a certain extent and with certain modifications they can be used to assess performance. This is because even if the primary motive is not to earn profit, this does not mean that public sector organisations do not earn profits and therefore the profitability ratio can be used to assess performance.

Example

Any public sector organisation such as a school can use the profitability ratio. When doing this, it may use the word 'excess of income over expenditure' instead of net profit. This means that 'net profit margin ratio' is described as 'net excess of income over expenditure margin'. This is because, although these organisations are run for an objective other than making profit, they may earn some profit (e.g. by charging reasonable fees).

1.2 Difficulties of having non quantifiable objectives in performance management

Non-quantifiable objectives in performance management are the qualitative objectives that are difficult to be measured and to be expressed in quantitative / monetary terms. Moreover, public sector organisations tend to have multiple objectives. Accordingly, even if they can be clearly identified and measured it is difficult to say which one of the objectives is key to the organisation.

Non-quantifiable objectives may be expressed in general terms:

providing best possible service
meeting customer needs
maintaining high quality standard

However, too much subjectivity is involved in the assessment of the non-quantifiable objectives. An alternative approach to assess non-quantifiable objectives is to attempt to attribute values to each of the non-quantifiable objectives. Such an approach will necessitate the use of management estimates in order to derive the cash flows to be considered for each of the non-quantifiable objectives / factors for taking a decision.

One inherent problem in this approach is gaining consensus amongst interested parties regarding the basis of the assumptions on which estimated cash flows have been derived.

Alternatively the management of an organisation may express qualitative benefits in specific terms linked to a hierarchy of organisational requirements. Accordingly, non-quantifiable benefits may be categorised as follows:

essential to the business
very useful attributes
desirable, but not essential
possible, if funding is available
doubtful and difficult to justify

Such a categorisation may help management assign relative importance to each category of objectives and accordingly can take a decision based on the non-quantifiable factors alongside the quantifiable factors.

Test Yourself 1

List the non-financial quantitative and qualitative measures of performance in the case of a government run hospital.

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2. Discuss the problems associated with the evaluation of performance of public sector organisations.

[Learning Outcome b]

The following are the problems associated with the evaluation of performance of public sector organisations:

1. Problem in setting objectives (multiple objectives)

A public sector organisation may have multiple objectives because of which it is not possible to decide the primary objective. In the absence of a primary objective, it is difficult to assess the organisation's performance. This is because performance is generally evaluated on the basis of the objectives set i.e. how well the objectives have been achieved.

Example

Providing education to the maximum number of students, providing quality education, performing research into education and finding new ways of teaching etc. may be the objectives of a government school. However, it is difficult to identify any objective as the primary objective.

Generally, when the number of students to whom education is provided increases there is the possibility that the quality of the education may be affected. Therefore, if performance is evaluated based on the number of students, the evaluation will be different from the evaluation if performance had been assessed on the basis of the quality of the education provided

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To identify any performance parameter, it is necessary to know the primary objective of the organisation in measurable terms. In the absence of any such identifiable objective, it is difficult to decide the parameter and hence to evaluate the performance.

Even if the problem of multiple objectives is solved and one objective is identified, a problem arises when this objective is not quantifiable.

2. Non-quantitative objectives

When an organisation has non-quantitative objectives i.e. qualitative objectives, it becomes difficult to measure the objectives / output. This is because they are difficult to record, communicate and analyse.

Example

When providing the highest quality services to patients is the objective, it is difficult to measure what is the highest quality service.

Non-quantifiable objectives are often expressed in general terms:

- providing the best possible service
- meeting customer needs
- maintaining high quality standards

They are very subjective to the person evaluating and therefore can be biased. As a result, it is difficult to measure the performance.

Sometimes an attempt is made to express these qualitative objectives in quantitative relative terms i.e. by attributing values to them such as grades.

Example

The quality of education provided can be measured by assigning grades to the various attributes, e.g. practical implementation of the knowledge gained.

However, this is again judgemental and subjective.

Example

Continuing the above example

How the criteria should be decided, e.g. what level of practical implementation of knowledge a student has to exhibit in order to receive grade A, is a problem associated with assigning values.

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3. Lack of profit motive

When there is a profit motive, it is easy to compare the results of two organisations and draw conclusions about their performance. However, in the case of public sector organisations, in the absence of a profit motive, it is difficult to find a basis for comparison.

In addition, even if terms such as excess of income over expenditure etc. are used and profitability is calculated, since making profits is not an objective of these organisations, it will fail to evaluate their performance.

Example

Heartbeat is a government run cardiac care hospital. It is run with an objective other than making profit. However, it can achieve excess income over expenditure by charging reasonable fees to the patients and by obtaining funds from other sources such as donations.

In this case, even if the excess of income over expense of Heartbeat is compared with that of a profit-making organisation, the results will not be informative.

4. Objectives driven by the politics

The public sector organisations are the most affected by politics. This is because in such organisations, management has to utilise the government grant according to the conditions on which the grant is received. Therefore management is not free to decide how the grant is used. This may adversely affect the main objective of the organisation.

Example

Life-line is a government run hospital. The management of the hospital is interested in extending its research on cancer treatment. However, it cannot do so due to a lack of funds. The conditions of the grant state that the money the hospital receives should be used to treat as many patients as possible. In this way Life-line cannot pursue its desired activity i.e. cancer research.

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5. Cost over quality

When public sector organisations provide goods / services, it is expected that the organisations should charge very low prices. However, in order to keep the prices at a minimum, the organisation may need to compromise on quality.

Example

If the performance measure is fees charged per student, the management of a school is pressurised to keep its costs at a minimum. This may result in curtailing expenditure on essential resources such as library books, gardening equipment, and computers, which may adversely affect the quality of education provided.

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6. Desire to measure on input basis

Often employment generation, resources employed etc. are used as measures for performance evaluation. However, this may lead to inefficiency in the services provided. This is because in order to meet the criterion additional staff may be employed even if the work could be managed with fewer staff.

Example

If the number of nurses in a government hospital is the criteria for assessing the performance of the hospital, more nurses may be employed even if they are not required and these nurses may not work efficiently.

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7. Serving non-priority sectors

This is one of the objectives of public sector organisations. Organisations working in the public sector are expected to provide services to those sectors which would not have been chosen if profitability were the criterion. On the other hand, if profitability were the objective, these organisations would not provide services which are essential but not profitable.

Example

The political priority for a public transport company may be to run vehicles on routes which are not profitable but are necessary in order to benefit underprivileged people.

However, if the performance of the company is measured in terms of profitability, there is the possibility that the corporation may stop running vehicles on unprofitable routes.

In addition, politics may affect the service outcome of an organisation by affecting the availability of funds. Funds may be provided to an organisation which is closely linked to the government, without assessing the organisation’s funding requirements.

When a government grant is the major source of income for an organisation, there is the possibility that the management objective of the organisation will be politically driven rather than necessity driven.
Moreover, political parties may only provide funds to organisations in which they are interested.

Example

In a country, the government has declared that the budget for spending on public sector organisations has increased by 20%. Accordingly, an organisation plans for development and the available funds are diverted towards development. However, although funds are given to a few organisations which are favoured by the leading political party, the organisation doesn't receive the funds it expects.

In this case, the services that the organisation will provide will be affected.

Test Yourself 2

Write a short note on the multiple objectives of public sector organisations.

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3. Explain how governmental regulations can affect the performance of public sector organisations.

[Learning Outcome c]

In the case of organisations which are owned or regulated by the government, financial performance indicators and non-financial performance indicators are equally important. The primary aim of the government for owing / regulating these organisations is the benefit of society.

This gives the profitability objective second preference. Rather than earning profit by increasing prices the government regulates prices and does not allow them to exceed a certain limit so that everyone can afford the product.

Government regulates these organisations by:

- regulating prices
- regulating quality
- regulating sale of goods / services
- concessional policies i.e. rewards and incentives provided by government
- funding
- monopoly
- other regulations such as for promotion of specific geographical area etc.

These government regulations affect the public sector organisations in the following ways:

1. Regulating prices

Generally, in the case of public utilities or state monopolies, a limit is set on the prices of the goods / services provided by them. They are not allowed to sell above a certain limit. This will obviously have influence on the performance of those organisations.

Example

In Tanzania, prices for the provision of gas, electricity, petroleum and water are controlled by Energy and Water Utilities Regulatory Authority (EWURA). EWURA is an autonomous multi-sectoral regulatory authority established by the Energy and Water Utilities Regulatory Authority Act, Cap 414 of the laws of Tanzania. It ensures that the monopolistic market of gas, electricity, petroleum and water do not take advantage of their position. However, this adversely affects the performance of these organisations since, if they were free to set the prices, they could have earned a handsome profit.

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2. Regulating quality

There are certain goods / services for which quality is of prime concern. In such cases, the government controls the quality.

Example

The government is the main provider of education in Tanzania. This may be viewed as a monopoly. The issue of quality surrounding education is paramount.

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3. Regulating sale of goods / services

In many cases, government regulation requires that a certain share of the sale should be made to a particular sector.

Example

In the case of banks / financial institutes regulated by the government, the government may have policy that a percentage of loans should be made for the development of particular (underdeveloped) sector, e.g. agriculture. This affects the performance of an organisation. This is because there is a higher possibility that a borrower from this sector would turn out to be a defaulter.

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4. Concessional policies

Since utilities provide infrastructure and essential services, government may give assistance to these organisations. This has an impact on the performance of the organisation.

Example

The government may implement a road congestion charge, to reduce the level of pollution in the city. It may offer a concession on this charge to allow low-emission vehicles such as, LPG or electric vehicles to travel free.

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5. Funding

The performance of an organisation may be affected on account of insufficient funds. In the case of state monopolies it is very easy to raise funds from the government but this option is not available to other private sector organisations.

Example

Government may offer a range of grants to influence consumer behaviour. An example is the financial support provided to “green” sources of energy such as Wind Powered Turbines and other clean energy.

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6. Privatisation

This refers to the removal of barriers on the entry of private parties into particular industries, or transferring the assets of government entities to private individuals. This policy has a major impact on the profitability of the former state monopolies. This is because the more the competition, the lower the profitability.

In many countries nowadays, competition is also allowed in the utilities industry. This legislative change will affect the performance of the utilities.

7. Other regulations

These include any regulations which promote a particular part of the country or any particular sector. In rural areas, there are few customers who therefore cannot provide high returns. As a result, an organisation may opt not to set up business there. However, in order to provide services to those areas, the government may have a regulation compelling them to provide services in such areas.

Test Yourself 3

Umeme Kwanza Plc is the only public utility providing electricity in a country and therefore it is a state monopoly. It generates, transmits and distributes electricity to the country. It is regulated by the government of the country.

Consumers are divided into classes of services or sectors (residential, commercial, industrial, and other) based on the type of service they receive and are charged accordingly.

However, the pricing policies of Umeme Kwanza are regulated by the government so that it cannot charge exorbitant prices. A price level is set for all the different classes of customer.

The government also forces the company to provide an uninterrupted power supply for 24 hours to all parts of the country. However, all parts of the country are not covered by the company. It has to make set up facilities in hilly areas and purchase additional machinery. For this purpose, government has agreed to subsidise the machines and provide lower interest rate funds for fitting. In return, Umeme Kwanza will provide disadvantaged people with electricity at reasonable rates.

Required:

Assess the impact of all these regulations on the performance of Umeme Kwanza.

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4. Explain the Value for Money (VFM) as an objective of public sector.
[Learning Outcome d]

The public sector organisations are currently under tremendous pressure to justify each of their actions in terms of economy, efficiency and effectiveness. Achieving value for money now assumes central place in every action plan and it is a continuous process of good governance.

In the absence of a profit measure, a public sector organisation requires an alternative focus to ensure that the funds are utilised in the best way and aimed towards achieving the objectives of the organisation. Value for money acts as such a measure. Value for money states that efforts must be made to ensure that the available funds are spent in a way that maximises the benefit to the users. This can be done through determining the economy, efficiency and effectiveness of the organisation's activities. There should be economy in using input; efficiency of the process (i.e. the input-output ratio) and effectiveness of the output i.e. impact on achieving the objectives.

Since not-for-profit organisations operate on limited, uncontrollable funds and have to achieve their objectives in the best possible manner using the available funds, value for money is best way of achieving this.

Diagram 1: Value for money

Economy: it implies the principle of prudence. It implies that the least possible cost should be incurred for acquiring / using resources, while maintaining the appropriate quality.

Efficiency: it implies the maximising of output input ratio i.e. per unit of input the output should be the most. It is concerned with the relationship between the resources (input) and the output of goods, services or other results. Ideally, minimum input should be used for a given output and maximum output should be achieved for a given input.

Effectiveness: it focuses on the achievement of the desired objectives through the spending of available funds. It is concerned with the relationship between the planned results and the actual results of projects, programmes or other activities. To what extent do the outputs of goods and services or other results successfully achieve policy objectives, operational goals and other planned effects?

The three measures may be in conflict with each other and may sometimes complement each other.

Example

Mshindi is responsible for the purchases in a public sector hospital which is run to serve the needy and not to make profit. Whenever a medicine is in short supply, a purchase request is sent to Mshindi. As soon as Mshindi receives the purchase request, he telephones a particular supplier on the list of approved suppliers and places an order for the medicine. The supplier assures 'next day delivery'.

Muhasibu is the newly appointed cost manager and she has noticed that, in certain invoices, the supplier has charged an additional Tsh1,000 for 'next day delivery'.

Muhasibu wants to evaluate the matter in the context of value for money.

Value for money (VFM) is continually associated with the achievement of the 3 E's i.e. effectiveness, efficiency and economy in operations.

Effectiveness

Being effective means getting the work done. Mshindi is very effective in the sense that he obtains the medicine within a very short time period i.e. instead of five days he obtains the medicine within one day.

Efficiency

Efficiency is related to factors such as time. The information states that "as soon as Mshindi receives the purchase request"; he places the order. Therefore Mshindi is efficient in carrying out his work.

Economy

Economy is how prudently money is used. In the given case, money is not used prudently. This is because, for certain orders, an extra Tsh1,000 was paid. This cost could have been avoided by placing the order 5 days in advance.

In addition, Mshindi procures the orders from "a particular supplier on the list of approved suppliers" without making enquiries into the rates and delivery charges of the other approved suppliers. This particular supplier may not have offered the cheapest terms.

Mshindi was therefore effective and efficient in the achievement of his objective but did not take the most economic course of action.

An example from a housing department viewpoint could be the desire to improve the quality of housing to occupants through a policy of installing double glazed windows. The purchase of cheap window units (economy) may help to increase the number of houses which can be converted (efficiency). But this economy could possibly lead to dissatisfaction through poor performance of the units e.g. high condensation and poor sound proofing and hence the non-achievement of improved quality of living (effectiveness).

A management accounting system should be capable of providing information to management about value for money. Whether VFM could be achieved or not and reasoning for the action should be reported to management.

Test Yourself 4

Wasomi Academy is a public sector school. It offers vocational education to students and provides them with the necessary materials at very low prices. The academy participated in an education fair with the objective of promoting the organisation and attracting more students. The volunteers working in Wasomi Academy went to the fair to explain how the organisation works.

Required:

Discuss various criteria to assess the 'value for money' of the participation in the education fair.

Answers to Test Yourself

Answer to TY 1

In the case of a government run hospital, the following non-financial quantitative measures can be sued to evaluate performance:

(a) Non-financial quantitative measures

number of patients admitted
time taken by doctor per patient / waiting time
number of operations carried out in a year
number of beds available

(b) Qualitative objectives

high quality treatment
emergency treatment

Answer to TY 2

Public sector organisations have multiple objectives which are non-quantitative i.e. qualitative objectives. It is extremely difficult to define the objectives of public sector enterprises.

Due to their multiple objectives, even if the objectives are identifiable, the large array of them does not make identifying the key objective(s) easy. This means that their prime objective(s) cannot be identified.

The objectives of a public sector organisation may include the following:

Maximising wealth creation for the society
Maximising customer / client satisfaction
Maximising value for money
Maximising recovery of costs in order to minimise subsidy
Maximising employee satisfaction

It is really difficult to measure non-quantifiable objectives and to record and analyse their achievements.

Answer to TY 3

The primary aim of public utilities and state monopolies is to serve the society at large. Therefore the government, while regulating these organisations, keeps this in mind and frames its policies accordingly. These regulations have an impact on the performance of such organisations.

In the given case, if it was not subject to government regulation, Umeme Kwanza could make a handsome profit by charging more for providing electricity since there are no competitors in the market.

In addition, if the company was not regulated by the government, it could decide to sell electricity only to industries and for commercial purposes so that it could charge higher prices to these consumers and make higher profits. However, it cannot do so because Umeme Kwanza is compelled to provide services to all types of customers including individuals using electricity for residential purposes.

Umeme Kwanza is also compelled to provide an uninterrupted power supply for 24 hours. For this purpose it has to generate electricity according to demand.

Extending operations to hilly areas will increase demand and therefore profitability. In addition the funds are provided by the government. This will also influence performance favourably. This is because the company is receiving a subsidy (free money which would otherwise not be available) and low interest rates.

Answer to TY 4

To assess the VFM of the participation in the education fair, the 3 E's should be evaluated i.e. economy, efficiency and effectiveness.

This can be carried out by considering the following factors:

(a) Objectives

The effectiveness of the seminar can be assessed by measuring how far the objectives of the seminar were achieved. Wasomi Academy participated in the education fair to promote the organisation and attract more students. The higher the number of students who visited Wasomi Academy's stall, the better the objective has been achieved. Therefore the number of students who visited Wasomi Academy's stall can be used as a measure of value for money.

(b) Cost incurred

The main cost of participating in the fair was the cost of occupying a stall. In addition to this, other costs such as the cost of the brochures distributed at the fair and the opportunity cost of the volunteers working at the fair should also be considered.

(c) Explaining the operation of the organisation

The objective of Wasomi Academy and the activities that it conducts etc. should have been explained at the fair. The volunteers should have been well equipped to do this. They should have a thorough knowledge of the organisation and be able to talk about their experiences of working for the organisation with the students.

(d) Response

The best way of assessing the effectiveness and analysing the cost benefit of participation in the fair is to assess the response of the students immediately after the fair. The higher the number of students who enrol at the academy, the more effectively the objective has been achieved.

Self Examination Questions

Question 1

Mwangaza is a state owned hospital run on a not-for-profit basis. It has a staff of 600 people. Hekima has recently joined the management of Mwangaza. In his first year of working at the hospital, he notices that the hospital is spending a lot on housekeeping expenses.

He also notices the following facts:

1. There is 25 staff appointed to clean 30 rooms.
2. Average salary paid to the housekeeping staff is Tsh20,000 per month per person.
3. The housekeeping workers take excessive time to clean the rooms and therefore more people are hired than are actually necessary.

Hekima immediately reduces the number of housekeeping staff employed to 18.

Required:

Evaluate the value for money of the housekeeping staff.

Question 2

A mixed economy operates a range of public services including Fire, Police, Education and Health. The services are provided on a regional basis but are funded from central government taxation. The government is endeavouring to improve the 'overall performance' of the services and is considering a range of issues surrounding this objective.

Required:

Explain the term 'overall performance' in respect of public services and suggest a structured approach to its assessment**.**

(Your answer should be from a generic point of view and references to particular services should be used only for illustrative purposes.)

Question 3

Explain the particular problems that are likely to occur in attempting to monitor the performance of a public service that would not arise when assessing private sector activities.

Answers to Self Examination Questions

Answer to SEQ 1

The value for money can be assessed with the help of the 3 Es i.e. economy, efficiency and effectiveness.

(a) Economy

Economy evaluates how wisely funds are utilised. By reducing the number of people working in housekeeping, Hekima achieves economy. He saves Tsh140,000 per month.

(b) Efficiency

In this case, efficiency is the performance of an act in the required time. Hekima takes the decision to reduce the number of housekeeping staff immediately i.e. without wasting any time. He noticed that the workers were not working efficiently and therefore there were more housekeeping staff than required which led to idle time. It is likely that, due to Hekima's decision, the workers will begin to work efficiently. This is because they know that unless they perform efficiently, it is unlikely that they will retain their job. In this way, Hekima will also improve the efficiency of the workers.

However, if the time taken by the workers is actually necessary and the standards were wrong then Hekima's decision will result in a reduction in the efficiency of the workers.

Nevertheless, Hekima was very efficient in taking his decision since he took the decision very quickly.

(c) Effectiveness

According to VFM, effectiveness is the achievement of the optimal solution for the proposed problem. The work has to be carried out within a required time using the available resources. In this case, Hekima has reduced the number of staff on the basis that too many had been appointed. This step will reduce the hospital's costs. It can be said that Hekima is effective in taking quick decision. However, the results of the decision are not known i.e. whether, after reducing the number of staff, the housekeeping service will be good.

However, at the same time, the issue of patient satisfaction arises. There may be times when the volume of patients in the hospital will suddenly increase, e.g. at weekends. It is not yet known whether, having reduced the number of staff members, the housekeeping staff will still be able to provide a good service at these times.

Answer to SEQ 2

The performance of an organisation can be evaluated with the help of profitability. However, in the case of a public sector organisation, profitability is not a good indicator. This does not mean that these organisations should not be evaluated on financial grounds. Financial indicators other than profitability may be relevant.

When it comes to the overall performance of an organisation, an evaluation can be made with the help of the three E's i.e. economy, efficiency and effectiveness. Economy is how wisely the resources were used, efficiency is how well the input resulted in the best output and effectiveness is how well the activities were targeted towards achieving the objectives of the organisation.

Instead of using only one or two indicators, it is better to use a range of performance indicators such as financial performance indicators, non-financial quantitative performance indicators and qualitative performance indicators.

(i) Financial indicators

cost per unit e.g. cost per operation, cost per arrest

variance analysis (by comparing standard cost and actual cost)

adoption of flexible budget approach

benchmarking costs with other regions with certain adjustments

(ii) Quantitative non-financial indicators

number of activities taken up in a year

waiting time i.e. time taken by doctor per patient, time taken by ambulance or fire brigade to arrive at scene of emergency

number of students passed, number of criminals arrested, number of patients alive, number of teachers appointed, number of successful operations and other numerical data

utilisation of resources such as bed occupancy

other ratios such as pass rate of students, % decrease in crime

spread of the activity i.e. area of operation covered etc.

(iii) Qualitative indicators cover the following measures

quality of services provided

utilisation of available sources

interaction between employees and customers

intelligence level of student

competence of teachers, doctors etc.

However, other performance measures can also be used:

Input measures: such as resources employed e.g. number of policemen, teachers, firemen etc. employed during the year.

Output measure: number of arrests in the year, number of operations carried out etc.

Stakeholders' satisfaction: society's satisfaction with public services

Anthony and Young method: social indicators e.g. peace in the society i.e. decrease in crime rate, result measures and activity measures such as number of activities carried out to spread awareness of safety in the society.

Apart from these indicators, a balanced scorecard can also be used to evaluate performance since it covers various performance measures and aims at goal congruence between the various activities conducted by the organisation.

Answer to SEQ 3

Common problems in assessing the performance of public sector organisations:

(i) Conflicting objectives

These organisations may have more than one objective and it is difficult to identify any specific primary objective.

(ii) Non-quantifiable objectives

Often the objectives of these organisations are such that they cannot be measured in quantity and therefore it is difficult to record, understand and analyse them. They are subjective in nature and therefore the evaluation may turn out to be biased.

(iii) Political interference

Political parties sometimes affect the objectives of public sector organisations. Often the objectives of these organisations are driven by political wishes. In addition, these organisations are assessed according to the expectations of society.

(iv) Funding

Obtaining funds is a major problem for these organisations. Again, even if they manage to obtain the funds, they may not have freedom to decide their utilisation.

(v) Benchmarking

Generally, benchmarking is a good method of evaluating performance. However, in the public sector it is difficult to find a suitable benchmark. This is due to the existence of monopolies.

SECTION A

ACCOUNTING FOR PUBLIC SECTOR

A18

STUDY GUIDE A18: CONCEPT OF PROJECT/INVESTMENT APPRAISAL IN PUBLIC SECTOR

Get Through Intro

Performance measurement has become increasingly important in public sector organisations. These organisations are established for the purpose of working towards the welfare of the society and not for earning profits. A major part of their objectives cannot be quantified in monetary terms. Their performance is measured on the basis of how well and efficiently they are able to achieve their objectives with the limited funds are available to them.

This Study Guide explores the problems of having non-quantifiable objectives in performance measurement and discusses 'Value for Money' as a public sector objective. By studying this Study Guide, you will be able to understand the most appropriate performance measures for public sector organisation.

Learning Outcomes

a) Discuss the nature of long-term investments and their role in public sector organisations.
b) Explain the investment appraisal process and the framework for evaluating investment projects.
c) Explain the various methods of investment appraisal that a public sector organisation can undertake.

1. Discuss the nature of long term investments and their roles in public sector organisations.

[Learning Outcome a]

1.1 Capital investment

It is the investment made to buy non-current assets or to improve the **earning capacity** of non-current assets already held in an organisation. As a result of the capital investment, the non-current asset works more efficiently, lasts longer or improves revenue generation. Hence, a capital investment increases the value of a non-current asset and the value of the firm.

Example

Types of capital investment

1. **Purchase of non-current assets:** computers, vehicles, building, land, plant and machinery
2. **Legal and professional fees paid for purchasing non-current assets:** stamp duty, registration fees, solicitor's fees, architect's fees, consultant's fees
3. **Improvement to existing non-current assets:** fitting of air conditioner in vehicles, extension to a factory site

Usually, capital investment decisions involve commitment of huge sums of money. In several cases the organisation has to immediately make payments for making capital investments. The organisation earns the benefit of a capital investment over a number of years. Hence, a capital investment made by an organisation affects its business for a number of years and is therefore, a long-term investment.

Tip

The terms capital investment and capital expenditure can be used interchangeably.

1.2 Capital investment planning and control in public sector

Capital investment planning and control allows the management of a public sector organisation to **assess the effectiveness of the capital investment decision-making process that is used by it.** It allows the management to refine its policies and procedures for appraising and implementing capital investment projects. This ensures that the capital investments made by an organisation:

(a) Are in line with its long term goals / objectives.

(b) Support the business needs of the organisation.

(c) Minimise the risk and maximise the returns throughout the non-current asset's life.

1.3 Role of of capital investment planning and control in public sector organisations

1. **Taking strategic decisions:** capital investments involve huge sums of money. An organisation receives the benefit of capital investments for several years. Hence, capital investments have a huge effect on the profits earned by an organisation. An opportune capital investment can yield spectacular results for an organisation. On the other hand a wrong capital investment can force the organisation into bankruptcy.

2. **Minimising the cost structure:** an organisation commits itself to certain fixed costs while making capital investments e.g. lease rental, wages, insurance charges etc. These fixed costs are not tied to the outcome of the project. The organisation has to bear these fixed costs irrespective of the success / failure of the project. These fixed costs have an effect on the sales, break-even point and profits of the organisation. Proper planning ensures that the organisation considers the various fixed costs associated with the investment while accepting / rejecting a capital investment. Proper control over the implementation of capital investment ensures that the organisation is able to minimise the fixed costs associated with the capital investment.

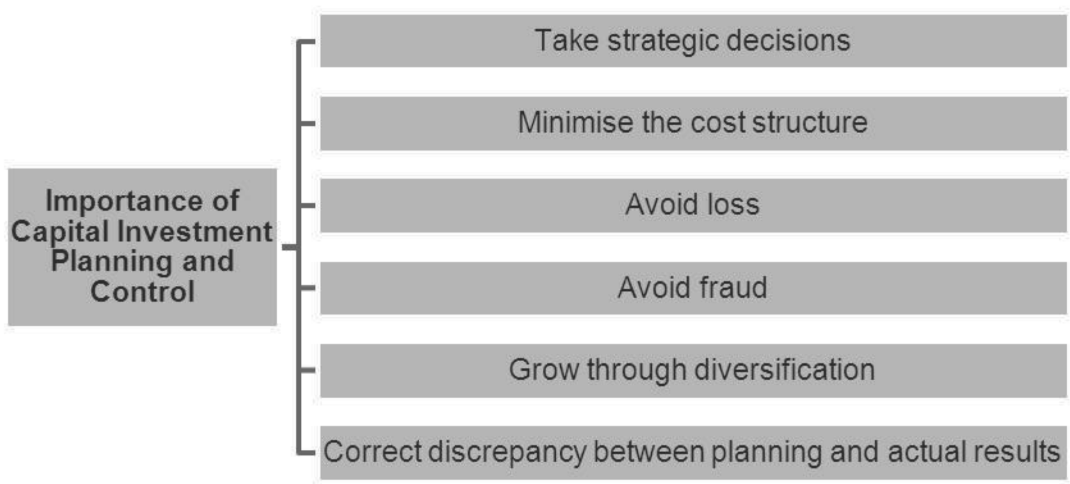
3. **Avoiding loss:** a capital decision once made is not easily reversible. The organisation may be unable to dispose of or find another use for the newly purchased asset such as a new plant and machinery. As a result the organisation will have to write off the investment made in the non-current asset. Proper planning ensures that the organisation avoids making imprudent capital investments. Proper control ensures that the capital investment gets implemented and works according to the plan.

4. **Avoiding fraud:** usually huge sums of money are involved in capital investment decisions. A fraud may result in heavy monetary loss to an organisation. In certain cases, it can even lead to irrecoverable injury to the reputation of the organisation. An organisation can prevent the occurrence of fraud by implementing strict capital investment control measures and ensuring the monitoring of such controls on a regular basis.

5. **Growing through diversification:** proper planning and control ensure that an organisation is successfully able to implement various types of capital investment projects. This allows the organisation to diversify its risks by investing in several types of capital investments.

6. **Correcting discrepancy between planning and actual results:** proper planning ensures that the management foresees and prepares for the various challenges that a capital investment project may face. Proper control ensures that any discrepancy between expected and actual results is quickly discovered and rectified. This allows an organisation to achieve desired results.

Diagram 1: Importance of capital investment planning and control



Test Yourself 1

Outline the importance of capital investment planning and control.

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2. Explain the investment appraisal process and the framework for evaluating investment projects.

[Learning Outcome b]

2.1 Investment appraisal process

1. Meaning

Investment appraisal process is the process through which an organisation generates, evaluates and selects various capital investment proposals. It allows the organisation to **assess the financial viability of a capital investment proposal.**

2. Issues considered and steps taken while preparing a capital expenditure / long term investment / project budget

Investment appraisal is the most important part of the capital expenditure process. It is at this stage that a decision is taken as to which projects are to be accepted and which are to be rejected. Investment proposals are appraised to determine if they lead to the fulfilment of the strategic objectives of an organisation.

Step 1: Quantify the costs and benefits

The costs and benefits of an investment proposal are identified and quantified.

Step 2: Compare the costs and benefits with appropriate techniques

The costs and benefits should be compared to each other by using techniques such as the payback period, Internal Rate of Return (IRR) or Net Present Value (NPV).

Step 3: Evaluate the risks involved and the sensitivity to changed situations

When we estimate the future cash flows, there is a risk that they may not actually materialise as the future is uncertain; the actual outcome may be different. It is necessary to consider how this will affect the final outcome.

Step 4: Consider qualitative factors such as the environment or employment generation

The decision on the project will not depend only on the numerical calculations. We must also take into consideration qualitative factors or non-financial factors.

A few factors considered at this stage are:

Legal issues: any legal action that the organisation may face due to the project.

Ethical issues: a project involving legal but unethical action will damage the image of the organisation.

Government regulations: various regulations that are applicable to the project e.g. employment laws, environment laws, competition laws etc.

Political issues: whether any change in government will have an effect on the project.

Competition: the reaction of the competitors to the project.

Step 5: Take a decision

Management of the organisation will review all the investment proposals and make a decision of any one of the following types:

(a) Accept/reject

This applies to **independent projects**. They do not compete with each other. You can either accept the proposal or reject it. If a proposal meets the minimum standards required, it is accepted; otherwise it is rejected.

(b) Mutually exclusive choice

Sometimes projects may compete with each other in such a manner that **acceptance of one signifies rejection of the other**. A criterion for the project is laid down. The best project is accepted and the others are rejected. This process assumes that all the competing projects are **found acceptable** by applying the **'**accept – reject' test. If all the projects are rejected by applying the test then there are no projects left to compete!

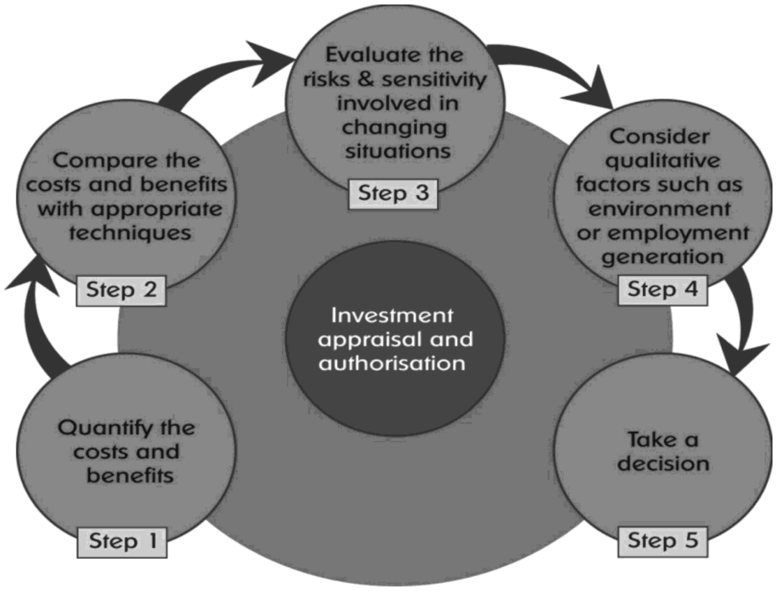
Example

A corrugated box manufacturer wants to purchase one new specialised corrugating machine. The criteria laid down are that it should satisfy the technical specifications and the minimum accounting rate of return (ARR) should be 15%.

There are four suppliers, Kat, Lat, Mat and Nat, who have submitted quotations. Kat's quotation is rejected on technical grounds. Nat's machine gives an ARR of only 10%; hence it is rejected as it does not meet the criteria. Only Lat and Mat are left in the competition since their machines satisfy the technical specifications. The machines give an ARR of 16% and 20% respectively.

Mat's machine is selected and this means that Lat's machine is rejected.

Diagram 2: Issues considered and steps taken while preparing a capital expenditure budget



3. Capital expenditure budget

The capital expenditure budget is an outline of an organisation's decision to allocate funds amongst its various existing and upcoming projects. The managers may overlook the risk of obsolescence while preparing their short term capital expenditure plans. Hence, it is advisable that an organisation must prepare its capital expenditure budget on the basis of the long term capital expenditure plans of its managers.

A capital expenditure budget is decided on the basis of:

An individual manager's request for issuing funds to the projects he handles.

The senior management's decision to allocate funds amongst the various projects of the organisation. The decision is made according to the long term objectives of the organisation.

An organisation can decide the amount of its expected capital expenditure by:

Forecasting the capital investment projects that it is going to undertake. Usually the amount of expected capital expenditure exceeds the amount of cash surplus that the organisation will have during the budgeted period. In such a case the organisation has to make arrangements to borrow money from various sources to finance the projects.

Obtaining the expected cash balance by preparing a long term budget. The organisation chooses the capital investments depending upon the expected cash surplus that it expects to have during the budgeted period.

2.2 Capital investment framework for evaluating investment projects

1. Appraisal of capital investment project

The stages involved in the project appraisal process of a capital investment project are as follows:

(a) Initial evaluation

Before actually starting a project, a decision evaluating the technical feasibility and commercial viability of the project must be taken. In order to do this, the company should consider whether the project is in line with the company's long-term strategic objectives.

(b) Detailed assessment

Following the initial evaluation of the project, the company should consider whether the cash flows generated from the project would add any economic value to the value and activities of the company. The organisation considers the various costs and benefits that it will obtain by implementing the project. This stage also involves performing sensitivity analysis and analysing the available sources of finance.

(c) Management's approval

Certain significant projects which have a material impact on the functioning and cash flows of the company should be approved by the organisation's senior management. For this approval to be obtained, the organisation's senior management should be satisfied that:

A detailed evaluation has been carried out.
The project conforms to the organisation's long-term strategy.
The project will contribute to profitability of the organisation.

(d) Project implementation

During this stage, the project is assigned to a party who will assume responsibility for the project and oversee its development. The resources will be made available for implementation and specific targets will be set. The project team would then work towards meeting those targets.

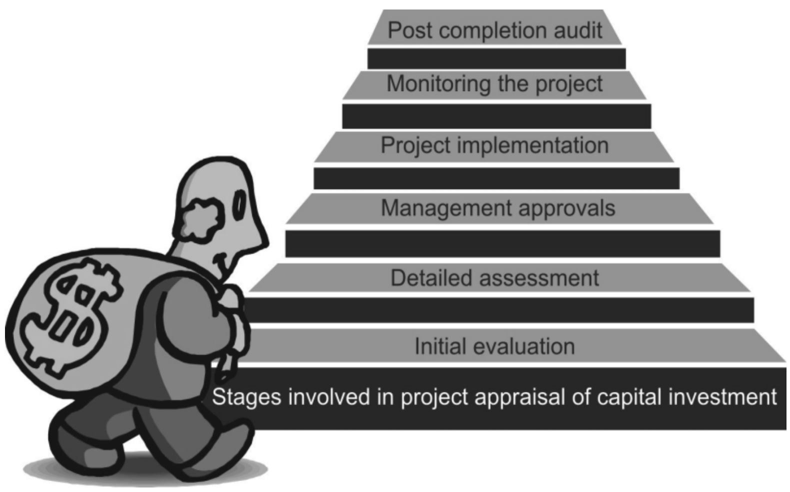
(e) Monitoring the project

Projects involving capital expenditure take place over a significant period of time. It is necessary to monitor the progress of a project by checking whether or not it is on schedule. Any delays in the implementation of a project invariably increase the cost of the project. It is also necessary to check whether or not the cost of the project is within the budget. In case any unforeseen events occur, all the costs and benefits associated with the project should be re-assessed.

(f) Post-completion audit

This last and final stage involves conducting an enquiry into the benefits, costs, wastages and deviations from the initial project plan. This investigation points whether or not the project is performing in line with expectations, and what lessons can be drawn for future appraisals.

Diagram 3: Appraisal of a capital investment project



Test Yourself 2

Tujenge is a public sector construction company, which is looking to start a new project of building residential housing on land that is already owned by the company.

(a) What are the 5 steps Tujenge needs to take while preparing a capital expenditure budget for the new project?

(b) What are the stages of evaluation of the housing project that Tujenge should consider?

3. Explain the various methods of investment appraisal that a public sector organisation can undertake.

[Learning Outcome c]

Investment appraisal techniques

Investment appraisals will feature an assessment of the expected return for the expenditure made and an estimation of the future costs and benefits of the project(s) under consideration. When evaluating a capital budget, the costs and benefits are required to be evaluated over the foreseeable future, which is usually the expected useful economic life of the non-current asset that is to be purchased.

Typical capital projects include the purchase of a non-current asset immediately, which is then used for several years to generate revenue or to attain operating cost savings. The asset will usually have running costs during its use and maybe residual value at the end of its commercial life; for example: motor vehicles, machinery, printing machines etc.

Capital projects go on for several years requiring estimations to be made for the revenues, costs and savings over the life of the project, which can often lead to problems of inaccuracy in assumptions and calculations.

There are a number of investment appraisal techniques a public sector company can use to assess the viability of capital investment projects.

3.1 Return on Capital Employed

Any capital investment is made in order to earn a good return and maximise shareholders' value. It is necessary to check how this is achieved in practice. Return on capital employed (ROCE) is one of the ways of measuring the return on an investment in terms of profitability.

ROCE measures the percentage of accounting profits (profits after depreciation) over the capital employed. A widely used formula to calculate this is as follows:

$$\text{ROCE} = \frac{\text{Average annual accounting profits}}{\text{Average investment}} \times 100$$

Accounting profits will be calculated after deducting depreciation from the cash profits.

As in other ratio calculations, slightly different formulae are sometimes used for ROCE. Hence, in place of average investment, initial or final investment may be used. Note that the initial investment may include cost of new assets bought, net book value (NBV) of existing assets to be used, investment in working capital and capitalised research and development costs.

Average investment

The investment at the beginning of the project is the initial cost. The investment at the end of the project is the disposable value or scrap value. If we want an average, we have to take the total of the two and divide it by two.

The formula will be:

$$\text{Average investment} = \frac{(\text{Initial investment + Scrap value})}{2}$$

Method of applying ROCE

A target or hurdle rate is decided beforehand. The projects that give an ROCE higher than the decided rate are accepted. If there are two or more competing proposals out of which only one is to be selected, then the project with the highest ROCE is selected.

Example

Msafara Transport run by the government of Tanzania is considering purchasing a new transport vehicle. It has two offers.

The expected life of both the vehicles is 5 years. The following information is available

	Offer A (Tshs)	**Offer B (Tshs)**
Original Cost	1,100,000	1,600,000
Scrap value at the end	120,000	150,000
Expected annual net cash inflows*	360,000	630,000

Assume the depreciation of the vehicle has already been deducted from the expected annual net cash flows

Calculate the ROCE on both offers and state which offer will be accepted.

Offer A

$$ROCE = \frac{360{,}000}{610{,}000\ (W1)} \times 100$$

= 59%

Working 1

Average investment

$$= \frac{1{,}100{,}000 + 120{,}000}{2}$$

= 610,000

Offer B

$$ROCE = \frac{630{,}000}{875{,}000\ (W2)} \times 100$$

= 72%

Working 2

Average investment

$$= \frac{1{,}600{,}000 + 150{,}000}{2}$$

= 875,000

Based on the workings above, it can be seen that offer B provides the higher return and therefore, would be accepted.

1. Advantages of ROCE

(a) It is reasonably **simple** to understand and use.

(b) It uses the familiar concept of percentage return: the percentage return can be compared with the company's ROCE in order to decide whether it is in line with the company's overall ROCE.

(c) It considers the cash flows for the entire life of the project: unlike the payback method (explained later), the ROCE considers the cash flows for the entire life of the project.

(d) It can be used to compare mutually exclusive projects: a decision involving mutually exclusive projects can be based on ROCE. The one with the higher ROCE is selected.

2. Disadvantages of ROCE

(a) It uses accounting profit which is subject to manipulations: if different estimates and accounting policies are used in two otherwise identical situations, then the accounting profits will be different even though the cash flows are the same. An example being differing depreciation rates applied to an asset will have an impact on the accounting profits.

(b) It ignores time value of money: this is indicated by the fact that this method as well as the payback method does not discount the cash flows.

(c) It is a relative measure and ignores the size of the investment and the length of the project: the size of the investment and the length of the project are relevant issues but are ignored. These factors determine the risk and the volume of the profits.

Example

The ROCE of two projects A and B are shown below:

Project A: ROCE = 50%

Project B: ROCE = 20%

If both projects were mutually exclusive, a rational manager would select Project A because its return is higher. However, ROCE is merely a relative measure. It does not indicate an absolute return to the company. Additional information regarding both the projects is as follows:

Project A

Initial investment = Tshs100,000,000

Return = Tshs50,000,000

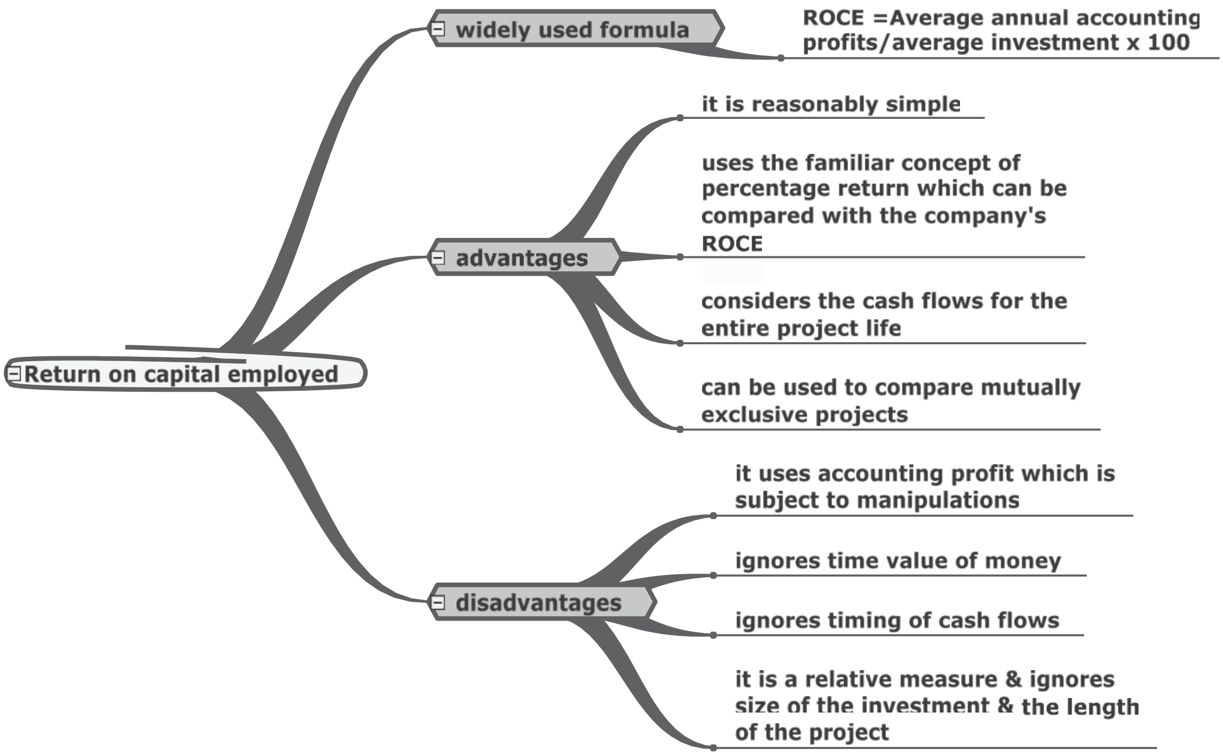
Project B

Initial investment = Tshs1,000,000,000

Return = Tshs200,000,000

From an absolute perspective, project B would have been the preferred choice, as profits generated amount to Tshs200,000,000.

SUMMARY



3.2 Payback

Payback period is a simple technique used for assessing the time it will take to pay back the money spent on the project or asset. This technique is used for smaller businesses and focuses on cash flow and liquidity rather than profits.

A widely used formula to calculate this is as follows:

$$\text{Payback period} = \frac{\text{Initial investment}}{\text{Annual cash flow}^*}$$

Uused for whesssn constant annual cash flows

Where cash flows are uneven, payback is calculated by working out the cumulative cash flow over the duration of the project. If an organisation is applying the payback period technique, they will need to set the target payback period and then assess projects and select those that pay back within the target period. The company may select projects on the basis of fastest payback period if timing of recovery of investment is of significant importance to the investment decision.

Example

If a project requires an investment of Tshs1,000,000 and is expected to provide an annual cash flow of Tshs250,000, the payback period would be:

$$\text{Payback period} = \frac{1,000,000}{250,000} = 4 \text{ years}$$

Example

Similar calculations can be used to work out the payback period for a project with uneven annual cash flows.

A project belonging to a public sector firm is expected to have the following cash flows:

Year	Cash flow in Tshs (000's)
0	(19,000)
1	3,000
2	5,000
3	6,000
4	8,000
5	5,000

What is the expected payback period?

First, we need to calculate the cumulative cash flows over the 5 year period as follows:

Year	Cash flow in Tshs (000's)	Cumulative cash flow Tshs (000's)
0	(19,000)	(19,000)
1	3,000	(16,000)
2	5,000	(11,000)
3	6,000	**(5,000)**
4	8,000	**3,000**
5	5,000	8,000

Payback period is between year 3 and 4 as this is when the cumulative cash flow goes from negative to positive cash flow. If we assume a constant rate of cash flow throughout the year, we could estimate that payback will be three years plus (Tshs5,000/8,000) of Year 4. This is because the cumulative cash flow is Tshs5,000 (negative) at the start of the year and the year 4 cash flow would be Tshs8,000. Therefore, payback will be after 3.625 years.

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1. Advantages of payback period

(a) It is **easy** to calculate and understand.

(b) It is useful under certain situations: the payback period method is useful for the rapidly changing technology markets and for improving investment decisions.

(c) It favours quick return: the method favours projects with quick return which help company growth, minimise risk and maximise liquidity.

(d) It considers the cash flows, not accounting profit: the payback method considers the cash flows rather than accounting profits which are subject to manipulation.

2. Disadvantages of payback period

(a) It ignores any return after the payback period: this method does not consider the cash flow over the life of the project, which the ROCE method does. For example, two projects could both have a payback period of four years, but one might be expected to produce no further return after five years, while the other might continue generating cash indefinitely.

(b) It ignores time value of money: this is indicated by the fact that this method as well as the ROCE method does not discount the cash flows. For example, a Tshs200 million investment that produced no cash flow until the fourth year - and then a payback of Tshs200 million - would have the same four-year payback period as an investment that produced an annual cash flow of Tshs50 million. In reality, the first is likely to be a riskier and less attractive investment.

(c) It ignores the project profitability: the overall profitability of the project is an important factor that determines the risk and volume of returns.

3.3 Discounting future cash flow techniques

Money received today is worth more than the same money received in the future, i.e. money has a time value. The time value of money occurs for three main reasons:

1. Potential for earning interest / cost of finance
2. Impact of inflation
3. Effect of risk

Discounted cash flow (DCF) techniques such as Net Present Value, discounted payback method and Internal Rate of Return take the time value of money into account. These apply a discount rate to work out the present day equivalent of future cash flows.

Example

For example, suppose you expect to receive Tshs10,000 in one year's time, and use a discount rate of 10 per cent. If you invest Tshs9,091 at 10 per cent for one year, at the end of the year, you would have Tshs10,000. In other words, the present value of that Tshs10,000 can be calculated as Tshs9,091.

Similar calculations can be used to work out the present value of cash flows you expect to receive further into the future. For example, suppose you expect to receive Tshs10,000 in two years' time and use a discount rate of 10 per cent. If you invest Tshs8,264 for two years at 10 per cent, then at the end of two years, you would have Tshs10,000. In other words, the present value of that Tshs10,000 is Tshs8,264.

3.4 Net Present Value (NPV)

In the earlier section, we understood how the value of money depends upon the time of the cash flows. The same amount of money received or paid at different times has different values. To make the cash flows at different dates comparable, their present values are calculated.

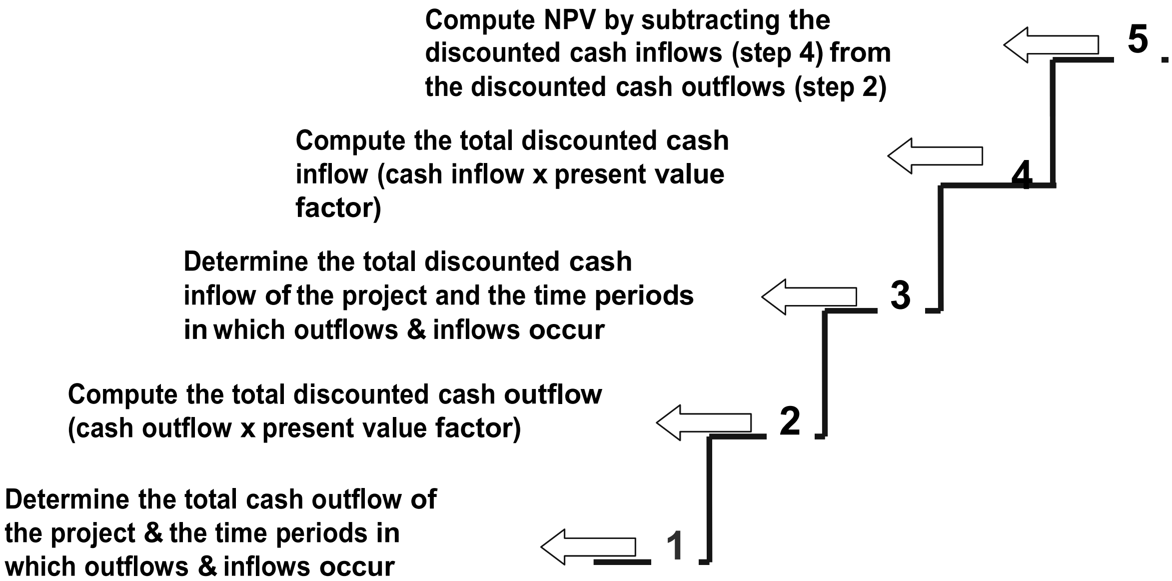
Definition

The net present value (NPV) of an investment (project) is the difference between the present value of cash inflow and the present value of cash outflow.

The following steps are included to calculate the NPV of a project:

NPV = Present value of cash inflows - Present value of cash outflows

Diagram 4: Calculation of net present value (NPV)



The present value can be either positive (cash inflow greater than outflow), negative (cash outflow greater than inflow) or zero (cash outflow and inflow exactly equal). The rule is to accept all the independent projects with positive net present value or the competing projects with the highest NPV.

Exam Focus

To obtain present value of a period:

calculate the relevant net cash flow of a period, and then apply the discount rate to the net cash flow.
to arrive at the net present value of the cash flows, add the present values calculated for each period.

Example

An initial investment in a government project is Tshs100,000,000. The target or required rate of return is 12%.

The expected cash inflows are as follows:

Year	Tshs
1	60,000,000
2	50,000,000
3	45,000,000

Calculation of present value

Year	Cash flow	Discount factor	Present value
	Tshs		Tshs
0	(100,000,000)	1.000	(100,000,000)
1	60,000,000	0.893	53,580,000
2	50,000,000	0.797	39,850,000
3	45,000,000	0.712	32,040,000
NPV			**25,470,000**

Since the project's NPV is positive, it should be accepted. The positive NPV equates to a net cash inflow which would add to shareholder wealth.

Tip

Rate of return is also called 'cost of capital', 'discount rate' or 'required return', and therefore these terms can be used interchangeably.

Timing assumptions made about cash flows when calculating NPV

The discounted value depends on the date of expected cash flows. Some assumptions relating to NPV calculations include:

1. **Initial cash outlay** is incurred at the **beginning of the first period**, i.e. the year is taken as **0**. The present value of this initial investment is the same as the amount of investment; it is not required to be discounted since the time is 'now'. The discount factor for year 0 is 1.000.

2. **Any transaction** during a period is assumed to **occur at the end of the period**. E.g. receipts during year 2 are assumed to have taken place at the end of year 2.

3. **Cash flows** occurring at the beginning of a year will be assumed to have occurred in the previous year for discounting purposes.

4. Cash flows generated during the life of the project will be reinvested at a rate equal to the cost of capital.

Example

A cash payment of Tshs600,000 on 1 January 20W8 will be assumed to have occurred in 20W7, for the purposes of cash flow discounting.

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1. Advantages of Net present value method

(a) It assumes that cash flows are re-invested at the company's cost of capital: the company's cost of capital represents the average opportunity cost of the company's providers of finance.

(b) It is directly related to the objective of maximising shareholders' wealth: if a project is accepted, its NPV represents the change in the total market value of the company. Other investment appraisal methods are not directly related to the objective of maximising shareholders' wealth.

(c) It is not a relative measure of return: unlike IRR (explained later in this study Guide) or ROCE, NPV is an absolute measure of return. It is therefore able to reflect the amount of initial investment or the absolute increase in the corporate value.

(d) It considers the time value of money: money has a time value i.e. the same amount of money has a different value at a different time. NPV considers the time value of money while appraising investment projects.

(e) It does not consider the accounting profit: the NPV method considers the cash flows involved in a project. Financial management, unlike accounting, considers cash flows to be more effective, as accounting profits can be manipulated. However, cash inflows / outflows spread over a long period of time have no common ground to be measured upon due to several factors.

(f) It considers all the cash flows over the life of a project.

(g) It can be used to appraise projects with non-conventional cash flows: a project has non-conventional cash flow when negative cash flows occur during the life of the project.

2. Disadvantages of Net present value method

(a) It is more **complex** than ROCE, payback and IRR investment appraisal techniques.

(b) It fails to relate the **return** of the project to the size of the **cash outlay**.

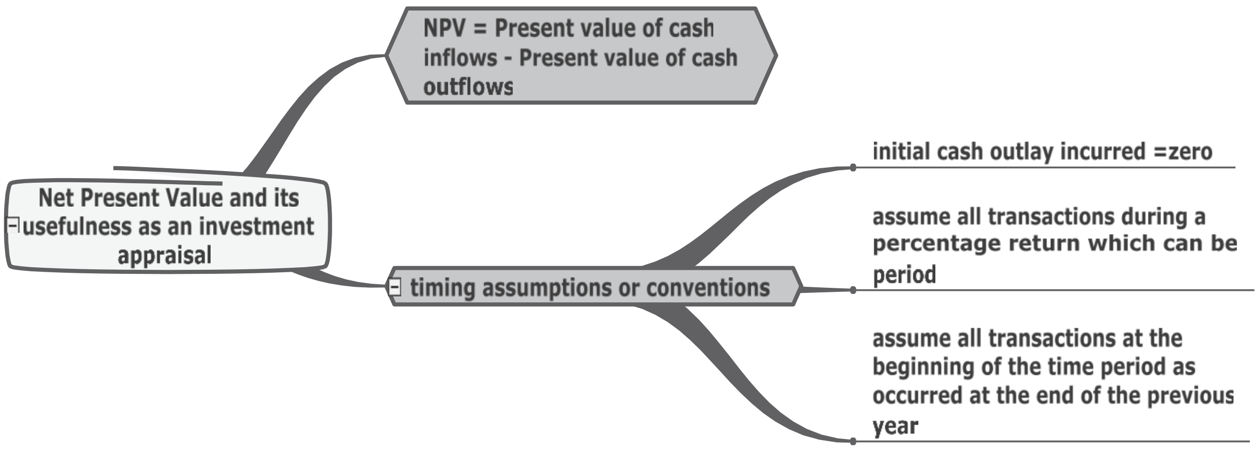
(c) **It requires detailed forecasts of long term cash flows which can be difficult to explain to management:** NPV assumes that the management is accurately able to estimate long term cash flows.

Long term cash flows are affected by several factors such as cost of labour, material, interest rates, etc. Due these factors the management usually overestimates or underestimates the long term cash flows.

(d) It requires **knowledge** of cost of capital.

(e) **It is difficult to compare NPV with economic variables:** NPV is an absolute measure of return. Hence, unlike IRR or ROCE it cannot be compared with economic variables such as interest rates and inflation.

SUMMARY



3.5 Discounted payback method

Payback period has been discussed in detail earlier in this Study Guide.

Discounted payback method is similar to the payback method. It is the length of time that the discounted cash flows require to recover the initial investment. Under this method, the cash flows are discounted at the organisation's cost of capital. After this, the present values of the cash flows are cumulated until they are equal to the initial investment.

Tip

Payback period uses nominal cash flows.

Discounted payback period uses the discounted cash flows.

The organisation rejects the projects that have a discounted payback period of more than the discounted payback period that is desired by the organisation. This ensures that all the projects that the organisation accepts have positive net present value within the desired discounted payback period.

The advantages and disadvantages of the discounted payback period are similar to those of the payback period. However, the discounted payback period overcomes the shortcoming of the payback period, which is ignoring the time value of money.

Example

Let's assume that cost of capital for a government run company is 10% and the following table shows the cash flows as well as cumulative discounted cash flows for one of the company's Project C:

	Cash flow	Discounting factor at 10%	Present value of cash flows at 10%	Cumulative discounted cash flows
Year No.	Tshs 000's		Tshs 000's	Tshs 000's
0	(300.00)	1.000	(300.00)	(300.00)
1	80.00	0.909	72.73	(227.27)
2	150.00	0.826	123.97	(103.31)
3	140.00	0.751	105.18	1.88
4	80.00	0.683	54.64	56.52
5	70.00	0.621	43.46	99.98

Discounted payback period = 2 years + Tshs103.31/ Tshs105.18 x 12 months = 2 years and 11.79 months, i.e. almost 3 years.

3.6 Internal Rate of Return (IRR)

Definition

An investment project's internal rate of return is the required rate of return or cost of capital which produces a net present value of zero when used to discount the project's cash flows.

In other words, **when internal rate of return is used to discount the cash flows, the present value of outflows and the present value of inflows will be equal.**

Calculation of IRR

Two different methods can be used for calculation of IRR in the following two situations:

1. when the project cash inflows are identical
2. when the project cash inflows are not identical

1. When the project cash inflows are identical

Example

Calculation of IRR for a project with identical cash inflows

The following table gives the particulars of a proposed project X of Strilco, a public sector company.

Period	0	1	2	3	4	5	6
Cash flow in 000's (Tshs)	(6,000)	1,450	1,450	1,450	1,450	1,450	1,450

In this case, the inflows are identical; therefore, we can use the cumulative present value factors table.
As we know, IRR represents the rate where NPV is Nil

Therefore,

(Tshs1,450,000 x CPVFr,6) – Tshs6,000,000 = 0

Where,

CPVFr,6 is the cumulative present value factor for 6 years, and r is IRR

CPVFr,6 = 6,000,000/1,450,000 = 4.137931

If we look at the cumulative present value factor table and check the row of 6 years, we will find that the value of 4.111 (refer to the cumulative present value table below) which is the nearest to 4.137 appears in the 12% column.

Therefore, we can conclude that the internal rate of return is approximately 12%.

Continued on the next page

Present value of an annuity of 1 i.e. $\frac{1-(1+r)^{-n}}{r}$

where, r = discount rate
n = number of periods

Discount rate (r)

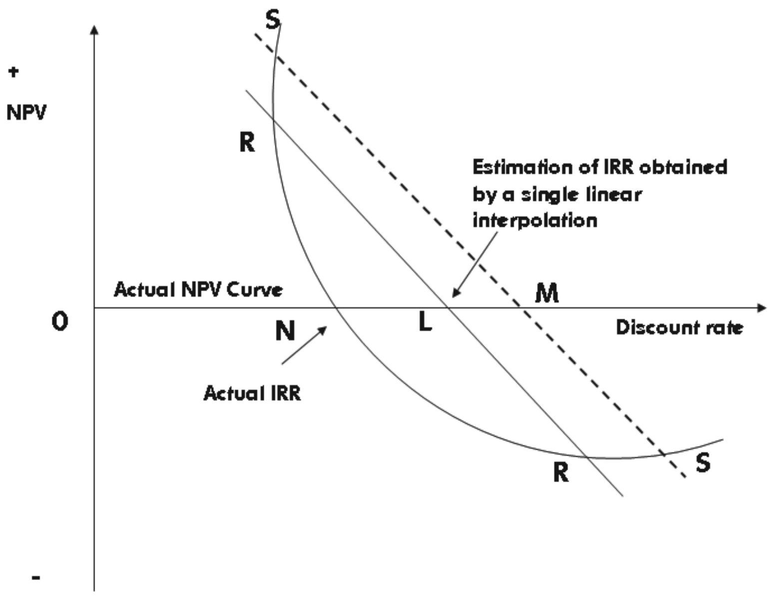
Periods (n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0·901	0·893	0·885	0·877	0·870	0·862	0·855	0·847	0·840	0·833	1
2	1·713	1·690	1·668	1·647	1·626	1·605	1·585	1·566	1·547	1·528	2
3	2·444	2·402	2·361	2·322	2·283	2·246	2·210	2·174	2·140	2·106	3
4	3·102	3·037	2·974	2·914	2·855	2·798	2·743	2·690	2·639	2·589	4
5	3·696	3·605	3·517	3·433	3·352	3·274	3·199	3·127	3·058	2·991	5
6	4·231	4.111	3·998	3·889	3·784	3·685	3·589	3·498	3·410	3·326	6
7	4·712	4·564	4·423	4·288	4·160	4·039	3·922	3·812	3·706	3·605	7
8	5·146	4·968	4·799	4·639	4·487	4·344	4·207	4·078	3·954	3·837	8
9	5·537	5·328	5·132	4·946	4·772	4·607	4·451	4·303	4·163	4·031	9
10	5·889	5·650	5·426	5·216	5·019	4·833	4·659	4·494	4·339	4·192	10

This **table of cumulative present value factors** can be used in cases where the project cash inflows are identical.

IRR obtained by the linear interpolation is only an approximation.

The actual NPV line is a curve rather than a linear as shown in the diagram below.

Diagram 4: Actual NPV Curve and estimation of IRR obtained by a single linear interpolation



The relationship between the discount rate and NPV can be seen in the above diagram. As the rate increases, the NPV decreases.

If we base our interpolation on points R, then we will get the IRR at L. Similarly, if we base our interpolation on point S, we will get the IRR at M. However, the actual NPV is a curve and the actual IRR is at N where this curve intersects the discount rate line.

2. When the project cash inflows are not identical

In this situation we use the interpolation method. The NPV at two discount rates will be required.

$$\mathrm{IRR} = \mathrm{a} + \frac{\mathrm{A}}{\mathrm{A} + \mathrm{B}}(\mathrm{b} - \mathrm{a})$$

Where,

a is lower of two rates of return used
b is higher of two rates used
A is NPV obtained using rate a
B is NPV obtained using rate b

Example

Continuing from the previous example of Strilco,

The following table give the particulars of a proposed project Y:

Period	Cash flow in 000's (Tshs)
0	(6,000)
1	1,450
2	3,250
3	500
4	1,450
5	600
6	1,450

The internal rate of return of the above project can be calculated in the following way.

First, we take 10% as a PV factor. That gives us a positive NPV of Tshs560
Next, since the NPV is positive, we increase the rate to 14%

Period	Cash flow in 000's (Tshs)	10% PV factors	Present value in 000's (Tshs)	14% PV factors	Present value in 000's (Tshs)
0	(6,000)	1.000	(6,000)	1.000	(6,000)
1	1,450	0.909	1,318	0.877	1,272
2	3,250	0.826	2,685	0.769	2,499
3	500	0.751	376	0.675	338
4	1,450	0.683	990	0.592	858
5	600	0.621	373	0.519	311
6	1,450	0.564	818	0.456	661
NPV			**560**		**(61)**

$$\mathrm{IRR} = 10\% + \frac{560}{560 - (-61)} \times (14 - 10)\%$$

= 10% + 3.61%

= 13.61%

1. Advantages of IRR

(a) It is a percentage which is more **easily understood.**

(b) **It considers the time value of money:** money has a time value i.e. the same amount of money has a different value at a different time. IRR considers the time value of money while appraising investment projects.

(c) **It uses cash flow, not profits:** the IRR method considers the cash flows involved in a project. Cash flow consideration is deemed to be more effective, as accounting profits can be manipulated.

(d) It considers all the **cash flows over the life** of a project.

(e) **It is directly related to the objective of maximising shareholders' wealth:** it means if a firm selects projects where the IRR exceeds the cost of capital, it should increase shareholders' wealth.

2. Disadvantages of IRR

(a) It is not a measure of **absolute profitability**.

(b) Interpolation only provides an **estimate,** and an accurate estimate requires the use of a spreadsheet programme.

(c) It is fairly **complicated** to calculate.

(d) **It cannot be used to appraise projects with non-conventional cash flows**: projects that have non-conventional cash flows are those where negative cash flows occur during the life of the project. Non-conventional cash flows may give rise to multiple IRRs, which means the interpolation method cannot be used.

Decision Rule

Accept all independent projects where the IRR is greater than the company's cost of capital or target rate of return.

SUMMARY

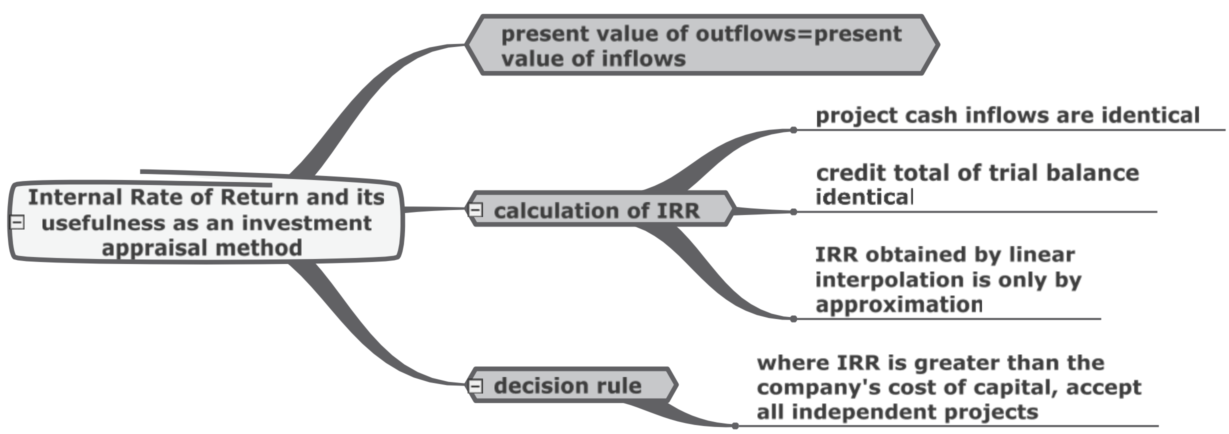
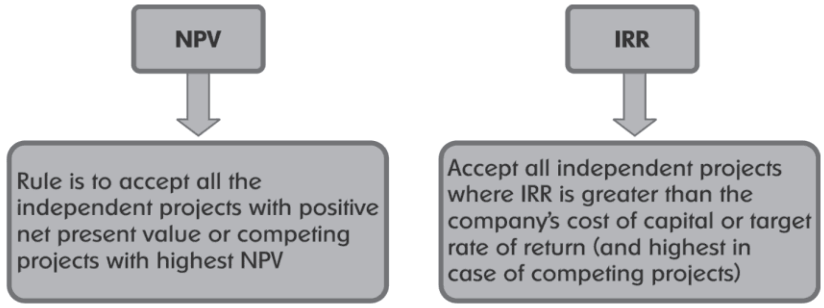


Diagram 5: NPV and IRR



3.7 Cost benefit analysis

Cost benefit analysis is a very commonly used technique in evaluating projects in the public sector. It is very widely applied in areas like transport and postal services, road and bridge construction, communication projects and projects related to education and training. Cost benefit analysis is an analytical decision making tool which facilitates comparison of costs associated with a project and the benefits attached with the execution of the project. It establishes a minimum desirable equilibrium point between the costs and benefits of a proposed project.

Benefit / Costs Comparison: here, the ratio between the benefit of the proposed project and cost of the project is calculated. The project is undertaken if the ratio is greater than 1. However, this method ignores adjustments for inflation.

In case it is not possible to determine benefits associated with a project, the concept of shadow pricing is used.
A shadow price is an increase in value which would be created by having available one additional unit of a limiting resource at its original cost. This represents the opportunity cost of not being able to use the one extra unit. The shadow price is the change in the objective value of the optimal solution of an optimisation problem determined by relaxing the scarce resources by one unit. Each constraint in an optimisation problem has a shadow price or dual variable.

Example

If a public sector firm has a constraint that limits the labour availability to 200 hours per week, the shadow price will indicate how much the management of the business should be willing to pay for an additional hour of labour.

If the shadow price is Tsh3,000 for the labour constraint, one should pay no more than $30 an hour for additional labour. Labour costs of less than Tsh3,000 per hour will increase the contribution margin objective value); labour costs of more than $30 per hour will decrease the contribution margin objective value). Labour costs of exactly Tsh3,000 will cause the contribution margin to remain the same.

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1. Following are the steps involved in carrying out cost benefit analysis of a capital investment / project:

Step 1: Analysing the problem and defining objectives of the cost benefit exercise

Step 2: Evaluating alternative courses of action through which the stated objectives can be achieved

Step 3: Analysing the various costs that would be incurred and the benefits that would be attained, both with regards to the firm and the society at large

Step 4: Evaluating the costs and benefits against pre-set parameters

Step 5: Drawing conclusions regarding the proposed project based on the evaluation carried out in Step 4

Step 6: Re-examining the problem and the objectives and matching the same with the conclusion

2. Advantages and disadvantages of cost benefit analysis

The **advantages** of the cost benefit approach are as follows:

It enables a government to exercise its monopolistic powers while deciding upon projects which are vital with regards to public interest

This analysis enables a public sector company to take a decision keeping in mind its service rendering objective

This analysis considers externalities and thus the favourable and unfavourable impacts on the society

This analysis reminds the political class that the costs and benefits of a proposed investment / project should be undertaken in the light of social costs and benefits too

The **disadvantages** of the cost benefit approach are as follows:

Cost benefit analysis cannot be undertaken when the government needs to decide between two projects which are not similar in nature. For example, the costs and benefits of road construction cannot be compared with the costs and benefits of establishing a healthcare centre.

Carrying out cost benefit analysis requires collection and analysis of intelligent data. Such data may not be available with public sector units.

It is extremely difficult to analyse the effects of 'spill-overs' in cost benefit analysis. 'Spill overs' are indirect benefits of a project which may not be visible without very in-depth analysis.

Uncertainties, inflation and time value of money are not considered in the cost benefit analysis.

3.8 Cost-Effectiveness Analysis - (CEA)

CEA identifies the most efficient way of achieving stated objectives. This decision making tool is often used by public sector companies to establish the economic effectiveness of a proposed investment / project. This method helps in identifying the least cost of performing an activity or carrying out a project and the maximum output that can be produced at a given target cost.

CEA can be used in the following forms:

Ex ante evaluation: this involves decision makers evaluating the economic efficiencies of potential projects, before deciding finally as to which project to go ahead with.

Ex post evaluation: this involves measuring the actual effectiveness of a project which has been completed.

Intermediary evaluation: this involves measuring the economic effectiveness of an on-going project. It gives a chance to the management to change a particular course of action within the project in order to improve the overall effectiveness.

CEA uses monetary values to measure costs and physical units of outputs to measure effectiveness. The ratios can be computed in the following ways:

CE ratio = C1/E1 (Equation 1)
EC ratio = E1/C1 (Equation 2)

Where,

C1 = the cost of option 1 (in Tshs)

E1 = the effectiveness of option 1 (in physical units).

Equation 1 shows cost per unit of effectiveness (for example, in case of police services, the amount of money spent against number of arrests made). If CE ratio criterion is used to choose between projects, the projects should be ranked in order of CE ratio, from lowest to highest. Thus, the most cost-effective project would have the lowest CE ratio.

Equation 2 shows the effectiveness per unit of cost (using the example of police services, it would represent the number of arrests made against the amount of money spent). If the EC ratio criterion is used to choose between projects, the projects should be ranked from highest to lowest. Thus, the most cost-effective project would have the highest EC ratio.

3.9 Value Analysis / Value Engineering

Value engineering is a planned approach of attempting to reduce costs and avoiding any unnecessary costs relating to a project before it is implemented. This is done by changing decisions relating to processes, raw materials, design of products, etc. in order to adopt cheaper alternatives. The primary focus is on reducing cost without compromising on the quality of the output.

Value analysis is similar to value engineering, but, it is performed after the product has been produced or the service has been offered. The aim here is to control future production of similar output.

Test Yourself 3

1. One element of superiority to the discounted cash flow method over the non-discounted cash flow method is that the timing of cash flows and the time value of money are taken into account through discounting. True or False.

2. Which of the following are types of methods of discounted cash flow?

   A Payback period
   B NPV and IRR
   C ROCE and payback period
   D NPV, IRR and ROCE

3. Internal rate of return takes the relative size of project into consideration. True or False.

4. For projects with non-conventional cash flows, there are more than one IRR. True or False.

5. For projects with non-conventional cash flows, IRR is more suitable than NPV. True or False.

6. NPV should be followed where a conflict occurs between mutually exclusive projects, as it demonstrates contribution of project in absolute terms. True or False.

7. For projects where discount rates change during its life, IRR method should be used as it can accommodate these changes. True or False.

Test Yourself 4

Warinx, a public sector company, needs to decide whether to invest in Project P or in Project Q.

The details have been given as under:

	Average Investment Tshs
Project P	101,250,000
Project Q	101,250,000

Both the projects have a total life of 4 years.

Expected cash inflows are as follows:

Year	**Cash inflows**	
	Project P (Tshs)	**Project Q (Tshs)**
1	24,750,000	38,812,500
2	27,562,500	38,812,500
3	27,562,500	37,687,500
4	72,000,000	36,562,500

Required:

Calculate the ROCE and state which project is acceptable.

Answers to Test Yourself

Answer to TY 1

Proper capital investment planning and control allows an organisation to:

(a) Take strategic decisions that help the organisation to exploit opportune investment opportunities.
(b) Minimise the fixed costs associated with the capital investment project.
(c) Avoid financial losses caused due to the failure of a capital investment project.
(d) Minimise the risk by investing in various types of capital investment projects.
(e) Avoid occurrence of frauds.
(f) Discover and rectify any discrepancy between the planned and the actual results.

Answer to TY 2

(a) In relation to the new development, Tujenge is considering the following steps

(i) Quantify the cost and benefits: management will need to prepare a forecast of costs and revenue for the new project.

(ii) Compare the cost and benefits with appropriate techniques: once a forecast has been prepared, management will use techniques such as the payback period, net present values and return on capital employed and compare the results of each.

(iii) Evaluate the risks involved and the sensitivity to changed situations: when we estimate the future cash flows for the construction project, there is a risk that they may not actually materialise as the future is uncertain; the actual outcome may be different. It is necessary to consider how this will affect the final outcome, by performing sensitivity analysis. For example, if cost of concrete becomes even higher than forecasted, what would the net present value of the project be after adjusting the calculations for this?

(iv) Consider qualitative factors such as the environment or employment generation: non-financial factors also need to be considered a part of this process such as legal issues on obtaining licences for building, ethical and environmental factors such as the impact of building to the surrounding areas and destruction of plantation, what competitors' reaction would be if the project went ahead etc.

(v) Take a decision: if the result of the above steps is viable and conforms to the business requirements, the project will be accepted by management. However, if the outcome of the above steps shows the project is not a viable option, as the return is too low or the legal issues too high for example, the project will be rejected.

(b) For any capital investment project, the following stages of evaluation are usually followed

(i) Initial evaluation: before a project starts, the company needs to evaluate the technical feasibility and commercial viability of the project by ensuring it is in line with the company's long-term strategic objectives.

(ii) Detailed assessment: as noted in part a), the cash flows of the project need to be viewed in detail together with sensitivity analysis performed to ensure the project adds value to the business.

(iii) Management approval: for such an important project for Tujenge Ltd, senior management approval is required, so they can assess if the project is deemed in line with long term strategy of the firm as well as ensuring the project adds to the profitability of the company.

(iv) Project implementation: this is when a team or person is assigned responsibility for overseeing the project development with targets set as part of the process.

(v) Monitoring the project: given that the housing development is a long term project, regular monitoring is essential to ensure the progress is in line with the forecasts and expectations. Regular monitoring allows for re-assessment at any stage of the project.

(vi) Post-completion audit: the final stage involves an enquiry into the cost and benefits of the project and identifying any deviations from the initial plan. The final stage allows for lessons to be learnt for future projects of the company.

Answer to TY 3

1. True, one of the factors that make DCF method more superior to non-DCF is that the timing of cash flows and time value of money are taken into account.
2. The correct option is **C**, as only NPV and IRR are types of methods of discounting cash flow.
3. False, one of the drawbacks of IRR is that it ignores the relative size of the project.
4. True, there are more than one IRR for non-conventional cash flow projects.
5. False, where there are non-conventional cash flows, NPV is more suitable method than IRR.
6. True, for mutually exclusive projects, the NPV method should be followed.
7. False, if there are varying discount rates over the life of a project, IRR method cannot accommodate for this, but NPV can.

Answer to TY 4

Depreciation 1/4, on straight line basis

Project P	25,312,500 Tshs
Project Q	25,312,500 Tshs

Year	Initial Investment	1 Tshs	2 Tshs	3 Tshs	4 Tshs	Total Tshs
Project P						
Cash Flows	(101,250,000)	24,750,000	27,562,500	27,562,500	72,000,000	151,875,000
Depreciation		(25,312,500)	(25,312,500)	(25,312,500)	(25,312,500)	(101,250,000)
Accounting Profit		**(562,500)**	**2,250,000**	**2,250,000**	**46,687,500**	**50,625,000**

Year	Initial Investment	1 Tshs	2 Tshs	3 Tshs	4 Tshs	Total Tshs
Project Q Cash Flows	(101,250,000)	38,812,500	38,812,500	37,687,500	36,562,500	151,875,000
Depreciation		(25,312,500)	(25,312,500)	(25,312,500)	(25,312,500)	(101,250,000)
Accounting Profit		**13,500,000**	**13,500,000**	**12,375,000**	**11,250,000**	**50,625,000**

Average investment = 101,250,000/2 = 50,625,000

Average profits

Project P = 50,625,000/4 = 12,656,250

Project Q = 50,625,000/4 = 12,656,250

$$\text{ROCE} = \frac{\text{Average annual accounting profits}}{\text{Average investment}} \times 100$$

Project P

$$\text{ROCE} = \frac{12{,}656{,}250}{50{,}625{,}000} \times 100$$

= **25.00%**

Project Q

$$\text{ROCE} = \frac{12,656,250}{50,625,000} \times 100$$

= **25.00%**

Both the projects give the same ROCE. However, Project Q is preferable because of its consistency. Project P shows heavy cash inflows at the end and little in the beginning, therefore it is risky.

Self Examination Questions

Question 1

You have been appointed as a financial manager in Marksons, a public sector pharmaceutical firm and are about to analyse a proposal to market a drug, which claims to be able to cure a particular disease. You are given the forecasts shown in the table. The project requires an investment of Tshs25 million in plant and machinery (line 1). This machinery can be dismantled and sold for net proceeds estimated at Tshs4,873,000 in year 7.

This amount can be taken as the plant's salvage value.

The discount rate used by the company for evaluating projects is 20%.

Required:

Calculate the NPV and advise management on the acceptability of the project.

	Tshs'000							
Years	**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**
1. Capital investment	25,000							(4,873)
2. Working capital		1,375	3,222	8,153	12,225	8,957	5,005	
3. Sales		1,308	32,218	81,525	122,253	89,585	49,293	
4. Cost of goods sold		2,093	19,323	48,880	73,363	53,730	29,575	
5. Other costs	10,000	5,500	3,025	3,328	3,660	4,028	4,430	
6. Depreciation		3,958	3,958	3,958	3,958	3,958	3,958	
7. Profit (3-4-5-6)	**(10,000)**	**(10,243)**	**5,913**	**25,360**	**41,273**	**27,870**	**11,330**	

Question 2

	Tshs
A government run company has to decide whether to buy a machine for	210,000,000
Saving for each of the 5 years	55,000,000
Resale value at the end of 5 years	22,500,000

Decide whether or not to take on this project using:

(a) Return on Capital employed (ROCE)
(b) Internal rate of return (IRR)

Question 3

Sisyphean, a public sector company, is planning to augment its production facility by purchasing new equipment. It has received quotations from two suppliers.

The details of the equipment are given below.

Equipment 1

	Tshs
Cost of equipment	150,000
Net expected cash flows for six years	40,000
Salvage value	0

The piece of equipment has a life of six years.

Equipment 2

	Tshs
Cost of equipment	100,000
Net expected cash flows for six years	28,000
Salvage value	0

The piece of equipment has a life of six years.

The cost of capital for Sisyphean is 11%.

Ignore taxation and inflation.

Required:

(a) Calculate the Net present value (NPV) of both pieces of equipment.

(b) Calculate the Internal rate of return (IRR) of both pieces of equipment.

(c) Consider both the pieces of equipment as mutually exclusive. Which piece of equipment should Sisyphean buy?

Answers to Self Examination Questions

Answer to SEQ 1

		Tshs'000							
	Years	**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**
1.	Sales		1,308	32,218	81,525	122,253	89,585	49,293	
2.	Cost of goods sold		(2,093)	(19,323)	(48,880)	(73,363)	(53,730)	(29,575)	
3.	Other costs	10,000	(5,500)	(3,025)	(3,328)	(3,660)	(4,028)	(4,430)	
4.	Cash flow from operations (1 - 2 - 3)	(10,000)	(6,285)	9,870	29,317	45,230	31,827	15,288	
5.	Change in working capital		(1,375)	(1,847)	(4,931)	(4,072)	3,268	3,952	5,005
6.	Capital investment and disposal	(25,000)							4,873
7.	Net cash flow (4 + 5 + 6)	(35,000)	(7,660)	8,023	24,386	41,158	35,095	19,240	9,878
8.	PV Factor @ 20%	1	0.833	0.694	0.579	0.482	0.402	0.335	0.279
9.	Present value	(35,000)	(6,381)	5,568	14,119	19,838	14,108	6,445	2,756
10.	**Net present value (sum of 9)**	**21,453**							

Conclusion: the NPV is positive by a reasonable amount; hence the project should be accepted.

Net present value = Sum of 9 = Tshs21,453, 000

Answer to SEQ 2

(a) ROCE of the investment

Accounting profit = Tshs55,000,000 – Tshs37,500,000 (W1) = Tshs17,500,000
Average investment 1/2 of (Tshs210,000,000 + Tshs22,500,000) = Tshs116,250,000

$$\text{ROCE} = \frac{\text{Tshs } 17{,}500{,}000}{\text{Tshs } 116{,}250{,}000} \times 100 = 15.05\%$$

Workings

W1 Calculation for depreciation

	Tshs
Value of machine	210,000,000
Less: Resale value	(22,500,000)
Amount to be recovered in 5 years	187,500,000
Depreciation charged every year (187,500,000/5)	**37,500,000**

(b) IRR of the investment

Step 1: Discounting cash flows at 10%

NPV using 10% as the discount rate

Year	Cash Flows Tshs (000s)	PV Factor 10%	PV of Cash Flows Tshs (000's)
0	(210,000)	1	(210,000.00)
1 to 5	55,000	3.791	208,505.00
5	22,500	0.621	13,972.50
		NPV	**12,477.50**

Note: the cumulative discount rate table figures for 10% have been used for 1-5 years cash flow as it is consistent.

Step 2: Calculate the second NPV using a higher rate (Since the NPV using 10% is positive a higher rate will be used to obtain a negative NPV)

NPV using 14% as the discount rate

Year	Cash Flows Tshs (000s)	PV Factor 14%	PV of Cash Flows Tshs (000s)
0	(210,000)	1	(210,000.00)
1 to 5	55,000	3.433	188,815.00
5	22,500	0.519	11,677.50
		NPV	**(9507.50)**

Step 3: Use the two NPV values to estimate IRR

The interpolation method assumes that the NPV rises in a linear fashion between the two NPVs close to 0. The real rate of return is therefore assumed to be on a straight line between NPV = Tshs12,477.5 at 10% and NPV = Tshs(9,507,500) at 14%.

$$IRR=10+\frac{12,477.5}{12,477.5-(-9,507.5)}\times(14-10)$$

= 10% + (0.5675 x 4)

= 10% + 2.27%

= 12.27%

If the company policy is to undertake investments which are expected to yield 11% or more, this project would be undertaken.

Answer to SEQ 3

(a) Net present value

Equipment 1

Year	Cash flow (Tshs)	Discount cash flow @ 11%	Present value (Tshs)
0	(150,000.00)	1	(150,000.00)
1	40,000.00	0.901	36,040.00
2	40,000.00	0.812	32,480.00
3	40,000.00	0.731	29,240.00
4	40,000.00	0.659	26,360.00
5	40,000.00	0.593	23,720.00
6	40,000.00	0.535	21,400.00
NPV			**19,240.00**

Net present value of Equipment 1 = Tshs19,240.00

Equipment 2

Year	Cash flow (Tshs)	Discount cash flow @ 11%	Present value (Tshs)
0	(100,000.00)	1	(100,000.00)
1	28,000.00	0.901	25,228.00
2	28,000.00	0.812	22,736.00
3	28,000.00	0.731	20,468.00
4	28,000.00	0.659	18,452.00
5	28,000.00	0.593	16,604.00
6	28,000.00	0.535	14,980.00
NPV			**18,468.00**

Net present value of Equipment 2 = Tshs18,468.00

(b) Internal rate of return

We can use 11% as the lower rate and 20% as the higher rate as both showing positive NPV at 11%.

Equipment 1

Year	Cash flow (Tshs)	Discount factor @ 11%	Present value @ 11% (Tshs)	Discount factor @ 20%	Present value @ 20% (Tshs)
0	(150,000.00)	1.000	(150,000.00)	1.000	(150,000.00)
1	40,000.00	0.901	36,040.00	0.833	33,320.00
2	40,000.00	0.812	32,480.00	0.694	27,760.00
3	40,000.00	0.731	29,240.00	0.579	23,160.00
4	40,000.00	0.659	26,360.00	0.482	19,280.00
5	40,000.00	0.593	23,720.00	0.402	16,080.00
6	40,000.00	0.535	21,400.00	0.335	13,400.00
NPV			**19,240.00**		**(17,000.00)**

$$IRR = 11 + \frac{19{,}240}{19{,}240 - (-17{,}000)} \times (20 - 11)$$

= 11% + 0.53 x 9%
= 11% + 4.77%
= 15.77%

Equipment 2

Year	Cash flow (Tshs)	Discount factor @ 11%	Present value @ 11% (Tshs)	Discount factor @ 20%	Present value @ 20% (Tshs)
0	(100,000.00)	1.000	(100,000.00)	1.000	(100,000.00)
1	28,000.00	0.901	25,228.00	0.833	23,324.00
2	28,000.00	0.812	22,736.00	0.694	19,432.00
3	28,000.00	0.731	20,468.00	0.579	16,212.00
4	28,000.00	0.659	18,452.00	0.482	13,496.00
5	28,000.00	0.593	16,604.00	0.402	11,256.00
6	28,000.00	0.535	14,980.00	0.335	9,380.00
NPV			**18,468.00**		**(6,900.00)**

$$IRR = 11 + \frac{18{,}468}{18{,}648 - (-6{,}900)} \times (20 - 11)$$

= 11% + 0.73 x 9%
= 11% + 6.55%
= 17.55%

(c) Choosing the equipment

Net present value is a better method than internal rate of return for appraising investment projects. Equipment 1 has a higher NPV than Equipment 2. Hence, Equipment 1 must be selected.

SECTION B

ACCOUNTING FOR COOPERATIVES

B1

STUDY GUIDE B1: CONCEPTS AND EMERGENCE OF CO-OPERATIVES

Get Through Intro

Co-operative societies help in the uplifting of members of public, especially those who belong to the lower middle classes. These societies enable people to come together voluntarily and achieve common goals. Members can get goods and services of good quality at reasonable rates. Members also come together and form such societies for mutual benefits like conducting production and agriculture activities.

This Study Guide introduces you to the concepts of co-operative societies, including their features, types, advantages and disadvantages. It will enable you to understand the purpose of formation of such institutes and also recognise the fact that such organisations contribute tremendously in developing an economy.

Learning Outcomes

a) Explain the concepts of co-operation and co-operatives.
b) Explain the history of co-operatives.
c) Explain the characteristic features of a co-operative society and its distinction from other forms of business organisations.
d) Identify and explain various types and classification of co-operatives.
e) State the co-operative laws and regulations.
f) Explain the advantages and disadvantages of co-operatives including the SACCOS.

1. Explain the concepts of co-operation and co-operatives.
Explain the history of co-operatives.
[Learning Outcomes a and b]

1.1 Co-operation and Co-operatives

(a) Co-operation

Man is a social being, and, thus cannot live in isolation. He needs to be a part of and accepted by the society. In order to survive and grow, he needs the support and company of his fellow beings. Thus, co-operation among human beings is the basic principle underlying human life.

Every person, every society and every country needs to engage themselves in co-operating with each other in order to fulfil their endeavours. Co-operation brings people and nations together and motivates all to move towards achieving their goals and living in peace and prosperity.

(b) Co-operatives

Definition

Co-operatives are defined as being autonomous associations of persons united voluntarily to meet a common economic, social and/or cultural objective, through a jointly owned and controlled enterprise.

Source: International Co-operative Alliance statement on the Co-operative identity

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In short, it is an organisation that is **owned and managed jointly by those who use its facilities and services.** A co-operative's purpose is to provide services on a non-profit basis to the shareholders or members who control it.

Co-operatives are based on the spirit of co-operation and equality.

1.2 History of co-operatives

Historians have found evidence of co-operation in periods relating to ancient Greece, Rome, Babylon, Egypt and China. Basic forms of co-operation helped early agriculture efforts. People co-operated with each other in activities relating to defending lands, sharing equipment, harvesting crops and storing the crops.

But the co-operation in its true sense developed after the industrial revolution when people faced the dearth of poverty and so had to come together to get out of hardships.

1. Early co-operative societies

Co-operation was present in business prior to the era of Industrial Revolution. Evidence in the form of records of mutual fire insurance companies have been found by historians in Paris and London. The first organised co-operative society was the Amicable Society formed in London in the year 1705. Later on, industrial co-operative societies, mostly related to flouring mills and baking, started to be organised from 1760. However, these co-operatives failed to make big impacts. In the 19th century, a well-known businessman, Robert Owen (1777-1858) began lobbying for co-operative societies in order to help the distressed industrial workers. Owen had brilliant thoughts based on co-operative lines relating to the fields of agriculture, industry, distribution and housing.

2. Evolution of co-operation and co-operative thought

After the unsuccessful era of early co-operative ideas, famous co-operative pioneers like Robert Owen proposed the thought that co-operative institutions needed to be self-sufficient in meeting its production and consumption goals. Owen's plans revolved around establishing self-sufficient communities like the Fourier's Phalasentre, wherein the producers and consumers would be the same set of people. He tried to advocate the fact that instead of people dividing themselves into separate categories of producers and consumers, they would benefit if the work together to fulfil their goals. Thus, the seeds of co-operation and its benefits were sown.

Owen was successful in bringing members of public together by establishing Grand National Consolidated Trade Unions. More than 500,000 members had joined the movement. These unions were aimed at re-structuring industries in lines of co-operative ideas. However, these unions could also not make a significant impact. But, Owen's thoughts and ideas, actions and establishment of the unions paved way for co-operation between people. Owen was the first person to coin the term 'co-operative".

Another pioneer of the co-operative movement in England (along with Owen) was Dr William King. He advocated the importance of capital in formation and operation of a co-operative, but, however, also emphasised that such capital should be contributed by members themselves.

Besides the above, Dr King emphasised two very fundamental aspects of co-operative societies:

Co-operatives are voluntary association of people. People cannot be coerced into joining a co-operative.

Co-operatives should be free from religious and political ambitions and interference.

While the co-operative revolution was taking shape in England, such thoughts were also becoming popular in France, especially after the Great French Revolution. Charles Fourier is considered to be the visionary of French co-operatives.

3. The Rochdale Pioneers

In the initial days of the co-operative movement, a prominent co-operative was established in Rochdale, England. However, the co-operative which was established in 1833 failed to make its mark and eventually closed down in 1835.

In 1844, the world's first consumer co-operative store was established which became the prototype for all such stores set up across the globe in later periods.

The following revolutionary co –operative practices were adopted in Rochdale, which later became popular as the Rochdalian Principles:

Open and voluntary membership

Capital of the co-operatives to be contributed by the members themselves for which they would receive a fixed rate of interest

The goods supplied to the members to be in their purest form in order to prevent members from consuming adultered products

Goods supplied to be of proper weights and measures

Prices charged to be at par with or below market rates

No credit transactions between a co –operative and its members

Profits to be distributed in ratio of the purchases made by individual members

Principle of 'one member one vote' to be followed strictly (democratic control)

Statements of financial position and profit and loss need to be provided to members from time to time

The above principles have evolved as principles of modern era co-operatives too.

Test Yourself 1

Which of the following was the first ever organised co-operative society?

A Rochdale Society
B Amicable Society
C Grand National Consolidated Trade Union
D The French Society

2. Explain the characteristic features of a co-operative Society and its distinction from other forms of business organisations.

[Learning Outcome c]

2.1 Characteristic features of a co-operative society

Voluntary association: people desirous of coming together at their own free will in order to improve their economic conditions form co-operative societies. Individuals with common objectives and interests join a co- operative by subscribing to its shares and are also free to leave whenever they wish to. However, a member cannot transfer his / her share to another individual.

1. **Legal entity:** a co-operative society needs to be registered under the provisions of the law of the land. Once registered, it becomes a legal entity, that is, it can carry on business, sue other parties or get sued in a court of law. It is thus an autonomous self-governing body. Income generated by the co-operative is taxable.

2. **Democratic control and equal voting rights:** co-operative societies work on the essence of equality. Each member of a co-operative has one vote, regardless of the number of shares held by them. This ensures democratic form of working as no member can dominate or influence any decision.

3. **Non profit and service motive:** co-operative societies are formed with the sole aim of serving the members by providing them goods, services and credit at reasonable rates. They are mostly non profit making in nature and work on the principle of mutual help.

4. **Fixed, but limited return on investment:** members need to contribute some amount of capital during joining a co-operative. They are assured of a fixed rate of return out of the surplus funds of the co-operative as an incentive to motivate them to keep their investment intact with the Society. However, this interest rate usually goes up to a maximum of 10%.

5. **Trading in cash:** co-operatives make sales mostly on cash basis. The co-operatives run on limited capital and hence their capacity to deal on credit basis is also limited. Further, cash dealings also secure them from delayed receipts and bad debts.

6. **Moral emphasis:** a co-operative is built upon mutual trust and co-operation among its members. Thus, these institutes inculcate the qualities of honesty, integrity and loyalty among members. Members apart from looking into their self-interests also work selflessly for each other.

7. **State control:** co-operatives, as mentioned earlier, need to be registered as per the laws of the land where they choose to operate. Thus, they come under regulation from the State. Apart from this, since they are formed with the goal of providing service to members of society, they receive grants and subsidies from the State and are such also regulated by the State.

2.2 Differences between co-operatives and other forms of business organisations

The differences between co-operatives and other forms of business organisations are discussed in the following table:

Basis of difference	Sole traders	Partnership	Company	Co-operative Societies
Objective	To earn profit.	To earn profit.	To maximise shareholders' wealth.	To provide service to members.
Decision making	Controlled by the sole proprietor.	Divided between partners as specified in Partnership Deed.	Board of directors appointed by the shareholders.	Democratic, each member has one vote irrespective of the shares held by them.
Source of capital	Own contribution and partly borrowed funds.	Contribution by partners and partly borrowed funds.	Equity and preference shares, long term loans, debentures, etc.	Contribution by members in form of shares or membership fees.
Liability	Unlimited liability of the owner.	Unlimited liability of partners.	Liability of equity shareholders limited to the extent of the face value of the shares held by them.	Limited liability of members.
Number of members	One	Minimum two and maximum ten members.	Private Limited Companies: minimum one and maximum fifty Public Limited Companies: Minimum seven and maximum unlimited	(a) 50 people or more if it is an agricultural society (b) 20 people or more if it is a savings and credit cooperative society (c) 10 people or more if it involves people with specialised skills (d) d) 10 people or more for other types of cooperative society.

Test Yourself 2

Which of the following statements is correct regarding the voting rights of the members of a Co-operative Society?

A Every member of a co-operative society has two votes
B The votes of the members of a co-operative society are decided based upon the purchases made by them
C The votes of the members of a co-operative society are decided based upon the amount of capital contribution made by them
D Every member of a co-operative society has one vote

3. Identify and explain various types and classification of co-operatives. [Learning Outcome d]

Co-operatives can be classified in accordance with the groups which they serve.

The classification (and types within each classification) of co-operatives can be discussed as follows:

3.1 Producers' co-operatives

Also known as industrial co-operatives, these are voluntary associations of small producers who come together to face challenges posed by the capitalist groups and middlemen. Their primary goal involves production of goods for the benefit of members. Production, day to day operations and marketing activities are undertaken by members themselves. Surplus production is at times sold to non-members at a profit. Members get dividends in accordance with the amount contributed by them in the co-operative.

Examples include crafts, agricultural products, carpentry and lumber.

Following are the **types** of producers' co-operatives

(a) **Industrial service cooperatives:** here, producer members carry out industrial work independently and sell their outputs to the co-operative. Raw materials, machineries and other tools are supplied by the co- operative to the members. The co-operative also markets the outputs. At times, hire purchase facilities are also extended to members to enable them to acquire machines and tools.

(b) **Manufacturing cooperatives:** here, producer members are the salaried employees of the co-operative. Raw materials, machineries and other tools are supplied by the co-operative to the members. The goods are produced by the members at a common location and are sold in the market by the co-operative. Profits are distributed among members as per their investment in the co-operative.

3.2 Consumers' co-operatives

These are formed by consumers to eliminate middlemen and establish direct relationship with producers in order to obtain their daily requirements at reasonable prices. The co-operative buys goods directly from manufacturers or large wholesalers at reduced price, the benefit of which is passed on to the members. Membership can be availed by purchasing a share of the co-operative. Any surplus funds left is distributed among the members in accordance with the amount of purchase made by them. Goods can also be sold to non- members, but, such members will not have right in the surplus funds.

Types of consumers' co-operatives include:

Consumers' wholesale c-operatives
Consumers' retail co-operatives

Both the above enable consumers to establish their own wholesale / retail stores which would help them meet their daily needs at reduced prices and share earnings, if any. These stores are especially useful where other stores have closed their businesses. Food, agricultural products, hardware and other fast moving consumer goods are usually distributed to members through these stores.

Examples include University Co-operative Bookshop Ltd (Australia), Coop Italia (Italy) and Natural Markets (USA).

3.3 Marketing co-operatives

They are voluntary associations of small and medium scale producers (like, farmers and artisans) who wish to come together to sell their outputs at decent prices through a centralized agency. In this way, middlemen can be eliminated, good storage facilities are available, common marketing efforts are undertaken, etc. The central sales agency would be responsible for grading, packing and labeling of output, warehousing, advertising and sales promotion, transportation, etc. The sale proceeds obtained are distributed among members according to the ratio of their output.

Examples include Land O'Lakes, Sunkist and Blue Diamond.

Marketing co-operatives can be single purpose or multipurpose co-operatives.

(a) **Single purpose co-operatives** are established to cater to a particular need of members. Such a need may either relate to credit or advertising or supply of resources, etc.

(b) **Multipurpose co-operatives** are formed with the goal of meeting various needs at the same time, like, supply of improved seeds, modern agricultural tools, credit, healthy sanitation, etc.

3.4 Farming co-operatives

These co-operatives primarily are present in agriculture dominated economies. The farming co-operatives are voluntary association of small farmers who come together to take advantages of economies of large scale farming and maximise their agricultural outputs.

As small farmers, they are often unable to use good quality seeds and modern methods of production. But by coming together and carrying out farming activities in a joint manner, it becomes possible for them to produce good quality produces at a low cost.

Example

Examples include Alberta Wheat Pool (Canada), Flora Holland (Netherlands) and United Egg Producers (USA).

Following are the types of farming co-operatives:

(a) **Better-farming co-operatives:** primary objectives of these co-operatives are to educate farmers regarding enhanced farming methods like, improved seeds, manures, tools, etc. Farmers are also informed about availability of farm credit and sources of various farm supplies. In this kind of co-operatives, the ownership and management of the farm lands is vested with the individual farmers.

(b) **Tenant-farming co-operatives:** here, the co-operative owns / leases the land, but the farming is done by the farmer members. The land is divided into smaller blocks, and, each block is handed over to individual farmers for cultivation. Cultivation is carried out by the farmers in accordance with predetermined plans made by the co-operative.

(c) **Joint-farming co-operatives:** primary objectives of these co-operatives are to address issues relating to uneconomical cultivation of small fragmented lands. Farmer members pool their lands to cultivate jointly as per predetermined plans made by the co-operatives. Decisions regarding purchasing of lands, seeds, manures, tools, raising of finance, sale of produce, etc. are taken jointly.

(d) **Collective-farming co-operatives: the co-operative** owns / leases the land the cultivation is carried out collectively the farmer members. Mostly, these co-operatives are organised on Government waste lands. Members are paid wages for their work. Profits, if any, are divided in the form of bonus in the ratio of wages paid.

3.5 Credit Co-operatives

People of moderate means voluntarily come together with the objective of meeting short term financial needs of members and also to cultivate the habit of savings among members. Funds are pooled in by way of contributions from members and deposits by members and non-members.

The Savings and Credit Cooperative Organisations is an example of credit co-operatives.

There are two types of credit co-operatives:

(a) **Agricultural credit co-operatives** which grant credit primarily in rural areas to meet needs of residents of villages.

(b) **Non-agricultural co-operatives** which are formed in the semi urban and urban areas to meet the credit requirements of members.

3.6 SACCOS (Savings and Credit Cooperative Organisations)

Savings and Credit Co-operative (SACCOS) refers to a form of credit co-operative whose primary goal involves pooling of savings for its members and extend them credit facilities whenever required. Microfinance in many African nations including Tanzania began with SACCOS.

The membership of a SACCOS is open to all members of society, regardless of their religion, race and social and economic status. In a SACCO, members agree to pool funds by saving together meet credit requirements of each other by lending from the saved funds at reasonable interest rates. The interest cost on savings and the cost of administration are met from the funds collected by way of interest on credit.

3.7 Housing Co-operatives

Such co-operatives are usually formed in urban areas by middle and low income group people in order to buy / rent properties for residential or business purposes. Members are assisted in obtaining finance and construction materials at competitive rates. Each member subscribes to at least one share of the co-operative and his / her liability is limited to their shares held.

Test Yourself 3

What are the two types of consumers' co-operatives?

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4. State the co-operative laws and regulations.

[Learning Outcome e]

4.1 The Co-operative Societies Act No.20 of 2003 and the Co-operative Societies Rules of 2004

The Cooperative Societies Act specifies guidelines on establishing and running of co-operatives. The Cooperative Societies Rules are a simplified guide to the step by step operation of the Act

The Tanzanian Government and the minister in charge for co-operatives make laws in order to encourage formation of co-operatives throughout the country. An officer and a Registrar are appointed by the Government who oversee and supervise the enforcement and implementation of the provisions of the Act and Rules.

Specific functions of the Registrar are as follows:

- registering, promoting, inspecting and advising cooperative societies
- acting as an advisor to the co-operatives minister
- encouraging formation of cooperative societies in all areas of the economy

4.2 Main areas in which co-operative societies can be set up in Tanzania

- Agriculture (including sericulture, fishing, etc.) and mining
- Savings and credit provision, like, SACCOS (Savings and Credit Cooperative Organisations)
- Consumer goods, that is, wholesale and retail store for members
- Small and medium scale industries
- Housing societies which would help members in building and construction
- Other specialised skills like carpentry, handicrafts, etc.

4.3 Basic requirements for establishing a cooperative society

agricultural society: minimum 50 members

savings and credit cooperative society: minimum 20 members

co-operative societies involving people with specialised skills: minimum 10 members

other types of cooperative societies: minimum 10 members

4.4 Qualifications of members

For becoming a member of a co-operative society, a person needs to fulfil the following:

The person should

be engaged in an occupation similar to that being carried on by the co-operative

share a common goal and need with the other members of the co-operative

have attained 15 years of age (18 in case he / she wants to be elected to the board of the co-operative)

be financially capable of buying the shares of the co-operative or paying its membership fees

4.5 By-laws of co-operative societies

Pre co-operative societies and co-operative societies should have their own rules in order to ensure that they work towards fulfilling their objectives. These rules are known as by-laws and are necessary for efficient managing of a co-operative. The by-laws are framed depending upon the type of co-operative society (types of co-operatives have been covered in the previous Learning Outcome).

The bye- laws are framed with help from the District Cooperative Officer or any other competent officer. The bye-laws deal in the following areas:

Proposed name and area of operation of the co-operative society

Goals and objectives of the co-operative society

Rules of membership relating to terms of admission, shares and membership fees

Rules regarding payment to a member in case they terminate the membership

Application of the funds of the Society, including the source of such fund, how the funds would be held and disposed

Extent of liabilities of individual members and procedure of transfer of shares in the unfortunate event of death of a member

Procedures regarding conduct of general meetings of the co-operatives and matters to be debated in such meetings

Rules regarding appointment, duties and removal of board members

Names of authorities who would be eligible to sign on documents on behalf of the co-operative

4.6 Documents to be submitted to the registrar

The members who wish to establish a co-operative society need to submit an application to the Registrar (or his representative in the area, like, the District Cooperative Officer (DCO) at district level and the Assistant Registrar at regional level). The following documents need to be submitted along with the application:

- Certified copy of the first meeting that had taken place between the members and the Registrar / Assistant registrar / DCO
- Four copies of the proposed by-laws of the co-operative
- Four copies of the feasibility report of the co-operative
- Any document other than those mentioned above requested by the Registrar

Satisfactory applications will lead to awarding of a letter of recognition by the Registrar. This letter permits the members to work as a pre co-operative society for a period of three years. After three years if the Registrar is satisfied that the pre co-operative society has fulfilled the necessary conditions, the organisation is granted the status of a full co-operative society. In case after three years the Registrar does not grant the group such a status, they can appeal to the minister responsible for co-operatives within 60 days. The minister's decision would be final in this matter.

4.7 Rights and obligations of members

On paying the membership fees or subscribing to the shares of a co-operative, a member enjoys the following **rights**:

- To vote in policy matters of the co-operative. Each member is entitled to one vote.
- To obtain share certificates, once they have subscribed and paid for the shares.
- To call for and participate in the meetings of the co-operative as per provisions contained in the by-laws
- To be informed about all matters of the society and also audit documents of the co-operative
- To get a share of the income of the co-operative
- To withdraw membership after following due procedures and also nominate a successor

The members have the following **duties** towards the co-operative and other members:

- To follow the rules and regulations as set by the co-operative and as contained in the Co-operative Societies Act
- To pay amounts due on shares and any debts to the co-operative on time
- To attend meetings of the co-operative and follow the decisions taken at such meetings
- To make every effort to safeguard the properties and the image and reputation of the co-operative
- To nominate successors

A person **ceases to be a member** of a co-operative in the following cases:

- Gives up their shares or ceases to contribute in accordance with the rules contained in the by-laws
- Relocates to a different area, away from the co-operative
- Fails to participate in affairs of the co-operative
- Performs an action which is detrimental to the interests of the co-operative and thereby removed

4.8 Liabilities of members

Liability of members towards the debts of a co-operative can take one of the following forms:

Liability of a member can be limited to the extent of the value of shares held by them.

At times, the by-laws of the co-operative may allow members to assume a liability greater than the value of their shares. This is called as liability limited by guarantee.

4.9 Management of Cooperative Societies

(a) General meetings

Important policy decisions of a co-operative are taken at its general meetings. The members hold such meetings at least once a year. The quorum of a general meeting should be either 100 members or at least half of total number of members, whichever is less. Members should be provided with the date, time, venue and schedule of the meeting at least three weeks in advance.

The following matters are taken up in a general meeting:

appointment and removal of board members and auditors

decision regarding how the surplus funds would be distributed among members

discussions on matters relating to the audited accounts

discussions relating to proposals of amending the by-laws

decisions regarding acquiring and disposing the non current assets of the society

decisions regarding business plans and budgets

(b) The board

The board of a society is responsible for ensuring that the affairs of the society are carried on in accordance with the by-laws. The board can hire people for carrying out its day-to-day activities. The members of the board are replaced on a regular basis in order to avoid concentration of power in a few hands.

The following are some of the basic rules followed by every society while forming a board:

The board of a co-operative society must have a minimum of five and a maximum of nine members.

In order to avoid concentration of power in a few hands, no member can remain a member of the board for a period of more than nine years at a stretch.

In the initial years of the society, it is recommended that at least one-third of the members of the board be replaced every three years.

Each year, all members of the board need to fill a form declaring the properties and other businesses held by them. The forms then need to be submitted to the registrar for records.

(c) Duties of co-operative societies

i. Maintaining records

All records relating to the society must be kept in the office of the society at all times so that the same can be inspected by the members and the Registrar whenever there is such a need. Following are the list of the general records that need to be maintained:

Register containing names and addresses of members and the amount of shares held by them.
An audited statement of financial position of the society.
Audited income statement of the society.
Copies of the Co-operative Act 2003, the Co-operative Societies Rules 2004 and the by-laws of the society.

ii. Changes in by-laws

Any changes to the by-laws of a society recommended / accepted by members of the Board during the general meeting must be sent to the Registrar for his approval before the same becomes an accepted part of the by- laws. This is done to ensure that such changes are incorporated in accordance with the legal provisions.

iii. Accounts

It is the duty of every registered co-operative society to maintain copies of audited final accounts in its office premises. An independent, qualified financial auditor must audit the accounts at least once every year. A society needs to draw up its final accounts and get it audited within three months of the end of its financial year. Then the accounts need to be submitted to the Registrar for verification and record.

Test Yourself 4

Before a co-operative society can be formed, certain documents need to be submitted to the Registrar. What are they?

5. Explain the advantages and disadvantages of co-operatives including the SACCOS.

[Learning Outcome d]

5.1 Advantages of co-operatives

Co-operatives are formed with the objectives of co-operation and mutual benefit. Following are some of the advantages of co-operatives:

1. **Ease of formation:** as compared to other forms of organisations, formation of co-operatives involves lesser capital and legal procedures.

2. **Open, unrestricted membership:** the membership of co-operatives is open to all irrespective of people's colour, religion, economic or social status. This facilitates the growth of the entire society. Members of public belonging to the lesser income groups can solve their economic issues through co-operatives.

3. **Limited liability of members:** the liability of members of co-operatives is limited to the contribution made by them / shares held by them in the co-operatives. Therefore, there is no risk of the members' personal assets getting attached in case a co-operative runs into financial losses.

4. **Service to members:** co-operatives provide their members quality service at reasonable rates. Members can purchase various goods and services from the co-operatives at reduced rates, borrow funds at concessional interest rates, obtain information regarding conduct of agriculture and other businesses, etc.

5. **Democratic management:** management of a co-operative is carried on by elected members. In matters of policy formulation and decision making, they work on the principle of one member, one vote. In this way it is ensured that no single member or a group of members dominate the co-operatives.

6. **Stability and continuity:** a co-operative is not affected by death and insolvency of individual members. New members join the co-operatives and existing members may leave by giving up their shares. Co-operatives enjoy perpetual succession and are continued until they themselves become insolvent.

7. **Economic operations:** as middlemen are eliminated, operations of a co-operative can be conducted in an economical manner. Members perform various activities thereby bringing down the cost of operation further. Co-operatives also enjoy the advantages of large scale buying and selling, thus enabling them to pass on such benefits to the members.

8. **State patronage:** co-operatives are established for the welfare of society, and thus, they enjoy special assistance from the State in matters of finance at cheap rates and purchase of various goods and services. State looks after the interest of co-operatives and ensures their sustainability as these institutes help in achieving well-being of the society.

9. **Non-economic benefits:** co-operatives are based on mutual co-operation among people. These institutes help build feelings of togetherness, trust, loyalty and inculcate good habits of saving and economising among members. Members also learn self-government as they are the ones who manage the co-operatives.

5.2 Disadvantages of co-operatives

Following are the disadvantages of co-operatives:

1. **Limited resources:** the financial strength of a co-operative depends upon its members' ability to pool in funds. Often the members are from very humble backgrounds and thus, the fund raising abilities of the institute may be very limited. Most of the times the co-operatives themselves are in search of loans at reduced interest rates, but, obtaining such funds may be very challenging.

2. **Lack of managerial expertise:** co-operatives are operated and managed by the members themselves. The members often do not have any past business experience and thus lack the expertise of managing an institute. Due to inefficiency of the management team, these institutes may not be very successful.

3. **Lack of secrecy:** sensitive matters relating to the operation of the co-operatives are openly discussed in meetings which are witnessed by all members. The success of an institute largely depends upon maintaining secrecy relating to certain aspects of its operations. But since this is less possible in a co-operative, many of their important information gets leaked out leading to their downfall.

4. **Less motivation:** members of a co-operative may be less motivated to continue as members because the laws relating to the co-operatives do not let them earn too much of profits. So, when the members realise that their voluntary work is not getting its due reward, they are less enthusiastic to work towards the progression of the co-operative.

5. **Lack of co-operation among members:** co-operatives are run on the principle of co-operation. In the initial days of a co-operative, there is good co-operation among members. But as time goes by, differences in opinion crop up, thereby, weakening the very foundation of the institute.

5.3 Advantages of SACCOS (Savings and Credit Cooperative Organisations)

SACCOS enjoy all the advantages relating to co-operatives mentioned above. Apart from them, the following are the advantages relating specifically to SACCOS:

1. The members of SACCOS are constantly encouraged to save. This not only benefits individual members, but also the society at large.

2. The savings of the SACCOS are locally mobilised, that is, members who require credit borrow from the SACCOS.

3. SACCOS educate their members in matters relating to rational handling of their finances, keeping a track of their investments, budgeting and safeguarding themselves from the clutches of money lenders.

4. The interest rates granted to the savers and charged from the borrowers by the SACCOS are always better than the rates prevailing in the general financial markets.

5. SACCOS pay dividend to their members once they start earning some profits, which benefit the members.

6. SACCOS do not pool any funds from non-members. Thus, members feel more committed towards working for the betterment of the co-operative by paying back the credit taken by them on time since it is their own funds.

7. SACCOS work as efficient financial intermediaries, catering to the financial requirements of the local communities.

may try to dominate the group further leading to the downfall of the co-operative.

5.4 Disadvantages / Weaknesses of SACCOS (Savings and Credit Cooperative Organisations)

Being a co-operative, a SACCO suffers from the disadvantages explained above.

Following are some weaknesses which are specifically relevant to the SACCOS:

1. Illiteracy among members of SACCOS limits their capacity to grow.

2. Very slow increase in member base makes it difficult for the SACCOS for pooling funds.

3. Inflationary pressures and unstable economic situation prevailing in countries where SACCOS operate lead to financial hindrances in the working of the SACCOS.

4. Failure by members to repay loans taken by them from the SACCOS on time lead to financial difficulties

Test Yourself 5

State the weaknesses of the Savings and Credit Cooperative Organisations.

Answers to Test Yourself

Answer to TY 1

The correct answer is **B.**

The first organised co –operative society was the Amicable Society formed in London in the year 1705.

Answer to TY 2

The correct answer is **D.**

A co-operative society functions on the principles of democratic management, and thus, each member has only one vote.

Answer to TY 3

The two types of consumers' co-operatives are:

Consumers' wholesale c-operatives
Consumers' retail co-operatives

Answer to TY 4

The following documents need to be submitted to the Registrar:

Certified copy of the first meeting that had taken place between the members and the Registrar / Assistant registrar / DCO
Four copies of the proposed by-laws of the co-operative
Four copies of the feasibility report of the co-operative
Any document other than those mentioned above requested by the Registrar

Answer to TY 5

The following are the weaknesses of the Savings and Credit Cooperative Organisations:

Prevailing of illiteracy among the members of the SACCOS stand in their path of growth
Pooling of funds is a challenge for the SACCOS as the number of members increase at a very slow rate
SACCOS generally are operational in countries where there are inherent economic problems like inflation
At times, members fail to pay back the loan amounts to the SACCOS, leading to increase in their financial difficulties

Self Examination Questions

Question 1

Explain the advantages of a co-operative society.

Question 2

What are the rights and obligations of the members of a co-operative society?

Question 3

Bring out the differences between co-operatives, sole trading concerns and companies.

Answers to Self Examination Questions

Answer to SEQ 1

The advantages of a co-operative society can be understood as follows:

The membership of a co-operative society is open to all members of public, irrespective of their religion, gender or race. Such attitude of these organisations helps in growth of an entire community.

The co-operative societies, as compared to other forms of organisations, can be formed by following simple procedure. They require lesser amount of capital and undergo fewer legal processes.

The personal liability of the members of co-operatives is limited to the contribution made by them / shares held by them in the co-operatives. Thus, under no circumstances their personal assets can get attached with the society. Such a set up encourages more and more people to join a co-operative society.

The co-operative societies work on the principle of providing service to its members. Members can buy goods and services from the co-operatives at controlled rates, take loans at concessional interest rates, obtain technical information regarding agricultural activities and other businesses, etc.

The co-operative societies are democratically managed and in this regard, every member of a society is eligible to cast one vole in policy decision matters. This is done to ensure that no single member or a group of members dominate the co-operatives.

The life and continuity of a co-operative society is not dependent on insolvency or death of its members. New members join the co-operatives and existing members may leave by giving up their shares. Until and unless a co-operative itself becomes insolvent, it continues to conduct its activities.

The services of middlemen can be eliminated in a co-operative set up. Thus, goods and services can be made available to the members at affordable rates. Members perform various activities thereby bringing down the cost of operation further. Co-operatives engage in large scale buying and selling, thus enabling them to pass on such benefits to the members.

Co-operatives are based on mutual co-operation among people. These institutes help inculcate feelings of togetherness, trust, loyalty and develop good habits of saving and economising among members. Members also learn self-governance as they are the ones who manage the co-operatives.

Answer to SEQ 2

On paying the membership fees or subscribing to the shares of a co-operative, a member enjoys the following **rights**:

They are eligible to vote in policy matters of the co-operative. Each member is entitled to one vote in policy decision matters.

They can acquire share certificates, once they subscribe and pay for the shares.

They can call for and participate in the meetings of the co-operative as per provisions contained in the by-laws.

They have a right to be informed about all society matters and can also audit documents of the co-operative whenever they want to.

They are entitled to a share in the income of the co-operative in accordance with the amount of purchases made by them.

They are withdraw their membership after following due procedures and can also nominate a successor.

The members have the following **duties** towards the co-operative and other members:

Members should follow the rules and regulations set by the co-operative.

Members should pay amounts due on their shares and also pay back any amounts taken by them from the co-operative on time.

Members should attend and contribute in the meetings of the co-operatives.

Members should make every effort to safeguard the properties and the image and reputation of the co-operative.

Answer to SEQ 3

The differences between co-operatives, sole trading concerns and companies are discussed in the following table:

Basis of difference	Sole traders	Company	Co-operative Societies
Objective	Earning profit is the prime objective.	Maximising wealth of shareholders is the prime objective.	Providing goods and services to member's at most reasonable rates is the prime objective.
Decision making	All decisions are made by the proprietor, thus, this type of an organisation is centralized.	Board of directors appointed by the shareholders takes decisions on behalf of shareholders.	Democratic management, each member has one vote irrespective of the shares held by them.
Source of capital	Own contribution and partly borrowed funds.	Equity and preference shares, long term loans, debentures, etc.	Contribution by members in form of shares or membership fees.
Liability	Unlimited liability of the owner.	Liability of equity shareholders limited to the extent of the face value of the shares held by them.	Liability of members is limited to the capital contribution made by the members. That is, members' personal assets would not get attached in case of insolvency of the society.
Number of members	The sole trader is the owner manager of his business. Thus, one member is sufficient to start this form of organisation.	Private Limited Companies: a minimum of one member and maximum fifty members can form a private limited company. Public Limited Companies: A minimum of seven members is required. Maximum number of members can be unlimited.	(a) 50 people or more if it is an agricultural society (b) 20 people or more if it is a savings and credit cooperative society (c) 10 people or more if it involves people with specialised skills (d) d) 10 people or more for other types of cooperative society.

SECTION B

ACCOUNTING FOR COOPERATIVES

B2

STUDY GUIDE B2: FINANCING AND FINANCIAL ISSUES

Get Through Intro

Cooperatives are established with the basic aim of promoting the economic and social welfare of their members. In order to carry out these tasks, a cooperative society will need funds. Once the funds are accumulated, they will need to be spent appropriately and ensure that the expenditure is made in accordance with the society's objectives. Budgets need to be prepared in order to chart the path of development and controls need to be set up to ensure that the budgets are being followed and corrective action taken to ensure that budgets are met.

This Study Guide deals with these financial aspects of cooperatives, right from the process of capital formation, to utilization of the financial resources as well as a brief discussion on budgeting.

Learning Outcomes

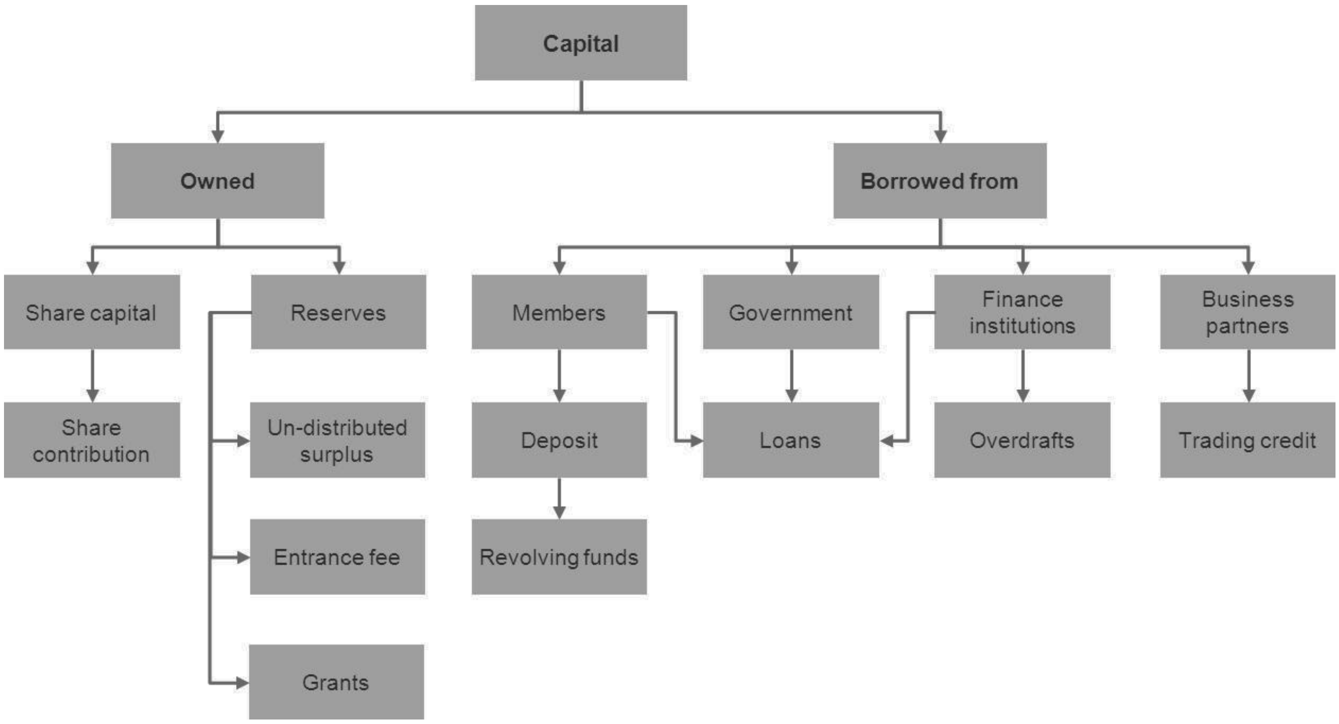
a) Explain mobilisation of cooperative finances.
b) Explain the process of capital formation in cooperatives.
c) Distinguish between budgets and budgetary controls.

1. Explain mobilisation of cooperative finances.
Explain the process of capital formation in cooperatives.
[Learning Outcomes a & b]

1.1 Capital formation

In order to work towards the goals of its members (which is to provide services on a non-profit basis to the shareholders or members who control it) a cooperative society needs capital, or funds. These funds need to be raised from various sources.

Diagram 1: Capital formation



Some of the ways in which funds can be raised are discussed below:

(a) **Share capital**: the bye laws of a registered society shall provide for the raising of funds to finance its activities by the issuance of shares. This is the first and foremost method of raising funds. While forming the society itself, members contribute money towards equity, in exchange for shares. This money forms the initial capital. Later, additional shares may be issued to raise more capital.

(b) **Cess:** the bye laws of a registered society shall provide for the raising of funds to finance its activities also by imposing cess or levy on agricultural or other produce or handicraft marketed through the society or by other means.

(c) **Deposits**: savings of members can be deposited with the society. This encourages the members to save, and also helps the society to raise finance. These deposits are returned to the members when they become due. Deposits may also be accepted from non-members, as provided for under the society's bye laws.

(d) **Entrance or membership fees**: Societies may charge certain entrance fees when a new member joins. Also, they may charge yearly membership fees for the existing members. The accumulated amount of such fees can be used by the society as funds.

(e) **Loans**: finance can be raised through obtaining loans, secured or unsecured. Members sometimes can be called upon to make a loan to the society, which is then repaid in instalments. Non-members can also give loans to the society, provided it is allowed under the bye laws of the society. Also, as with any other type of organisation, a society can obtain loans from banks, overdraft facilities from banks, loans from other lending institutions or from any other sources under the general powers of raising money by borrowing.

(f) Trade credit: trade credit is supported by many mechanisms, which may include revolving funds.

(g) Retained earnings: the operations of the cooperative may yield profits, which are accumulated in a fund. These profits may be earned from the sale of any produce of the society. These earnings of the society also form part of the financial resources.

(h) Reserves: reserves may be built to accommodate shortfalls of share capital. Reserves have a number of advantages, notably being:
Cheapest means of financing
Members have no claims for withdraw on reserves

(i) Other miscellaneous earnings: other earnings may include money derived from the fees or charges specified in the bye laws of the society. This includes penalties and other charges levied by the society on its members for late payments or non-compliance with certain rules of the society. Also, any money lawfully derived from any other sources not mentioned here shall also form part of the revenue of the society.

Example

Cotton Growers Cooperative Society is a society formed with the objective of furthering the trade of cotton farmers and exporting cotton. Here is how the society's capital was formed as on 31 December 20X4:

Type of Finance	Tshs (million)
Share capital	32.00
Cess	05.00
Deposits: from members	02.00
Deposits: from non-members	04.00
Membership fees	0.50
Loans	Nil
Retained earnings	06.00
Other miscellaneous earnings	04.50
Total	**54.00**

The finance thus raised shall be paid into the general fund of the registered society. However, any receipt derived from trade, industry, works, service or undertaking carried out or belonging to the society may be paid either in whole or in part into a separate fund.

Test Yourself 1

'Loans and deposits can only be accepted by a cooperative society from its members'. State whether the statement is:

A True; loans and deposits can only be accepted by a cooperative society from its members
B False; loans and deposits can be accepted by a cooperative society from its members as well as non-members
C False; loans can be accepted by a cooperative society from its members, but not deposits
D False; deposits can be accepted by a cooperative society from its members, but not loans

1.2 Mobilisation of funds

In the earlier section, we saw how a cooperative society raises funds to meet its various objectives. In this section, we will learn how these funds are mobilised.

The word 'mobilise' means to 'move around'. Hence, mobilisation of finances means moving, or utilising the funds of a cooperative society in order to meet its objectives in the best possible way. The bye laws of the society usually spell out the rules for utilising the funds of the society. Generally, provisions are made to spend the funds towards the achievement of the aims and objectives for which the society is formed.

Example

Continuing the example of Cotton Growers Cooperative Society above

The total funds of Tshs54 million of the society were spent to further the interests of the members, to give them loans to help them grow their businesses, to create a forum for regular discussions, to subsidise the raw material such as fertilizers, seeds etc.

However, there are certain rules and regulations imposed by the Cooperatives Societies Act on using the funds. These are discussed below.

1. Funds obtained from the issue of shares

A registered society shall, where its funds to finance its activities are obtained by the issuance of shares, ensure that:

(a) The share capital shall not be reduced without the consent of the Commission

(b) Unless the Commission otherwise in writing directs, a fund which shall be known as the share transfer fund shall be formed and maintained to meet the expenditure which may be incurred by the society in purchasing the share of members whose membership has been terminated with the consent of the Board

(c) No payment from the share transfer funds shall be made for the purchase of the share of any member who has terminated his membership without the consent of the Board

(d) No purchase of the shares of a member whose membership has been terminated by reason of any causes other than death shall be made except with monies available in the share transfer fund

(e) The amount standing to the credit of a share transfer fund shall not exceed ten per centum of the subscribed share capital

(f) Where the share of the member is purchased by the society under the foregoing provisions, the amount paid therefore shall not exceed the par value of the share, and it shall be lawful for the society to pay such less sum than the par value as it considers reasonable, regard being made to the financial position of the society at the time of purchase

(g) The shares of members purchased as aforesaid shall be reissued before any new allocation of shares is made.

2. Cooperative fund

(a) Every society shall contribute to a fund established by the Government and be administered by the Commission for the purpose of meeting the expenses of inspection and promotion of the cooperative.

(b) The Commission shall prescribe in the Regulations the manner in which the society shall contribute to the fund.

3. Investment of funds

(a) A registered society may invest its funds:

in interest bearing deposit in a cooperative financial institution, or any financial institution as may be approved by the Commission

in the shares of any other registered society

in government bonds and other securities

in such other investment options as the Registrar may by order with the aproval of the Commission published in the Gazzette declare to be authorised investments for the purpose of this section.

(b) The Commission may advise any registered sociey to invest its funds or any portion of its funds in any one or more of the investments authorised by or under subsection (1).

(c) Where there is any loss occasioned, in respect of the funds invested, every officer who is a party to the loss commits an offence and shall be liable on conviction to a fine of not less than two million shillings and in addition shall be required to compensate the loss so occasioned.

4. Restriction on loans

A registered society shall not give a loan to any other person other than to its members.

It may, with the approval of the Registrar, allow normal business credit to persons to whom goods have been sold or services rendered by the registered society.

Except with the permission of the Registrar, a society shall not lend money on the security of any movable property other than produce or goods in which the society is authorised to deal.

The Registrar may, by a general or special order, prohibit or restrict the lending of money by any society or class of societies on the security of immovable property.

A registered society whose main object is to supply commodities to its members shall not make any loans nor allow any credit without the sanction of the Registrar who may impose such limits on loans or credit as he thinks fit.

A registered society which markets agricultural produce or handicrafts or mineral products of its members may make advances only up to a limit not exceeding 75 per centum of the local value as estimated by the committee of agricultural products or handicrafts or mineral products delivered to the society for marketing.

A registered society may with the approval in the general meeting, make loans to another registered society.

5. Managing revenues and funds

A registered society should ensure that:

Admission fee is not refundable except in the case where an application for membership has been rejected

A regular obligatory deposit is made in accordance with the bye laws of the society and is not withdrawn except for purposes specified in the regulations.

Test Yourself 2

A co-operative society needs sufficient funds in order to run its business smoothly and to provide services required to its members.

Required:

Explain the various ways in which a cooperative society can raise money to finance its activities.

(May 2012)

2. Distinguish between budgets and budgetary controls of cooperatives. [Learning Outcome c]

2.1 Budgets

A budget is a quantitative statement for a defined period of time, which may include planned revenues, expenses, assets, liabilities and cash flows. A budget provides a focus for an organisation aids the co-ordination of activities and facilitates control. Planning is achieved by means of a fixed master budget, whereas control is generally exercised through the comparison of actual costs with a flexible budget.

Example

A manufacturing company is required to plan the future production in order to estimate the labour and raw material requirements. This information can be obtained from the sales budget.

The territory-wise sales budgets for the year 20X9 based on the estimates of the sales division managers were as follows:

South zone Sales of 20,000 units at a price of $10
North zone Sales of 12,500 units at a price of $9
East zone Sales of 10,000 units at a price of $9
West zone Sales of 8,000 units at a price of $9

Total budgeted sales were 50,500 units for the whole organisation.
Hence, the sales budget will look as follows:

	South zone	North zone	East zone	West zone	Total
Budgeted units	20,000	12,500	10,000	8,000	50,500
Budgeted selling price	$10	$9	$9	$9	
Total sales	**200,000**	**112,500**	**90,000**	**72,000**	**474,500**

With the help of this sales budget, the production department can prepare its budget for material and labour requirements.

Analysis of the meaning of a budget reveals the following:

(a) A budget is prepared and approved before the start of the accounting period (known as the budget period).

Example

The budget for the year 20X8 needs to be prepared before the start of 20X8 i.e. by the end of the year 20X7.

(b) It is all about **planning** for the **future period** and **controlling** the **activities** (and in turn the costs) of an organisation by pursuing management policies. The objective of this overall organisational plan is achieved by means of a master budget. A **master budget** is a statement showing estimation of revenue, costs and **profit** / (**loss**) for the organisation as a whole.

(c) It is a **quantitative** / **financial** statement with an **action plan**. In other words, it is a business plan, normally expressed in monetary terms.

(d) A budget includes statements showing income, expenditure, cash flow and the capital to be employed.

2.2 Budgetary controls

Control is the action necessary to ensure that objectives and plans are attained in reality. The budget is a widely used tool for controlling the operational activities of a business.

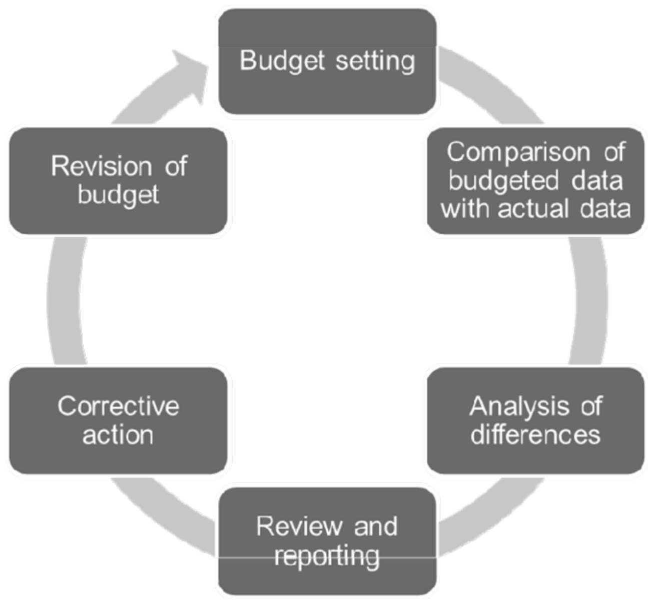
Budgets are more useful if actual performances are compared with those budgeted and the difference, or variance, is examined. This process of comparing and highlighting the variance / difference and then taking corrective measures is called budgetary control.

Definition

A budgetary control system is a means of monitoring revenue and costs and thereby exercising control in an entity by developing budgets and comparing budgeted figures with actual results. This system highlights any discrepancies and allows corrective action to be taken.

The procedure of budget monitoring can be seen as a periodic cycle, which is also termed as budgetary control cycle. It is illustrated in the below diagram:

Diagram 2: Budgetary control cycle



Budgetary control helps management to take timely corrective action in cases where actual performance is not in line with the budget.

Example

Skytel Ltd is a manufacturing company. Skytel's budget period is one year. However, in order to achieve better control, the company splits its budget period into twelve monthly budgets and at the end of each month actual figures are compared with the corresponding budgeted figures.

In the months of January and February, management observed that the actual cost of raw materials exceeded the standard cost. This comparison of budget and actual figures is budgetary control. With further detailed study, management discovered that the poorly managed inventory system had led to emergency purchases at short notice and this had resulted in an increase in the cost of raw materials.

Accordingly, as a corrective action, a perpetual inventory control system was introduced to ensure the timely purchase of the right quality and quantity of raw materials at the right price. Thus, the examination of the variance helped the company to take timely corrective action.

2.3 Budgets of cooperatives

Budgets of cooperatives refer to the financial plan showing details of providing services to the members and customers for the period of the budget. Budgets may also be made for some of the non-financial activities including encouraging non-members/customers to join the cooperative society; receiving and managing funds from purchase of shares, receiving loans and deposits; providing different loans to members and customers etc.

In short, a budget shows all activities which are targeted to be carried out within the budget period, how these activities should be carried out, the required inputs, the financing requirements, and the outputs.

Example

The following is a proforma of the cash budget of a cooperative society:

Kilimanjaro Society for Handicrafts

Cash Budget for the months of June 2014 and July 2014

Key Data	Jun-14	Jul-14
Number of Members B/F	xx	xx
New Members (target)	xx	xx
Total Members	xx	xx
Number of Customers B/F	xx	xx
New Customers (target)	xx	xx
Total Customers	xx	xx
Number of Loans to be issued	xx	xx
Average Loan Size Tshs	xx	xx
Number of Members and Customers who will increase their savings balances	xx	xx
Average amount of savings per person (Member or Customer) Tshs	xx	xx

	Tshs.	Tshs
Opening Balance		xx
Receipts (Sources of cash inflow)	xx	
Membership fees	xx	
Shares	xx	
Deposits	xx	
Savings	xx	
Loans Repayment	xx	
Interest on Loans	xx	
Interest from Banks	xx	
Membership/Customer subscription fees	xx	
Loan Application Fees	xx	
Penalties	xx	
Bank Loan	xx	
Sales of Members/Customers Passbooks etc.	xx	
Total Cash Inflows	**xx**	**xx**
Total Cash Available = (1+2b)		**xx**

Continued on the next page

	Tshs.	Tshs
Payments	xx	
Loans (members)	xx	
Loans (Customers)	xx	
Savings withdraw – Members	xx	
Savings withdraw – Customers	xx	
Interest on Members' Savings	xx	
Interest on Customers' Savings	xx	
Salaries	xx	
Purchase of Office Furniture	xx	
Total cash outflow	**xx**	**(xx)**
Closing balance		**xxx / (xxx)**

2.4 Budgetary controls of cooperatives

Monitoring and performance evaluation during the implementation period of the budget and taking corrective action where necessary comes under 'budgetary control'. This is important for enhancing the achievement of annual and long-term performance targets.

Budgetary controls achieve the following objectives for a cooperative society:

(i) Provide guidance to the management of a cooperative society on proper use of resources (financial as well as non-financial)

(ii) Exercise control against misuse of financial and other resources of a cooperative society

(iii) Serve as a control over staff or managers of a cooperative society who may not be following best practices for managing the cooperative society, including abiding to the approved budget and by-laws

(iv) Help members to evaluate operational performance of a cooperative society by enabling them to compare actual performance results (financial and non-financial) to the budget figures, analyze the causes of variances and take corrective action

(v) Evaluate performance of management and staff of a cooperative society

(vi) Strengthen communication between management, members, employees and other stakeholders

(vii) Coordinate all activities carried out in the cooperative society.

Example

Continuing the above example of Kilimanjaro Society for Handicrafts

If the actual number of new members is less than the number of new members recorded in the budget (key data) budgetary control will involve analysing the reasons why more new members could not be signed up to join the society, and taking corrective action – say identifying certain active members and giving them the responsibility of meeting prospective members and explaining to them the benefits of membership of this society.

2.5 Difference between budget and budgetary control

A budget refers to a plan of the financial or non-financial activities of a cooperative, whereas budgetary control refers to the analysis of the variance of the plan from the actual and taking corrective action.

A budget alone will be of no use to the cooperative. It will be useful only if it is followed up by budgetary control. Also, budgetary control cannot be put in place unless a budget is prepared beforehand.

Managers and staff are mainly involved in the preparation of a budget since they are the persons who are in a position to estimate the resources needed for various activities and prepare a plan, whereas members and directors of a cooperative are involved in budgetary control as they are the persons who monitor the working of the cooperative.

Test Yourself 3

Which of the following is a point of difference between budgets and budgetary control?

A A budget refers to a plan of the financial or non-financial activities of a cooperative, whereas budgetary control refers to the analysis of the variance of the plan from the actual and taking corrective action.
B Budgets may be made and budgetary control may be exercised for both, financial and non-financial activities.
C Both A and B
D None of the above

Answers to Test Yourself

Answer to TY 1

The correct option is B. Loans and deposits can be accepted by a society from non-members also, provided the bye laws of the society allow it and the rules and regulations of the Cooperative Societies Act in this regard are complied with.

Answer to TY 2

A cooperative can raise money through:

(a) Share capital: money contributed by members to their society to acquire effective membership.

(b) Entrance fees: entrance fees are paid by people applying for membership in society in some cases entrance fee is known as membership fee.

(c) Deposits: a society would encourage members to save money with it. The money saved by members in this way is known as deposits.

(d) Loans: a society can borrow from its members, banks or other financial institutions.

(e) Surplus and reserve funds: a surplus is a positives difference between income and expenses. The other name for surplus is profit.

Answer to TY 3

The correct option is A; a budget refers to a plan of the financial or non-financial activities of a cooperative, whereas budgetary control refers to the analysis of the variance of the plan from the actual and taking corrective action.

Self Examination Questions

Question 1

Identify four sources of funds for a cooperative.

Adapted from May 2011

Question 2

The sources used to finance cooperative enterprises have varied a lot in the past. Some scholars, for instance, believe in accumulating sufficient share capital to meet all the capital requirements before actually starting to operate and financed by further (more/other) investments, mainly by members' savings or by undistributed surplus. In the recent past, however, some advocates have emerged who are of the opinion that a cooperative enterprise can start by relying almost exclusively on borrowed funds which may be secured by pledging the unlimited liability of the members.

Required:

(a) Provide a general framework for financing a cooperative enterprise.

(b) In your opinion, which option of financing a cooperative enterprise is more plausible (viable?)

November 2011

Question 3

Explain briefly:

(i) Budgets of cooperatives

(ii) Budgetary controls of cooperatives

Answers to Self Examination Questions

Answer to SEQ 1

Funds can be invested by cooperatives:

In interest bearing deposits in financial institutions.
In the form of shares in other co-operatives or companies.
In government bonds or securities.
In any other investments as the Registrar may order with the approval of the Minister.

Answer to SEQ 2

(a) The sources of finance for a cooperative society are many and varied and for the sake of brevity and ease of comprehension these may be summarized pictorially as follows:

(i) Share capital

These are formed by contributions from members.

Limited to residents in the usual small area of operation or certain occupational groups.
Individual share contribution not fixed to actual capital requirement but on capacity of average to accommodate marginal members.
No interest is paid on shares
Several types of shares may be allowed

(ii) Reserves

Reserves may be built to accommodate shortfalls of share capital.

Reserves have a number of advantages, notably being:
Cheapest means of financing

Members have no claims for withdraw on reserves

(iii) Capital borrowing

Borrowing can be from:

Members

The government

Finance institutions

Business partners

The borrowing instruments may be:

Deposits

Loans

Overdrafts

Trade credit supported by a variety of mechanisms which may include revolving funds

Answer to SEQ 3

(i) Budgets of cooperatives

Budgets of cooperatives refer to the financial plan showing details of providing services to the members and customers for the period of the budget. Budgets may also be made for some of the activities including encouraging non-members/customers to join the cooperative society; receiving and managing funds from purchase of shares, receiving loans and deposits; providing different loans to members and customers etc. In short, a budget shows all activities which are targeted to be carried out within the budget period, how these activities should be carried out, the required inputs, the financing requirements, and the outputs.

(ii) Budgetary controls of cooperatives

Monitoring and performance evaluation during the implementation period of the budget and taking corrective action where necessary comes under ‘budgetary control’. This is important for enhancing the achievement of annual and long-term performance targets.

Budgetary controls provide guidance to the management of a cooperative society on proper use of resources (financial as well as non-financial), exercise control against misuse of financial and other resources of a cooperative society, help members to evaluate operational performance of a cooperative society by enabling them to compare actual performance results (financial and non-financial) to the budget figures, analyze the causes of variances and take corrective action, etc.

SECTION B

ACCOUNTING FOR COOPERATIVES

B3

STUDY GUIDE B3: COOPERATIVE ACCOUNTING MANAGEMENT

Get Through Intro

In the earlier Study Guide, we have learnt about the meaning and purpose of cooperatives and the way in which these organisations raise and utilise funds. The members of the cooperatives do not get involved in the operations and day to day workings, so they need to keep track of the direction in which the society is going and whether the objectives are being met in the most efficient way. For this, there needs to be strong internal control, which can be established with the help of collection of data and proper presentation. Then various accounts need to be maintained, reports generated and final accounts compiled to show the true and fair financial position of the cooperative society.

In this Study Guide, you will learn about the accounting principles that are applied, how data is collected and presented, and the internal controls put in place. You will also learn about basic financial reports and prepare final accounts of cooperative societies.

Learning Outcomes

a) Explain accounting principles applied or practiced in co-operative societies.
b) Explain the internal control, collection and presentation of data as an aid to decision making in management.
c) Explain basic financial reports to members.
d) Compile various final accounts for co-operatives including SACCOS.

1. Explain accounting principles applied or practiced in co-operative societies. [Learning Outcome a]

Similar to any other branch of study, accounting is also governed by a set of procedures and principles. Accounting principles and procedures are the pillars on which the whole structure of accounting rests. They are the fundamental ideas, rules and assumptions in accounting that must be followed while preparing the financial statements. A clear disclosure must be made in the financial statements if these are not followed.

Accounting principles are more or less universal, and just like any other organisation **co-operative accounts are also maintained on the basis of these Accounting Principles**. Some of the main accounting principles include the following:

1. Going concern

The going concern concept assumes that an entity:

(a) will **continue** its operations **for at least the next 12 months**

(b) does **not have any intention or need to close down its operations**

(c) does **not have any intention or need to curtail materially, the scale of its operations**

It is one of the fundamental accounting assumptions in preparing the financial statements.

Example

If a cooperative society is formed with the purpose of exporting a certain product to a certain country, and subsequently if that country bans the import of that product, then the very purpose for which the cooperative society was formed will no longer exist. So it will be reasonable to say that the society may close down its operations. In such cases, it can be said that the cooperative society is no longer a going concern.

The financial statements of entities (including co-operative societies) which are not a going concern are prepared on liquidity basis, which is different from the financial statements of entities which are 'going concerns'.

The difference in accounting for an entity which is a going concern and which is not a going concern is illustrated below:

Going concern Financial statements	
	Valuation
Assets	Normal value
Liabilities	Normal value

Not a going concern Financial statements	
	Valuation
Assets	Disposal value
Liabilities	Settlement value

The value for an asset which has to be sold forcibly

The value of a liability which has to be settled immediately

2. Materiality

Materiality means **relative importance**. Material items are **important items that the users of the cooperative society's financial statements must know**. The financial statements should show all the material items separately.

The concept of materiality relates to the time, efforts and the cost of accounting in relation to the usefulness of the data generated. Materiality requires that only those items which have a bearing on the determination of financial position and computation of profit and loss during the accounting period should be recorded and disclosed in the financial statements.

Example

MNJBA is a large cooperative society having a great number of affluent members. The total of the organisation's receivables for the year 2014 is Tshs 950,000 million. One of the stationery providers of the society to whom Tshs1000 was given as advance, closed his business. It was clear that the society would not be able to recover the advance.

Here, considering the society's scale of operations, Tshs1000 is not a material amount. Hence, the society need not adjust the total receivables amount immediately. The financial statements would still be fair.

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3. Substance over form

Substance over form would play a significant role while evaluating financial transactions and disclosures. One must critically analyse a transaction and present the reality of the transaction in the financial statements. Transactions and other events should be accounted for and presented in accordance with their substance and economic reality, and not merely their legal form. This ensures faithful representation of a transaction.

Example

A cooperative society provided domestic staff to certain influential members of the society. It pays Tshs100,000 directly to the staff. In the legal sense, the domestic staff are employees of the cooperative but they are actually working for the members.

Hence, the wages paid to the domestic staff should be treated as payments to the members and not as expenses.

---

4. Accruals

Exception – Statement of cash flow is prepared on a cash basis

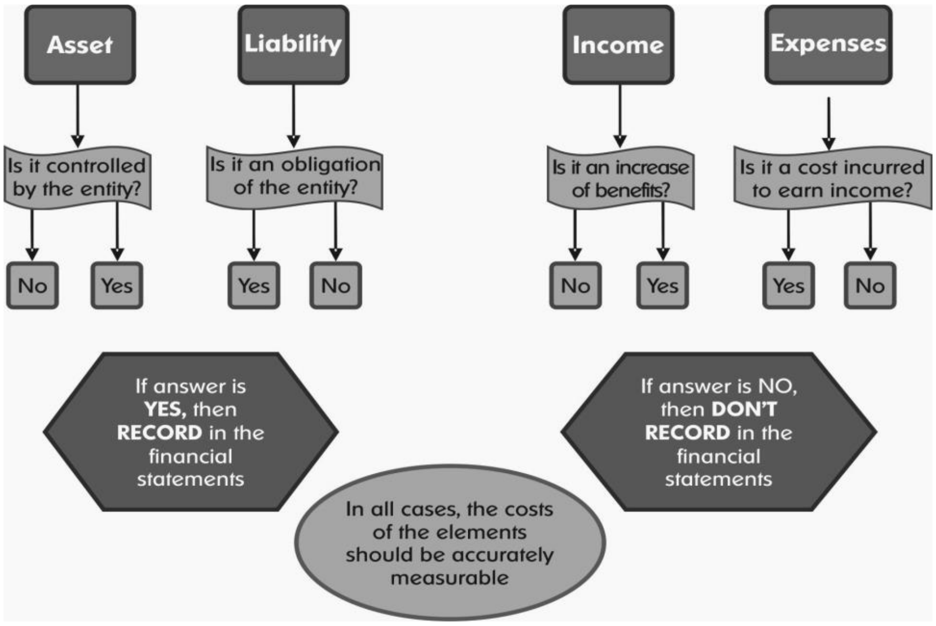
The financial statements should be prepared on the basis of an accrual system of accounting. In the accruals system, items are recognised as assets, liabilities, incomes and expenses **on the date they satisfy the recognition criteria mentioned in their definitions.** The actual date of payment of cash is immaterial for the purpose of recognition.

Example

A cooperative society purchased certain goods on 5 December 2013 but had paid the supplier on 9 November 2013. Here, the society came into possession of the goods on 5 December even though the payment was made earlier (in advance). Hence the purchase transaction should be recorded on 9 November.

Under the accruals system, all the elements of the SOPL and the SOFP are recognised as follows:

Diagram 1: Recognising elements in the financial statements (Note that the timing of actual payment is immaterial)



5. Fair presentation

Fair presentation is:

(a) presenting **accurate** financial statements e.g. free from mathematical errors

(b) complying with all **legal requirements** e.g. the Cooperative Societies Act requires every registered society to prepare a statement of accounts in a form which conforms to the best accounting standards.

(c) **not manipulating** the financial statements e.g. reporting more profit than the actual.

Example

A industrial cooperative society incurred a loss during 2013 due to poor management decisions. To hide this loss, the managers falsely issued sales invoices for transfers within departments. This adjustment converted the actual loss into profits. Here, the management has manipulated the financial statements to hide the poor performance. Hence, this is not a fair presentation.

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6. Consistency

Consistency means the financial statements should be prepared in the same manner period after period.

According to this principle, the policy once adopted in one accounting period should be consistently followed in the subsequent accounting periods.

Example

Until 20X5, MERERANI Co-operative bank followed the reducing balance method (RBM) for charging depreciation on assets. However, in 20X6, the bank calculated depreciation according to the straight line method (SLM). Here, the bank has not followed the principle of consistency.

A new method of preparing the financial statements **can be used if**:

(a) the new method is **more appropriate**
(b) the new method is **prescribed by law or by an accounting standard**

Example

A cooperative society valued its inventory under the last in first out method (LIFO) until 2013. But from 2014 the society suddenly decided to value inventory using the LIFO method of inventory valuation. This violates the principle of consistency.

Test Yourself 1

Which of the following is NOT an accounting principle?

A Going concern
B Internal control
C Materiality
D Fair presentation

2. Explain the internal control, collection and presentation of data as an aid to decision making in management.

[Learning Outcome b]

2.1 Importance of accurate information for decision making

Information is very essential to the management in any given situation for decision-making purposes.

At every stage from planning to decision-making until the implementation stage information can be critical since wrong information may lead to wrong decisions.

Definition

While raw unprocessed facts and figures are considered as **Data, Information** is data that has been analysed to give it some meaning, comprehensible to the user of that information.

To be useful, information should be able to be used for informative or inference purposes, arguments or as a basis for forecasting or decision making. Hence, it is essential for every organisation to provide the right information, in the right quantity, to the right person, at the right time. The right person would generally be considered as the decision makers in the organisation i.e. the top management.

For any person / entity within an organisation, only information in the right amount and the right kind of information should be available. Too much of information or information that is irrelevant would only waste the time and resources of the persons presenting the information and the user of the information.

Example

Perfect Fit Co-operative, a clothes manufacturing cooperative, is keen on taking out an insurance policy for its employees. It obtained quotations from 5 insurance companies. The literature it collected from the companies and the various conditions attached to the policies were so complicated, that Perfect Fit decided to abandon the idea. Instead, it increased the salaries of its employees!

Decision-making is an exercise of **choosing a particular course of action** out of several alternative courses, to achieve the given objective.

The operation of any typical organisation would be a mixture of strategic, operational and tactical decisions as discussed earlier in this learning outcome. More specifically, the types of decisions that are made in an organisation include:

No.	Type of decision	Meaning	Information required to take these decisions
1.	Product mix decision	which products are profitable and should continue to be offered	demand for the products offered availability of resources feedback from customers political or technological impact on the product
2.	Make or buy decisions	determining whether an organisation would be better off making a product or buying it.	availability of resources to produce the product is the product readily available? cost incurred if product is purchased
3.	Discontinuation decisions	determining whether an operation or division should be closed down	cost of closing down any operation or division alternative uses of the assets of discontinued operations
4.	Pricing decisions	determining if an organisation should increase or decrease the price of its goods or services	competitors' pricing policies customers' price expectations impact of price on the demand for the product impact of government policies (e.g. taxes and duties) on pricing

Tip

The above pints may also apply to cooperatives.

An important aspect of taking these decisions is the right kind and the right use of the underlying information. Put very simply, a decision-maker would select a suitable alternative / course of action from those available courses of action using the information available at that particular point of time.

In an organisational setting, the information these systems provide is used by executives / management to make decisions that will affect the future of the firm. Ultimately, the success or fate of any organisation depends upon the quality of decisions that this group makes. Therefore it is absolutely vital that the information they receive is of good quality.

2.2 Collection and presentation of data

> Internal controls are explained in Learning Outcome 3

From the above, we can conclude that unless managers and decision makers are provided with concrete data and information, they will not be able to reach conclusions and make proper decisions. For this, there should be effective and accurate collection and presentation of data to management and based on this data, proper internal controls need to be designed to ensure the society is on track to meet its objectives.

It is not possible to take proper decisions without supporting accurate information. Data needs to be collected and put in the form of various reports that are presented to management. Management then analyses these reports to make various operational and strategic decisions.

Some of the reports that are prepared and presented to management are discussed below:

Name of Report	Prepared by	Presented to	Purpose of report
Daily Cash Reconciliation	Clerk/ Accountant	Executive committee	Enables to understand whether there is any misstatement of cash balances
Loan Status /Portfolio	Treasurer, Manager	Supervisory committee, Board, Members	To understand credit worthiness of loans sanctioned
Demand for Loans	Treasurer, Manager	Supervisory committee, Executive committee, Board, Members	Detailed information of recovery process initiated for outstanding loans
Disbursements analysis	Treasurer, Manager	Supervisory committee, Executive committee, Board, Members	Detailed information of funds disbursed for various purposes
Approved Loans	Treasurer, Manager	Supervisory committee, Executive committee, Board, Members	Provides information of loans sanctioned
List of Loans in Arrears	Treasurer, Manager	Supervisory committee, Executive committee, Board, Members	Provides information of outstanding loans
Cash flow statement	Treasurer, Manager	Executive committee, Board, Members	Provides information of liquidity position
Trial Balance	Treasurer, Manager	Executive committee, Board, Members	Provides information of summarised financial information
Income Statement	Treasurer, Manager	Executive committee, Board, Members	Provides information of financial performance
Statement of financial position	Treasurer, Manager	Executive committee, Board, Members	Provides information of financial performance

Example

Maka cooperative society produces all the standard reports and submits them to management. To take decisions on future loan sanction limits, the management looks at the Loan Status Report, Disbursements analysis report, Approved Loans report, List of Loans in Arrears report etc.

Based on these reports, the management will decide allotment of funds for future loans, make policies for loan recovery etc.

2.3 Internal control

Definition

Internal control is a process set up by the management of a cooperative society with the help of managers, to provide reasonable assurance regarding achievement of basic objectives, including performance and profitability goals.

Purpose of internal control

The purpose of internal control is to improve decision making by providing accurate, complete, relevant and timely information. Management has the assurance that the reports submitted to it are reasonably accurate and free from errors, so that it can take effective decisions by relying on the reports. As an aid to decision making, internal control serves the following purposes:

1. **Keeping track of operations**: internal controls help gauge whether the entity is meeting basic objectives, including performance and profitability aims and safeguarding of resources. Internal control ensures reliability and completeness of financial and management information.

Example

Venus Cooperative purchases various grocery items at wholesale rates and sells them to their members at a very low profit margin. It has the following policies with respect to safeguarding of inventory:

Control	Impact on financial statements
Inventory is stored only in the inventory stores.	The control activities will ensure that the inventory is properly safeguarded. So the value of the inventory which appears in the financial statements will be reliable and accurate.
The stores are kept under lock and key.	
No outsiders are permitted to enter the stores.	
Only the persons who are working in the stores are allowed access to the stores.	
Every quarter, the management carries out a physical verification of the inventory.	
The inventory is also insured against natural disasters, theft and riots.	

2. **Financial reporting**: internal control helps to keep track of the cooperative society's financial resources, including interim financial position and ensure that they are reliable.

Example

Continuing the example of Venus

Venus Cooperative follows the following method of accounting for inventory:

Control	Impact on financial statements
Materials received in stores are supported by purchase orders.	The controls mentioned alongside will ensure that the financial statements with respect to purchases and inventory are reliable, since the information of receipt of purchases is accurate and complete.
Materials received are supported by goods received notes.	
Materials received are tested by the quality control department.	
Only tested material is issued for production.	
Purchase vouchers are prepared after comparing the goods received notes and purchase orders.	

3. **Complying with applicable laws**: with the help of internal control systems, management can ensure that all the procedures required by law are being followed and all the reports specified are being submitted to the proper authorities.

Example

Indo cooperative bank has employed Sam & Co as consultants. They are entrusted with the task of checking that the entity has complied with all applicable laws and regulations.

<table>
<tr><th>Control</th><th>Impact on financial statements</th></tr>
<tr><td>All the laws and regulations (banking laws, labour laws etc.) which are applicable to Indo bank.</td><td rowspan="2">The controls will ensure that the company adheres to all laws and regulations. This will ensure that the financial statements prepared by the entity have taken into account all the liabilities which are applicable to the entity in this account. Hence the financial statements will be more reliable and there is no risk of any statutory non-compliance.</td></tr>
<tr><td>Ensure that the bank is kept informed of all new laws or regulations which are applicable to Indo cooperative bank</td></tr>
</table>

A good internal control system ensures the following

- Early fraud detection
- Minimising errors in accounting records
- Improving accuracy of books of accounts
- Ensuring consistent adherence to policies, procedures, laws and regulations including general as well as those specific to cooperatives
- Protecting cash and other resources from misappropriation
- Enhancing timely preparation and presentation of reports

Areas where internal control is set up

The following areas may be subjected to internal control:

- Cash
- Loans
- Savings
- Deposit
- Transfer of funds
- Shares
- Non-current Assets
- Interest rate setting
- Daily Cash Reconciliation Forms
- Journal
- Accuracy and timeliness of financial and other statistical reports
- Financial statements
- Membership Register

Budgets

Meetings (Committees, Special and Annual General Meeting) as per the by-laws and the Cooperatives Societies Act

Internal control procedures

Following are some of the internal control procedures followed in almost all organisations, including cooperative societies:

(i) Segregation of duties: this means separation of responsibilities for allied activities that may lead to error or fraud if carried out by only one person. For example, a cooperative society can assign the responsibility for purchases to one employee and the responsibility of making payments towards the purchases to another employee. This will discourage fraud during purchases of materials.

(ii) Setting up limits: for each activity, a limit can be set, beyond which the activity will be monitored closely. For example, a limit can be set on the amount of cash that can be held with the cashier at any point of time.

(iii) Signatures: a cooperative society can insist on authorised signatures on transactions above a certain limit to protect the institution from unauthorized transactions. For example, requiring credit committee members to sign loan disbursements, to avoid bogus loans being issued by loan officers.

(iv) Physical controls: measures should be taken to verify the existence of assets recorded in the books of accounts. For example, physically verifying the existence and ownership of assets that are shown on the balance sheet.

Example

Continuing the example of Maka cooperative society above

The society has strict internal controls on all the major activities, including loan disbursements and loan repayments. The Loan Status Report, Disbursements analysis report, Approved Loans report, List of Loans in Arrears report etc. also come under strict internal control procedures. Therefore, management are assured of the accuracy of these reports, and know the reports can be relied upon. Decision making based on these reports will be easier and more accurate.

Test Yourself 2

Which of the following help members to make well-informed and appropriate decisions?

A Accurate collection and effective presentation of data together with well-designed internal control systems
B Effective handling of customer complaints
C Both A & B
D Neither A nor B

3. Explain basic financial reports to members.
Compile various final accounts for co-operatives including SACCOS.
[Learning Outcomes c & d]

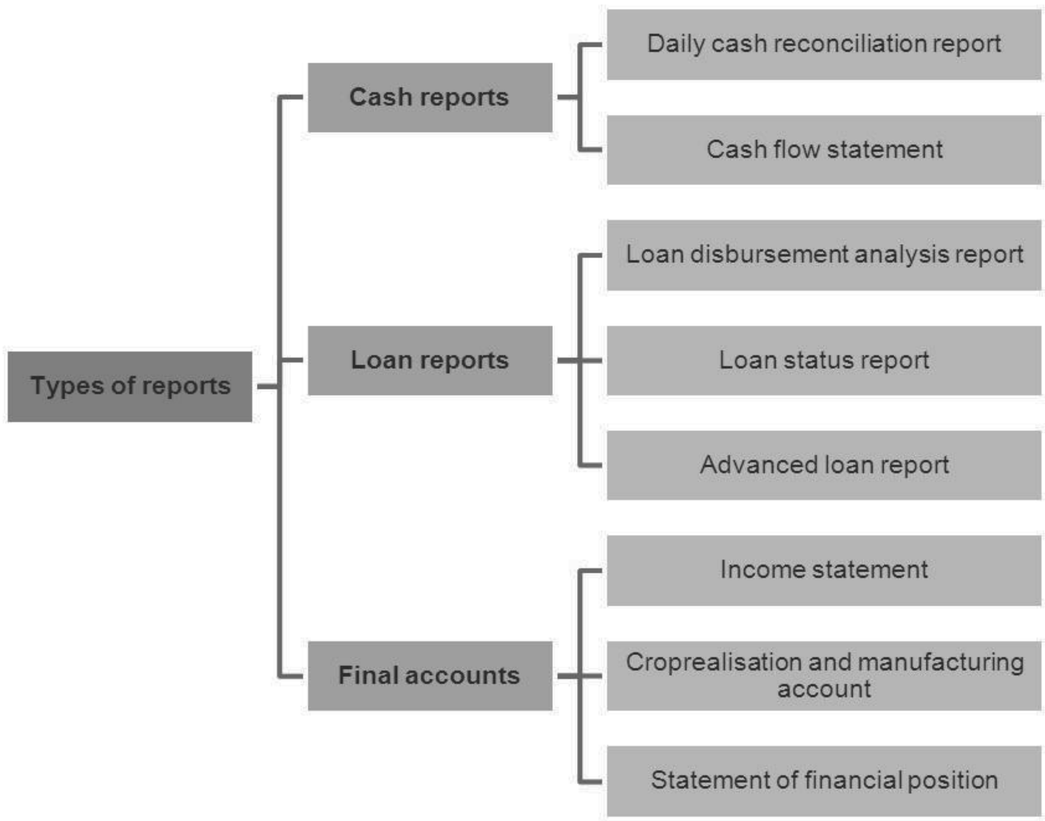
3.1 Basic financial reports

In the earlier Learning Outcome, we saw how collection and presentation of data are crucial for decision making. For this, data is collected and presented in the form of reports for the perusal of members, to help them to take informed decisions. We saw the types of reports that are generated. In this section we will discuss in detail what those reports are and how they are useful to the members.

Definition

A financial report can be defined as the documentation of the financial activities of a cooperative society, in which, relevant financial information is presented in a structured manner that will be easily understandable to the members.

Diagram 2: Basic financial reports



Let us discuss each of these reports in detail:

1. Cash reports

These reports disclose all transactions and events of the cooperative society that are related to cash. Some of the cash reports are:

(a) Daily cash reconciliation report

This report shows the inflow and outflow of cash during a particular day. The opening balance of cash is taken, the receipts during the day are added to it, the payments in cash during the day are deducted, and the closing cash balance is arrived at (Opening balance of cash + receipts during the day – payments during the day). This is physically reconciled with the actual cash balance by counting the cash available at the end of the day. With this report, members can keep track of the inflow and outflow of cash. **It assures the members that there is no misappropriation of cash.**

(b) Cash flow statement

When the cooperative society carries on operations, at various times cash comes into the business and at other times, cash goes out of the business. A cash flow statement records this inflow and outflow of cash in the organisation. **This statement is very important, because cash is vital, like blood, for any organisation and members and managers need to know the cash position,** and whether the society is generating enough cash and also whether there is enough balance to fund its day to day operations.

A cash flow statement is divided into three parts. Cash flow from operating activities, investing activities and financing activities is shown separately.

2. Loan reports

These reports contain information about the status, disbursement etc. of loans to members. Such reports help members know how the funds of the cooperative society are being used and how much money is being disbursed. Examples of loan reports are:

(a) **Loan Disbursement Analysis Report:** this report discloses all loans that have been approved, as well as all loans that have been given out, i.e. disbursed. Members can then check whether the amounts disbursed agree with the amounts applied for against the loan agreement.

(b) **Loan Status Report:** this report discloses the amount of outstanding loans and a list of all the members who have borrowed money from the cooperative society.

(c) **Advanced Loan Report:** this report ensures that the credit committee follows the society's by-laws when approving loans to members. Members can keep a check on how much money is being advanced to members as loans.

3. Final accounts

These reports are **generated annually** and **show the financial position as well as financial performance** of the cooperative society as a whole. These reports include an income statement and a statement of financial position as at the end of the society's financial year. These reports help members of the cooperative society to know whether the society is earning profits and increasing its assets, or incurring losses and depleting its asset base.

The Cooperative Societies Act requires every registered society to keep proper accounts and other records in relation there to and shall within three months prepare in respect of each year a statement of accounts in a form which conforms to the best accounting standards. It requires every society to exhibit its annual balance sheet during office hours to any person interested in its funds as a member, depositor or creditor.

It also requires the Board to prepare in such a form and for such period as the registrar may direct (a) an income statement (b) a crop realisation account for Agricultural Cooperative Societies (c) a manufacturing account for industrial societies and (d) a statement of financial position.

(a) Income statement

All profit making entities are required to measure the results of operations from time to time, and determine whether they are making profits or not**.** This is done by deducting expenses for the period from the total earnings during the same period. The difference between total income and total expenses is the net profit (when total earnings are greater than total expenses) or loss (when total earnings are less than total expenses).

The income statement shows the performance results for two years (two accounting periods), i.e. the current year and the preceding year. This is done to enable the users to compare the results of the current year with those of the previous year at a glance**.**

Tip

In Paper T01 and T05, you have studied how to prepare the final accounts of companies. The income statement of a cooperative society is prepared from the trial balance using the same rules and principles used in preparing an income statement of any other organisation. In other words, the method of preparing an income statement for a society is the same as that of a company.

Example

Proforma of the income statement of a cooperative society

Dodoma Cooperative Society

Income statement for the period from _______ to ________

	Financial income	Current year	Preceding year
I 1	Interest on Current and Past- Loans		
I 2	Interest on Restructured Loans		
I 3	Interest on Investments		
I 4	Loans fees		
I 5	Late fees on loan		
I 6	**Total Financial Income**		
	Financial costs of lending fund		
I 7	Interest on debt		
I 8	Interest paid on deposits		
I 9	**Total Financial Costs**		
I 10	**Gross financial margin**		
I 11	Provision for loan losses		
I 12	**Net financial margin**		
	Operating expenses		
I 13	Salaries and benefits		
I 14	Administration expenses		
I 15	Occupancy expenses		
I 16	Travel		
I 17	Depreciation		
I 18	Other		
I 19	**Total Operating Expenses**		
I 20	**Net income from operations**		
I 21	Income from Grants for Credit Services		
I 22	Income from Grants for Loan Fund Capital		
I 23	**Excess of income over expenses**		

(b) Crop realisation account and manufacturing account

Agricultural Cooperative Societies draw up a crop realisation account for each crop, which shows the revenue earned from that crop during the year. In case there is more than one crop, a realisation account is usually drawn up for each crop. This account helps the cooperative society to know which crops are more profitable and which crops are incurring losses, so that corrective action can be taken.

Industrial cooperative societies draw up a manufacturing account, which is similar to the crop realisation account, as in it shows how much revenue is earned from manufacturing activities.

Example

The following balances were extracted from the books of MBINGA Marketing Cooperative Society Ltd as at 31 December 2005.

	Tshs
Coffee crop sales	14,000,000
Cash on hand	10,900
Cash at bank	100,300
Share capital	15,000
Entrance fees	7,500
Advance to coffee producers	10,585,000
Co-operative union deposits	10,200,000
Stationery expenses	6,500
Postage expenses	1,200
Stocks: 11,700 kgs @ Tshs50/=	585,000

Additional information is given as follows:

(i) Society charges are as follows:

Local authority cess is Tshs.0.50/= per kilogram sold
Union levy is Tshs.2.00/= per kilogram handled (i.e. sold)
Society levy is Tshs.0.65/= per kilogram collected (i.e. purchased)

(ii) Direct production expenses include:

Produce transport Tshs8,000
Produce insurance Tshs15,700

Required:

Prepare for the Mbinga Marketing Cooperative Society Ltd, the Crop Realisation Account for the year ended 31 December 2005.

(Adapted from May 2012)

Answer

Coffee realisation account for the year ended 31 December 2005

	Tshs	Tshs
Coffee sales 200,000 kgs @ Tshs70		14,000,000
Add: Closing stock 11,700 kgs @ Tshs50		585,000
		14,585,000
Less: Direct expenses		
Produce transport	(8,000)	
Produce insurance	(15,700)	(23,700)
		14,561,300
Less: Advance payment to farmers i.e. 211,700 kgs @ Tshs50	(10,585,000)	
Less: Society levy i.e. 211,700 kgs @ Tshs0.65	(137,605)	
Less: Union levy i.e. 200,000 kgs @ Tshs2.00	(400,000)	
Less: Local authority cess i.e. 200,000 kgs @ Tshs0.50	(100,000)	(11,222,605)
Net Balance (Profit to Grower's Account)		**3,338,695**

Continued on the next page

Working notes:

1. Calculation of coffee sales (kg)

Particulars	Amount
Advance paid to farmers for all coffee bought (cost price of total coffee bought)	Tshs10585000
Coffee not sold yet (valued at cost price), i.e. closing stock(11,700 kg X Tshs50)	Tshs585000
So remaining amount is cost price of coffee sold	Tshs100,00,000
Cost price of coffee	Tshs50
Therefore coffee sold in kg will be Tshs1,00,00,000/Tshs50	**2,00,000 Kgs**

2. Calculation of selling price of coffee (in Tshs per unit)

Particulars	Amount
Coffee crop sales as given in the question	Tshs14,000,000
Coffee sold (in kg)	2,00,000 kg
Therefore selling price of coffee will be Tshs14,000,000/ 2,00,000 kg	**Tshs70**

3. Calculation of total coffee bought from farmers (in kg)

Particulars	Kg
Coffee sold	2,00,000
Coffee in stock	11,700
Total coffee bought from farmers	**2,11,700**

4. Calculation of other charges

(i) Society levy for the year is 211,700 kgs @ 0.65/= Tshs. 137,605.00

(ii) Union levy for the year is 200,000 kgs @ sold to them x Tshs. 2.00 = Tshs.400,000

(iii) Local authority cess for the year is based on total production delivered x cess rate i.e.

200,000 kgs x 0.50/= Tshs. 100,000.

Tip

There is some information given in the question, which is not to be used while preparing a crop realisation account.

Cash on hand, cash at bank, share capital and cooperative union deposits have to be recorded in the statement of financial position, and entrance fees, stationery expenses and postage expenses have to be recorded in the income statement.

(c) Statement of financial position (SOFP)

A statement of financial position, also called the balance sheet, is prepared at the end of the financial year and shows what the cooperative society owns in the form of assets and how these assets are financed from equity and liabilities. This statement comprises a list of:

assets (i.e. what the cooperative owns) made up of current assets (i.e. resources that have a lifespan of up to a year) and non-current assets (i.e. resources that have a lifespan of more than a year);

liabilities (i.e. what the cooperative society owes to other parties); and

capital (what the organisation has put in as a start-up).

A statement of financial position is prepared from a statement called a trial balance (which lists all the account balances, both debit and credit); whose debit side = credit side.

In the statement of financial position, the total of current + non-current assets = the total of liabilities + capital.

Tip

You have studied how to prepare the final accounts of companies in Papers T01 and T05. The SOFP of a cooperative society is prepared from the trial balance using the same rules and principles used in preparing a SOFP of any other organisation. In other words, the method of preparing a SOFP for a society is the same as that of a company.

Example

Here is how a statement of financial position of a cooperative society looks like:

Dodoma cooperative society

Statement of financial position as on ___________

	Tshs	**Tshs**
	31 Oct 2002	**31 Oct 2001**
Assets:		
Current assets		
Cash	X	X
Cash at bank	X	X
Deposits (Interest bearing)		
Loan outstanding:		
(a) Current	X	X
(b) Past -due	X	X
(c) Restructured	X	X
Loan Outstanding = (a) +(b) + (c)	**X**	**X**
Less: loan loss reserve	(X)	(X)
Net loan outstanding	**X**	**X**
Interest receivable	X	X
Other current Assets	X	X
(A) Total current assets	**XX**	**XX**
Non-current assets		
Investments	X	X
Land and buildings (at cost)	X	X
Less: accumulated depreciation	(X)	(X)
Machine and office equipment's (at cost)	X	X
Less: accumulated depreciation	(X)	(X)
Office furniture (at cost)	X	X
Less: accumulated depreciation	(X)	(X)
Motor vehicles and motorcycles (at cost)	X	X
Less: accumulated depreciation	(X)	(X)
(B) Total non-current assets	**XX**	**XX**
(C) Total assets = (A) + (B)	**XXX**	**XXX**
Liabilities		
Current liabilities		
Loans	X	X
Members' savings	X	X
Members' deposits	X	X
	XX	**XX**

Continued on the next page

Interest on Members' Savings	X	X
Interest on Members' Deposits	X	X
Interest on Loans (Banks and Council)	X	X
Accrued Expenses (salaries, electricity, etc)	X	X
Dividend payable	X	X
(D) Total current liabilities	**X**	**X**
Long term liabilities		
Loans	X	X
(E) Total long term liabilities	**X**	**X**
(F) Total liabilities = (D) + (E)	**XX**	**XX**
Capital		
Members' shares	X	X
Profit and Loss Account	X	X
Statutory reserves	X	X
Education reserve fund	X	X
Shares transfer fund	X	X
Grants	X	X
Loan fund capital	X	X
(G) Total capital	**XX**	**XX**
H) Total liabilities and capital = (F) + (G)	**XXX**	**XXX**

3.2 Final accounts for SACCOS (Savings and Credit Cooperative Society)

Just like any other cooperative society, a SACCOS is also bound by the requirement to produce final accounts as discussed above.

The Boards of SACCOS prepare annual income statement and balance sheet on the last day of the financial year for reporting to the Registrar and Bank of Tanzania as follows:

Value of total assets	SACCOS to
Assets not exceeding Tshs 100,000,000	Prepare monthly financial statements and statistical reports and submit them to the Registrar
Assets exceeding Tshs 100,000,000	Prepare a full set of Financial Statements according to Accounting Standards issued by the National Board of Accountants and Auditors
Assets exceeding Tshs 200,000,000	Prepare monthly, every six months, and annual financial statements according to NBAA guidelines; and report to the Registrar
Assets exceeding Tshs 500,000,000	Prepare Quarterly Financial Statements;

All financial statements sent to the Registrar must be signed by a majority of board members and supervisory committee;

SACCOS with assets exceeding Tshs200,000,000 must submit their financial statement to the Directorate of Microfinance of the Bank of Tanzania and must be in accordance to BOT accounting guidelines for institutions engaged in micro-lending activities.

Test Yourself 3

Safema co-operative society limited trial balance as at 30 June 2012

	Tshs	Tshs
Cotton sales		54,506,000
Purchases (Payment to Growers)	15,763,500	
Crop advance loan fee	225,000	
Curing expenses	1,875,000	
Transport charges	2,764,500	
Bags and produce handling expenses	1,845,000	
Produce insurance	75,000	
Bank charges	38,250	
Interest on loan	45,675	
Corporation tax	300,000	
Pension fund contribution (20% on salaries)	450,000	
Salaries	2,250,000	
Travelling expenses	1,162,500	
Stationeries and photocopying expenses	757,575	
Sitting allowance – Board members	1,200,000	
Audit fees	1,125,000	
Education and Training Fund	375,000	
Creditors		1,087,500
Statutory reserves		750,000
Debtors	7,425,000	
Buildings	27,500,000	
Cash on hand	3,800,000	
Cash at bank	7,375,000	
Investments		7,650,000
Share capital		5,362,500
General reserves		2,430,000
Income from Dairy Project		1,183,500
Bank interest earned		2,195,000
Entrance fees		1,187,500
	76,352,000	**76,352,000**

Additional Information:

(i)	District Council Cess	2.5% of produce sales
(ii)	Provision for doubtful debts	5% of debtors
(iii)	Education Fund	15% of net surplus (profit) before tax
(iv)	Statutory reserves	30% of net surplus (profit) before tax
(v)	Depreciation	5% of the cost of building
(vi)	Society's levy	15% of produce sales
(vii)	Union's levy	5% of produce sales
(viii)	Cotton Board research Cess	2% of produce sales

Required:

Prepare:

(a) Realisation Account
(b) Statement of Income and Expenditure
(c) Statement of Financial Position

(Adapted from May 2013)

Answers to Test Yourself

Answer to TY 1

The correct option is **B.**

Internal control is not an accounting principle, it is the method of keeping track of the workings of an organisation in order for management to exercise control.

Answer to TY 2

The correct option is **A.**

Accurate collection and effective presentation of data together with well-designed internal control systems aid management decision making. Effective handling of customer complaints will not in any way help management make effective decisions.

Answer to TY 3

In the books of Safema agricultural marketing cooperative society limited

Produce realisation account for the year ending 30 June 2012

Particulars	Tshs	Tshs
Cotton Sales		54,506,000
Less: Direct Expenses		
Transport Charges	2,764,500	
Produce handling expenses	1,845,000	
Produce Insurance	75,000	
Crop advance loan fee	225,000	
Curing expenses	1,875,000	(6,784,500)
		47,721,500
Less: Levies		
Union Levy ((5% of sales)	2,725,300	
TCB Research Cess (2% of sales)	1,090,120	
District Council Cess (2.5% of sales)	1,362,650	
Society's Levy (15% of sales)	8,175,900	(13,353,970)
		34,367,530
Less:		
Payment to Growers		(15,763,500)
Net Balance (Profit to Grower's Account)		**18,604,030**

Income and expenditure account for the year ending 30 June 2012

	Tshs	Tshs
Income		
Society Levy		8,175,900
Income from Dairy Project		1,183,500
Bank Interest Earned		2,195,000
Entrance fees		1,187,500
		12,741,900
Less: Expenditures		
Interest on Loan	45,675	
Bank Charges	38,250	
Pension Fund Contribution	450,000	
Salaries	2,250,000	
Travelling expenses	1,162,500	
Stationery and photocopying	757,575	
Sitting allowance – Board Members	1,200,000	
Audit fees	1,125,000	
Provision for doubtful debt (5% of debtors)	356,250	
Depreciation	1,375,000	(8,760,250)
Net Profit/Surplus before Tax (NPBT)		**3,981,650**
Less:		
Corporation Tax	300,000	
Education Fund (15% of NPBT)	597,248	
Statutory Reserves (30% of NPBT)	1,194,495	2,091,743
Net Profit/Surplus		**1,889,907**

Statement of financial position as at 30 June 2012

Particulars	Tshs	Tshs
Assets		
Current assets		
Cash	3,800,000	
Cash at bank	7,375,000	
Debtors	7,425,000	
Education fund	375,000	
(A) Total current assets		**18,975,000**
Non-current assets		
Building	27,500,000	
Less: depreciation	(1,375,000)	
(B) Total non-current assets		**26,125,000**
Total assets = (A) + (B)		**45,100,000**
Liabilities		
Current liabilities		
Accrued expenses:		
Union levy	2,725,300	
Cotton board research cess	1,090,120	
District council cess	1,362,650	
Creditors	1,087,500	
(A) Total current liabilities		**6,265,570**
Long term liabilities		
Investments (i.e. Investments by others in the cooperative)	7,650,000	
(B) Total long term liabilities		**7,650,000**
(C) Total liabilities (A) + (B)		**13,915,570**
Capital		
Share capital	5,362,500	
Profit on produce	18,604,030	
Profit and loss account	1,889,907	
Statutory reserve 7,50,000	750,000	
Statutory reserve during the year	1,194,495	
General reserve 24,30,000	2,430,000	
Provision for doubtful debt	356,250	
Education fund	597,248	
(D) Total capital		**31,184,430**
Total liabilities and capital (C) + (D)		**45,100,000**

Self Examination Questions

Question 1

The following is a trial balance for Kikuyu Rural Savings and Credit Cooperative Society Ltd as at 30 June 2011:

		Tshs.	Tshs.
1	Loans in good standing	9,180,900	
2	Members' deposits		10,684,800
3	Cash in hand Cash	1,700,450	
4	at bank Stocks and	10,450,800	
5	debtors	1,000,000	
6	Investments	830,000	
7	Fixed assets	11,700	
8	Interest on members' loans		6,300,000
9	Entrance fees		57,000
10	Interest from bank (on savings)		1,140,000
11	Other income		290,000
12	Salaries, wages and NSSF	1,400,300	
13	Board meeting expenses	1,440,000	
14	Transport insurance	516,000	
15	Stationeries and rent	615,300	
16	Education expenses	404,900	
17	Other expenses	950,000	
18	Bank charges	102,780	
19	Interest paid on members' deposits	5,834,500	
20	Share capital		15,965,830
		34,437,630	**34,437,630**

Required:

From the above trial balance, prepare:

(a) Total income
(b) Total expenses
(c) Net gain/loss

(Adapted from May 2012)

Question 2

The following transactions are extracted from Gema Cooperative Society:

1. A member of the cooperative paid shares of the value of Tshs.50,000 into the Cooperative through Cooperative's bank account.
2. Bought goods on credit worth Tshs.20,000
3. Goods sold on cash worth Tshs.32,000
4. A member withdrew Tshs.100,000 from the cooperative after resigning from the society
5. Office building was renovated for Tshs.1,000,000
6. Cooperative received from Bank Tshs.800,000.

Required:

Indicate the effect of each transaction above by showing how the following items increase or decrease:

(i) Assets

(ii) Liabilities

(iii) Equity (capital)

(May 2013)

Answers to Self Examination Questions

Answer to SEQ 1

(a) Total income

Particulars	Tshs
Interest on members' loans	6,300,000
Entrance fees	57,000
Interest from bank (on savings)	1,140,000
Other income	290,000
Total income	**7,787,000**

(b) Total expenses

	Tshs
Salaries and Wages	1,400,300
Board Meeting expenses	1,440,000
Stationeries and Rent	615,300
Transport Insurance	516,000
Education expenses	404,900
Other expenses	950,000
Bank charges	102,780
Interest on Members' deposits	5,834,500
Total expenses	**11,263,780**

(c) Net Gain/Loss

	Tshs
Total Income as per (a) above	7,787,000
Less: Total Expenses as per (b) above	11,263,780
Net loss	**3,476,780**

Answer to SEQ 2

1. **Payment of shares, Tshs50,000/= by a member**

   Equity increases
   Cash at Bank as an asset increases as well

2. **Buying goods on credit worth Tshs20,000**

   Stock as an asset increases
   Liability (Creditors) increases as well

3. **Selling goods on cash – Tshs32,000**

   Cash as an asset increases
   Stock as an asset decreases

4. Withdrawals and resignation by a member – Tshs100,000

Equity decreases
Cash as an asset decreases

5. Office building renovated - Tshs1 Million

Cash as an asset decreases
Building as an asset increases in value

6. The Cooperative received money from Bank - Tshs800.000

Cash as an asset increases
Liabilities (loan) increases