**Unit one**

**Introduction to Federal Government of Ethiopia Accounting and Financial Management**

1. **Introduction**

Accounting is mainly governed by conventional concepts and principles. These conceptual backgrounds are very important to study the structure and operations in accounting system. As information processing system of an organization accounting is affected by various factors such as *its environment and characteristics*. This is what is to be explained in the first unit of this course.

Accounting provides critical information for good financial administration system of organizations. Government money is a public resource which the government has to spend as per clear directives and procedures. The accounting system has to control this resource through a budget control. Thus, this course also deals with financial administration in FGE accounting system in the assumed administrative structure and the roles and responsibilities of different units of the government. The course also describes *procedures in accounting for transaction and budget control in FGE accounting system*. Itfocuses on accounting for daily economic activities and budget control that is the broad goal of the FGE accounting system and hence employs mechanisms for budget control.

The overall objective of this course is therefore to capacitate students on understanding basic concepts and principles of FGE accounting and reporting system, budget preparation financial reporting and control mechanisms. In general, you are expected to apply appropriate accounting and financial treatments capture government activities with financial effect as occurred, prepare financial reports and ensuring control and transparency in using public financial resources, under the statutory framework and applicable accounting principles.

* 1. **Historical overview of Federal 1Government Accounting System**

The federal government of Ethiopia has been undertaking various reforms in the management of government affairs service delivery, under the broad umbrella of

"The Public Sector Capacity Building Program (PSCAP), [which] is a large national program planned to be implemented by different government offices in different government structures. The MoFED will be responsible for the disbursement of program fund to the different beneficiaries and for the eventual gathering of financial reports, consolidating them and preparation of financial reports to the government, donors and other stakeholders.'(PSCAP –Financial Management Guidelines, p.1)

The MoFED at federal level and BoFED at regional level leaded the reform undertakings in the government accounting and financial management.

The Accounting and financial management system reforms under this package resulted a change on the FGE accounting system that had been in service for more than half a century. The reform improved of accounting and reporting, and financial management process at federal, regional and local government bodies.

The FGE accounting system, as explained in the budget manual which is prepared by ministry of Finance and Economic Development and in the financial law of Ethiopia, is applicable in all Public bodies (PB). Public Bodies are those government institutions which have got legal responsibilities (mandates), receive their partial or full budget from the government to discharge their responsibilities. These Public Bodies are also required to submit their reports to ministry of Finance and Economic Development and respective Finance or Planning both at Federal and Regional states.

* 1. **Changes in the FGE accounting system**
* The Federal government of Ethiopia (FGE) accounting system used in 1994 EC has been in service for more than half a century. The old system had been using a cash base accounting system. The system has been revised at various times and the revisions through time house brought major changes in recording, summarizing and reporting of the government financial information by inculcating a modified cash base double entry accounting system.
* The federal government decided that there was a need to revise the current accounting process as an integral part of the civil service Reform. The civil service Task force, formed in the prime minister’s office, began the revision process. Further study and implementation responsibilities were given to the accounts Reform Team established by the ministry of finance and Economic Development (MOFED)
* The overall strategy of the civil service Reform for accounts is to move from strictly cash controls to on emphasis on management and accountability.

**Similarities and Differences of FGE accounting system with business organizations**

There are many similarities between the accounting for business and not-for-profit government organizations. A double entry system of accounting is recommended for both. The general mechanics for record keeping are the same: documents from the basic record, books of original entry (journals) are kept and posted to general ledgers and subsidiary ledgers, trial balances are drawn to prove the equality of debits and credits, a chart of accounts properly classified and properly fitted to the organization’s structure is essential to good accounting, and of course, uniform terminology is highly desirable in both fields. Both prepare financial statements, closing entries, etc.

In most of the operations, government budgetary institutions are not concerned with profit measurement, but only to assure continuity and/or improvement of services to the public, and the need to ensure compliance with extensive legal requirements often results in government organizations having more stringent operational and administrative controls than in commercial organizations. But the market in which they operate regulates commercial businesses. If the management is not responsive to the market demand and fails to provide the quality of services demanded by the market, the commercial organization will ultimately be forced out of business.

* 1. **Goals achieved by FGE Accounting System**

As stated in the first volume of FGE Accounting system, Manual 3, The FGE accounting system achieves three goals: *budget control, cash control*, and *accountability*.

**Budget control**

* The ability of the accounting system to report expenditure consistent with budgetary principled and
* Including accounting for commitments in the system. A commitment is an amount of budgeted funds that is reserved for a specific future expenditure. Any committed budgeted funds are no longer available for future commitments. Commitments are made against the budget when a purchase order is approved.

**Cash control**

* Maintaining the balance of cash at bank and cash in safe in a general budget.
* Clarifying the responsibilities and duties of the cashier and the accountant for cash at bank and cash in safe. The cashier handles cash in safe, while the accountant is assigned overall responsibility for cash in safe and specific responsibility for the checkbook and cash at bank.
* Using on impress system to control cash in safe. In an imprest system, the can safe is from the safe is documented. The cash in safe is periodically reimbursed, based on vouchers, for the exact amount necessary to restore the original cash balance deposited in the bank intact.
* Applying double entry bookkeeping techniques in the accounting system. Double entry bookkeeping creates a set of self balancing account ledgers (general ledger), Because the account ledgers are self balancing accounting records in a general ledger, So cash also in controlled by double entry bookkeeping. Therefore a running cash balance in the register ledger reflects the actual cash available.
* Employing a modified cash basis of accounting when accounting for transactions, the modified cash basis of accounting allows the accounting system to recognize revenue and expenditure consistent with the budgetary process and financial low.

**Accountability**

* Imploring a general ledger system. Each accounting unit maintains a general ledger for each source of funding, so each unit maintains a balanced and continuous record of its responsibilities and performance. A set of financial reports can be produced from any single general ledger or from any combination of general ledgers.
* Creating the ability to record and report on any assets and liabilities using a cost method of valuation. The FGE accounting system included a simplified process for recording any assets and liabilities in a set of registers and in a general ledger that is independent of accounting for transactions using a modified cash basis of accounting.
* Establishing a system of financial reporting that produces two reports for use by government and a statement of changes in cash position for use by interested p[arties outside of Budget and Actual for revenue and expenditure and a statement of Net assets.
* Every attempt is made to design a system that is consistent and clear. To permit jurisdictions some ability to adapt the system to their capacity, the design allows implementation of the system initially for recording other assets and liabilities using the cost method can be deferred for later implementation.
  1. **Chart of Accounts of FGE Accounting Systems**

A chart of accounts is a system of coding used to identify and classify financial entities and events. The current chart of accounts, described in the Budget Reform Manual incorporates detailed codes for items of domestic revenue, external assistance, external loans, and items of expenditure. This sub section completes the FGE chart of accounts by adding detailed codes for transfers, assets, liabilities, letters of credit and net assets/equity.

The classification of the chart of accounts is structured in a systematic manner and facilitates the recording of transactions and the reporting of information in accordance with the budget.

The chart of accounts treats all detailed account codes as temporary accounts and permanent accounts. ***Temporary accounts*** are accounts that begin each year with a zero balance. ***Permanent accounts*** are detailed account codes whose balance at the end of a year becomes the balance in the account at the beginning of the next year.

**Chart of Temporary Accounts**

Revenue, expenditure and cash transfers are temporary account code categories. Account codes in these categories:

* are always treated as temporary accounts, and
* begin each year with a zero balance.

The Budget Reform Team under the Expenditure Management and Control Sub-Program of the Civil Service Reform designed codes in the chart of accounts for detailed coding of:

* Items of domestic revenue, external assistance and external loans using code numbers 1000 through 3,999, and
* Transfers using code numbers 4000 through 4099.
* Items of expenditure using code numbers 6,000 through 6,999.

The Budget Manual created account codes for the FGE chart of accounts as follows:

* Items of domestic revenue using account codes 1000-1799,
* External assistance using account codes 2000-2999,
* External loans using account codes 3000-3999,
* Transfers using code numbers 4000 through 4099, and
* Items of expenditure using account code 6000-6999.

**Chart of Permanent Accounts**

Assets, liabilities and net asset/equity are permanent account code categories. Account codes in these categories:

* are always treated as permanent accounts, and
* begin each year with the account balance as long as they had at the end of the previous year. In other words, these accounts are not closed.

The Accounts Reform Team under the Expenditure Management and control Sub-Program of the Civil Service Reform designed codes for detailed coding of:

* *Assets* using code numbers 4100 through 4999.
* *Liabilities* using code numbers 5000 through 5499.
* Le*tters of Credit* using code numbers 5500 through 5599.
* *Net Assets/Equity* using code numbers 5600 through 5699.

**Assets:** Assets are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity. The categories of assets in the FGE accounting system are: *cash and cash equivalents, receivables, goods in transit, stocks, fixed assets, loans receivable, investments, liabilities*, letters of credit, *and net assets/equity.*

**Cash and cash equivalents:** Cash is cash on hand and cash at bank. Cash equivalents are short-term, highly liquid investments that are readily convertible to known amount of cash and which are subject to an insignificant risk of change in value.

**Receivables:** receivables are amounts owed to (given to) a government unit by another government unit, a person, or a non-government entity except public enterprises. Salary advances to employees and advances to suppliers are two examples of receivables commonly occurring in FGE transactions.

**Goods in transit:** Goods in transit are goods that are owned by the FGE but not yet in the FGE's possession. Typically, these are goods that are purchased overseas using a letter of credit.

**Stocks:** Stocks are goods that are consumed in less than one year.

**Fixed assets:** Fixed assets are physical items that are expected to have a useful life of longer than one year and have a certain minimum value.

**Loans receivable:** Loans receivable are amounts due from public enterprises over a period of time exceeding one year.

**Investments:** Investments are FGE investments in public enterprises and private organizations that are held for more than one year.

**Liabilities:** Liabilities are formally defined by the Institute of Public Sector Accounting standards as "present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential." Liabilities are better defined by example. The categories of liabilities in the improved and expanded accounting system are:

* Payables. Payables are obligations to pay that are due in less than one year. Examples of FGE payables are deposits, grace period payables, treasury bills, and retention on contracts.
* Long-term debt. Long-term debt is an obligation to pay that is due in more than one year.

**Letters of Credit:** A letter of credit represents a guarantee to pay suppliers with cash set aside in bank account restricted for that purpose.

**Net assets/equity**: Net assets/equity is formally defined by the Institute of public sector accounting standards as "the residual interest in the assets of the entity after deducting all its liabilities." Net assets/equity is the balance remaining after liabilities are deducted from assets. This balance represents the equity interest of Regional and Federal Governments

###### **1.4 Basis of Accounting**

The basis of accounting is the basic set of principles and rules employed by the accounting system to determine when and how to record transactions. The cash basis of accounting is a basis of accounting that recognizes transactions and other events when cash is received or paid.

Although organization’s earnings and related operating activities are continuous, they are reported at specific intervals (i.e. an accounting period or budget year) in order to provide useful information for decision-making on a timely basis. Some activities may begin and end during the accounting period, while others may require two or more accounting periods for completion. Budget year for FGE is from **Hamle1 to Sene 30**.

In summary, accrual accounting is based on cash flows but reports transactions and other events with cash consequences at the time the transactions occur rather than at the time cash is received or paid. Accrual accounting is also superior to cash-basis accounting from the standpoint of measuring financial statement elements.

The FGE accounting system employs a modified cash basis of accounting. Modified cash basis of accounting is a compromising basis of accounting between the two extreme bases of accounting. It adopts features from both bases of accounting. Most transactions are recorded using cash basis of accounting and some transactions are recorded using accrual basis of accounting.

The modified cash basis of accounting in FGE means that cash basis applies except for recognition of the following transactions:

* Revenue and expenditure are recognized when aid in kind is received.
* Expenditure is recognized:
  + When payroll is processed.
  + At the end of the year when a grace period payable is recognized.
  + When goods are received or services are rendered if payment for the goods or services was rendered in advance.
  + When cash moves from an unrestricted to a restricted bank account to meet the requirements of a letter of credit. When cash moves out of the restricted account, no expenditure is recognized.
* Intergovernmental transfers are recognized in the absence of actual cash movement.
* Transactions resulting from salary withholdings are recognized in the absence of actual cash movement.

The modified cash basis of accounting is consistent with the budgeting process and produces information useful for comparing budgeted and actual revenue and expenditure. The modified cash basis accounting system requires the same temporary accounts as the cash basis of accounting plus the following permanent accounts: cash and cash equivalents, receivables and payables.

The FGE accounting system employs a combination of temporary and permanent accounts. All account balances at the end of the year may not have a zero balance. So, a process is necessary that distinguishes temporary accounts and sets them to zero. The process of setting the balance in temporary accounts to zero is called closing the accounts, and the process is performed by a closing entry. The closing entry is an accounting activity that takes place at the end of each budget year. This process requires a net assets/equity account.

All assets and liabilities are not recognized in the modified cash basis accounting system. Only those receivables and payables included in the chart of accounts are included in the system. The modified cash basis accounting system produces financial information that is reported in a Statement of Changes in Cash Position and a Statement of Budgeted versus Actual Expenditure.

Asset and liability accounts other than cash, receivables, payables, and letters of credit are included in the chart of accounts to allow institutions that have the capacity to maintain accounting records of all assets and liabilities. These other assets and liabilities are recorded using the cost method. The cost method values assets at their original cost and liabilities at the amount still due.

**Book keeping methods**

Every transaction that is recorded by accounting has two aspects: effort and reward, source and use, cash inflow and expenditure. The purpose can be, for example, expenditure, revenue deposit, or transfer.

The FGE accounting system uses double-entry bookkeeping. Double-entry bookkeeping means that both aspects of each transaction are recorded in the accounting records with at least one debit and one credit so that the total amount of debits and the total amount of credits are equal to each other.

The advantages of double-entry bookkeeping are numerous, including:

* All aspects of the transaction are properly recorded in accounts.
* The accounts are self-controlling because the total of all debits must equal the total of all credits; therefore, many errors are easily detected and corrected.
* Modified cash basis of accounting can be introduced.

Double-entry bookkeeping requires an understanding of some additional basic accounting concepts and terms. The most basic are the terms debit and credit. Debit literally means left and credit literally means right. By convention, the rule for increases for Letter of Credit and Net Asset /Equity is Credit which is used in modified cash basis of accounting.

Transfer Accounts:

* If cash is sent by transfer, Transfer account is debited.
* If cash is received by Transfer, Transfer account is credited

In a double-entry system, each debit to cash is matched by a credit to another account of an equal amount, and each credit to cash is matched by a debit to another account of an equal amount.

Because each transaction is entered in the accounting records as debits and credits of equal amounts, the total debits in all account balances always equals the total credits in all account balances. For FGE modified cash basis of accounting, the basic accounting equation always applies.

FGE Basic Accounting Equation is as follows:

Asset

= Liabilities + Net Assets/Equity

Cash & Cash Equivalents + Receivables = payables + Letters of Credit + Net Assets/Equity

In a double-entry bookkeeping system, the book of original entry is the register. A register is a chronological listing of transactions and serves as the book of original entry into the accounting system. Information regarding transactions is taken from various documents (invoices, receiving reports, etc.) and recorded in the accounting system for the first time on the register. The transactions in the register are in chronological order.

Each transaction entered on the register in the double-entry system affects at least two accounts. One is a debit and the other is a credit, but both accounts are affected by the same amount. Therefore, for each transaction that is recorded in the double-entry register, the amount recorded as a debit equals the amount recorded as a credit. The total of debits recorded in the register will always equal the total of all credit in the register.

In the double-entry system, a ledger card is created and kept for all accounts. All transactions entered in the register must be transferred to ledger cards. The process of transferring transactions information from the register to the ledger cards is called posting.

In the double-entry system, a ledger card is created and maintained for each account. Because each transaction is entered on the register as a debit to one account and a credit to another account, each transaction is posted to at least two ledger cards.

The set of all ledger cards is called a general ledger. Two postings are made for each transaction in the general ledger of equal amounts in different accounts, but one is entered as a debit and one as a credit. Therefore, the total debit amount on all ledger cards must equal the total credit amount on all ledger cards.

The general ledger contains a ledger card for each account. The ledger card contains the running balance in that account. If postings to the ledger cards from the register are up-to-date, monthly reports are easily prepared by taking the balance from each account's ledger card. Mistakes are easily identified if the total debt balances on all ledger cards do not equal the total credit balance on all ledger cards.

If a general ledger is kept, a set of self-balancing accounts (total debits equals total credits) is maintained and a report of financial information is available. Financial reports can be prepared from general ledgers.

Some accounts in a general ledger do not provide sufficient detailed information for control purposes. The account "Advances to Employees" is an example. The account in the general ledger maintains the total balance in the account, but identifying each individual and the amount each owes is important.

A control account is an account in a general ledger that maintains the total balance of all related accounts in a subsidiary ledger. For each control account, a subsidiary ledger is kept. A subsidiary ledger is a ledger separate from the general ledger that contains a group of related accounts. The control account is part of a general ledger. The subsidiary ledger accounts provide details about the balance in the control account.

Any account in the general ledger that requires more detail than simply the amount in the account becomes a control account with a subsidiary ledger. An example of a subsidiary ledger is presented here. Suppose advances are provided to three employees. The account code in the general ledger for Advances to staff is 4203. A subsidiary ledger for account code 4203 is created where each advance is assigned an account code as follows:

|  |  |  |
| --- | --- | --- |
| **No** | **Employee** | **Subsidiary Account code** |
| 1 | Abebe | 4203-01 |
| 2 | Kidane | 4203-02 |
| 3 | Hassen | 4203-03 |

The specific advance provided, for example, to Kidane for example, is maintained in account code 4203-02 in the subsidiary ledger. The total of all advances is the total of all account balances in the subsidiary ledger and is the balance recorded in control account code 4203 in the general ledger.

#### 1.5 Overview of Financial Administration in FGE Accounting System

The purpose of this unit is to present *Financial Administration* of *Public Bodies without* *Branch Accounts*. It provides the financial administration issues and a general description of the roles and responsibilities of each unit within the assumed administrative structure for Public Bodies without Branch.

To describe the FGE accounting system, its operations, and roles and duties within the system, the structure of financial administration and authority in the federal and regional governments must be understood to the extent that it impacts the accounting system. Although the structure of ***financial administration*** is not standard across all units in the Regional and Federal governments, a general pattern exists. Throughout this unit the structure of financial administration under MOFED is assumed, because the structures differ at Regions due to decentralization. Furthermore, this unit will also present an issue of *Public Bodies with Branch Bank Accounts.*

**1.5.1 Financial Administration**

The financial administration in FGE mainly involves Ministry of Finance and Economic Development (MOFED) and Regional Finance and planning offices and a Public Body. The specific Federal and Regional government administrative authorities and the required organizational structure in public bodies are illustrated in the following Figure 2.1 and Figure 2.2 below

**Figure 2.1**

**Structure of Financial Administration in the Budget Process**

**Ministry of Finance and Economic Development**

**Public Body**

**Budgetary Institution:**

**Project or Sub-Agency**

**Budgetary Institution:**

**Sub-Project or Sub-Sub-Agency**

**Figure2.2: Structure of financial administration within public Body**

**Figure 2.2**

**Structure of Financial Administration within a Public Body**

Head of public Body

Head of Administration and Finance

Head of Budget and Accounts

General Services

& Administration

Budget Section

Accounts section

Accountant

Cashier

The following are responsibilities of *MOFED, Budgetary Institutions, Accounting unit, Reporting Entity, Cashier and Accountant* in the financial administration in the Budget process and within the Public Body

**Ministry of Finance and Economic Development (MOFED)**

MOFED administers the financial system for the federal government and has the highest level of administrative authority. MOFED consists of a:

* Budget Department that prepares and distributes notification of approved federal budgets and administers the budget.
* Central Accounts Department that receives monthly reports and compiles financial statements for the federal government.
* Central Treasury Department that receives and distributes cash from central treasury.
* Credit and Investment Department that manages the federal government's investments and debt.

This is not a complete description of MOFED or its departments. This is description of their roles and responsibilities within the accounting system.

**Budgetary Institution (BI)**

Budgetary Institutions are defined as those institutions that are fully or partially financed by Government. The budget process assumes the appropriation of budgets. The appropriated budget is the budget approved by the Council of people's Representatives (CPR). The appropriated budget is broken down by:

* Recurrent and capital expenditure for the federal government, and
* Subsidy for each regional government

The federal government's portion of the appropriated budget is assigned to projects and sub-agencies within PBs and broken down by sources of funding (domestic, assistance and loan). This is called the approved budget. The approved and appropriated budget is published in the Negarit Gazeta.

A PB's entire approved budget is assigned to projects and sub-agencies under its immediate administrative control. The budget of a PB is the total budget of its projects and sub-agencies.

A project or sub-agency may allocate any portion of its approved budget to sub-projects or sub-sub-agencies. The budget of a sub-project or sub-sub-agency is called an allocated budget. A sub-project or sub-sub-agency for which a budget is allocated is always at a different location from the project or sub-agency. A notification of any allocation is sent to MOFED.

Projects, sub-agencies, sub-projects, and sub-sub-agencies are defined and coded in the chart of accounts. Any entity that receives an approved or allocated budget from a PB's approved budget is called a Budgetary Institution (BI). Generally:

* PBs are ministries, authorities, and commissions.
* BIs are projects, sub-agencies, sub-projects, and sub-sub-agencies.
* BIs are administered by PBs.
* The entire approved budget of a PB is assigned to BIs.

Figure 2.1 shows the structure of financial administration in the budget process. There are exceptions to these generalities, but the majority of government is organized in this manner. The focus of budgetary control is on the BI. PB's budgetary compliance can be computed by consolidating reports from all BIs included in its approved budget.

**Accounting Unit**

For cash management, another entity is created: the Bank Account (BA). The BA is not coded in the chart of accounts and does not receive a budget. However, it is important for cash Management and control. The FGE accounting system includes the BA in the accounting system.

A PB may administer many BIs and many BAs, or a PB may have only one BI and one BA. Each BA:

* Is managed by an accountant.
* May:
* Have its own cashier,
* Share a cashier with other BAs, or
* Have no cashier associated with it (like foreign currency bank accounts)
* Handles cash flows:
* For one or more than one BI, and
* From one source of financing (domestic, assistance or loan).
* For more than one type of budget (capital/recurrent).

An accounting unit is the unit that initially captures and records transactions into the accounting system. If a BA handles cash for only one BI(BI/BA), the accounting unit:

* Processes transactions for the BI/BA,
* Maintains registers for the BI/BA,
* Maintains a general ledger for the BI/BA.
* Maintains subsidiary ledgers for:
* Asset accounts.
* Liability accounts.
* Letters of credit.
* Prepares a monthly report for the BI/BA.

A complete set of accounts and general ledger is maintained for each BI by bank accounts, because each source of funding is budgeted distinctly, and the cash from each source is physically separated in distinct bank accounts.

Each month, a monthly report is prepared from the general ledger for the Bank Account (BA). Cash ledger cards in the general ledger control the cash balances in the bank and in the safe. If more than one BI shares a single BA, the accounting unit:

* Processes transactions for all BIs.
* Maintains a register for the BA.
* Maintains a general ledger for the BA.
* Maintains subsidiary ledgers for:
* Items of expenditures by BI and by type of budget.
* Asset accounts.
* Liability accounts.
* Prepares a monthly expenditure report for each BI.
* Prepares a consolidated monthly Trial Balance for the BA.

One general ledger is maintained for the BA. The only records maintained for each BI are accounts in subsidiary ledgers for items of expenditure. Monthly, the subsidiary ledger information is used to prepare an expenditure report for each BI. These reports are consolidated with information from the general ledger into a monthly report for the BA.

The balances of cash in safe and cash in bank are maintained in ledger cards of general ledger for the BA.

**Reporting Entity**

A reporting entity is the entity that sends monthly reports to MOFED. Although the accounting unit prepares monthly reports, every accounting unit may not send monthly reports directly to MOFED. The reporting entity may be the accounting unit or a higher level of authority (perhaps a PB).

Each of the following may apply to a reporting entity:

* A reporting entity may be an accounting unit, and an accounting unit may consist of only one BI. Therefore, a single BI may be a reporting entity.
* A reporting entity may be a PB that receives the monthly reports from several accounting units.

Whoever sends the reports to MOFED is the reporting entity. Therefore, the reporting entity is not, necessarily, an accounting unit.

**Cashier and Accountant**

In the FGE accounting system of cash control, the cashier's function and the accountant's function are distinct. Cash consists of currency and checks. The cashier's function is to maintain and control cash in the safe. The accountant's function is to maintain and control cash at the bank.

Only the cashier can receive currency and checks and make disbursements in currency. Daily, the cashier should count cash on hand and reconcile ending cash on hand to the cash book.

The cash in safe is controlled by an impress system. When cash is received as per the budget or other sources, the cashier will:

* Issue a cash receipt,
* Segregate the cash received from cash available to disburse,
* Deposit the cash received intact in the bank as soon as practical, usually daily, and
* Surrender copies of all cash receipts and a copy of the bank deposit slip to the accountant.

In the imprest system, a balance is established for cash in safe. The accountant issues this amount of cash to the cashier using a check. When cash is disbursed to establish the Imprest Fund, the cashier will issue a receipt voucher. If the amount of cash in safe is to be replenished, the cashier will surrender all payment vouchers to the accountant. The accountant will replenish the cash in safe by issuing a check to the cashier for the total amount of the payment vouchers that are surrendered. The replenishment should return the balance of cash in safe to the established level.

The accountant's responsibility for cash is to maintain a record of the total cash position of the entity, including cash at the bank and cash in the safe. The accountant records cash movements that flow through the cashier and cash movements that flow directly through the bank. Direct cash movements through the bank normally include bank transfers and charges, checks written, and any other transactions that do not require cash handling by the cashier.

When a PB has more than one cashier, one cashier is designated as the main cashier. The other cashiers are designated as assistant cashiers. Each PB is responsible for organizing assistant and main cashiers. However, some general principles apply.

Assistant cashiers are responsible for:

* Collection of Cash
* Issuing deposit and/or receipt vouchers
* Making deposits at Bank

The main cashier is responsible for:

* Reconciling cash and vouchers for each assistant cashier
* Depositing cash in the bank
* Disbursing cash for the proper functioning of the PB
* Managing the petty cash
  1. **FGE budget process**

**Definition and importance of budget**

The word budget was originally derived from French word “bougette” which means “small bag” or the public purse which serves as a container for revenues and expenditures of the state. Budget is the most important tool for the government to manage the public resources of the nation economy. It serves as an instrument to allocate the scarce resources among the different computing unlimited needs of the society. It is a document Containing planned program which planned ahead to reach objectives and targets. A budget may be stated in terms of quantity, money or both and is prepared for definite time period. A budget is a time bounded financial program systematically worked out and ready for execution in the ensuing fiscal year. It is comprehensive plan of action, which brings together in one consolidated statement of all financial requirements of the government. The budget goes into operation only after it is approved by the parliament. Thus budget is an annual statement of receipts and payments of a government.

**Classifications of budget**

The structure of government budget constitutes the formats in which the budget data are organized and classified for different purposes. The government budget in Ethiopia is classified into: - 1.revenue budget 2. Expenditure budget

1. Revenue budget:- is usually structured into three major sources:
2. Ordinary revenue b. external assistance and c. capital revenue
3. Ordinary revenue- consists of both tax and non-tax revenues. The tax revenues includes:
4. The direct tax of ordinary revenue consists of:

* Personal income tax
* Rental income tax
* Business income tax
* Tax on dividend and chance winning
* Land use fee and lease

1. The indirect tax consists of:

* Excise and sales tax on locally manufactured goods, services sale tax, stamps and duty.
* Tax on foreign trade includes customs duty on imported goods and export tax on coffee.

1. Non tax revenues includes:

Charges and fees, investment revenue, miscellaneous revenue and so on.

1. External assistance – include cash grants from multilateral and bilateral donors for different structural adjust programs; and technical assistance in cash and material form.
2. Capital revenue: - these could be from domestic (sales of movable properties and collection of loans), external loan from multilateral and bilateral creditor mostly for capital projects.
3. Expenditure budget

Government expenditures for administration and developmental activities are handled through the expenditure budget. These expenditures are categorized into:

1. Recurrent expenditure:- is structured by implementing agencies(public bodies) under four functional categories.
2. Administrative and general services includes such activities as:

* Council of representatives and ministers, ministers, defense and so on.

1. The economic services includes:

* Agricultural, industrial and service sector activities

1. The social service includes such activities:-Health, education and culture
2. Other expenditures includes: - pension payments, repayment of public debts etc.
3. Capital budget expenditure: - is usually made on acquisition and improvement in to fixed asset and consultant services. It is grouped under three headings;
4. Economic development
5. Social development and
6. General development
7. Economic development includes: - production activities in the agricultural and industrial sector, economic infrastructure in mining, commerce and communication.
8. Social development includes: - education, health, urban development and welfare etc.
9. General development includes:-general governmental activities.

**The budget process in Ethiopia**

Budgeting from the initial stage of forecasting the annual revenues and expenditures, to the final stages of approval of the annual budget by the council of people representatives, passes through a sequential and an interactive process. The budgetary process of FGE involves the following steps:

1. Preparation of macro-economic and fiscal frame work

* The frame work is composed of macro-economic forecast and fiscal forecast. The macro-economic forecast gives the forecast of gross domestic product based on past experience and estimates for future years. Fiscal forecast establishes the level of total resources available for expenditure, it provides a more detailed forecast of revenue (both federal and regional), and projection of expenditure. Once prepared by the concerned coordinating ministry, i.e MoFED.It will be reviewed and approved by the prime minister’s office (pmo).

1. Determination of federal government expenditure and subsidy to regional government.

* The shares of federal government expenditures and subsidies for regional governments will first prepare by MOFED, then reviewed by the PMO and finally approved by the federation council.

1. Allocation of federal government expenditures between recurrent and capital budget.

* First the amount of budget necessary to cover recurrent expenditures the balance will then be allotted to capital expenditures. This will be performed by the PMO in consultation with MOFED.

1. Budget call and ceiling notification

* Mofed issues detailed budget preparation guidelines to spending public bodies along with the ceilings provided to each line institution. Mofed will send the ceilings for each sector.

1. Budget request – is prepared by public bodies by depending on the budget ceiling to fit budget request to mofed.
2. Budget review by MOFED:

* Prior to a formal budget hearing, spending public bodies will submit their budget proposals to the MOFED-budget department. The sector department of the mofed reviews the budget requests from different public bodies.

1. Budget hearing and defense:- spending public bodies defend their budget submission in a formal hearing with the mofed. The hearing focuses on policies, programs and cost issues, when necessary it might involve discussion down to line of items. Presenting the hearing will be ministers and/or vice ministers, head of public bodies and the mofed.
2. Review and recommendation

* Each sector of MOFED review the budget that requested by public bodies and after review of the requested budget MOFED send the consolidated and submit to prime minister’s office then submitted to council of ministers. The budget committee of the MOFED will review the discussion and make recommendation. If there is an increase (over ceiling) this will go to PMO for approval.

1. Submission to the council of ministers:-

At this stage the two budgets (recurrent and capital) will be consolidated and MOFED will prepare a brief analysis of the total budget. First reviewed by ministers and vice ministers in an economic affairs and then presented to the prime minister along with brief. The prime minister may or may not make amendments and then will be sent to the council of ministers for discussion. MOFED defend the budget in the council, the council of ministers may make some adjustments.

1. Submission of budget to house of people representatives:-

Once approved by the council of ministers, the prime minister will present both budget to HPR.the budget then will be debated based on recommended of the budget of the committee and approved.

1. Notification and publication

The approved budget will then get the legal status through the publication in the” Negarit gazeta’. Spending public bodies will then formally be notified of their approved budget by line of items from MOFED for recurrent and capital budgets, respectively. MOFED will notify spending public bodies.

1. Supplementary budget: - in the course of budget year, supplementary (additional) budget will be proclaimed when necessary. Following almost same process as the initial budget preparation. Likewise budget reallocation will be made mainly based on performance.

**Budgetary process of regional level**

It is quite difficult to present the budget process at the regional level in the way in the discussed for federal budget. At present the budget process followed by regional is not uniform. The process is more or less a mirror image of the federal budget process. In place of MOFED, the regional finance bureau (RFB) is responsible for the preparation of the recurrent budget. While the regional planning and economic development bureau (RPEDB) is responsible for the capital budget. At the higher level the regional councils, the one responsible for the appropriation of the region’s budget. One significant deviation is the regional budget process starts at the woreda level and goes up to zone and regional level

## Budget Control in FGE Accounting System

**Approved Budget**

At a national level, Council of People's Representatives approve budget and the total budget is published in Negarit Gazet both for capital and recurrent budgets.

The approved budget is the detailed breakdown of the appropriated budget by:

* Sub-Agency or project, and
* Source of finance.

The budgetary institution is notified of its approved budget on Me/Be/Ma 4 Recurrent Budget Notification for Sub-Agency and Ka/Be/Ma 4 Capital Budget Notification for project at the beginning of a fiscal year.

##### Additions/Reductions to Approved Budget

During the year, the approved budget may be revised in two ways:

***Budget supplement:*** A budget supplement is an additional appropriated budget. The supplementary amount increases the approved budget. Notification of budget supplement is made on Me/Be/Ma 6 for recurrent budget and Ka/Be/Ma 6 for capital budget.

***An addition to one budget item and a corresponding reduction to the budget of another item of expenditure:*** There are two processes for accomplishing this transfer: *budget transfers* and *vehement changes*

* *Budget transfers,* is Transfer of expenditure Budget from one Public Body to another. The transfer can be made from recurrent Budget of a Public body to recurrent Budget of another Public Body and from recurrent budget of one Public Body to capital budget of another Public body. But Transfer from Capital Budget to recurrent budget is impossible.
* *Virement changes,* when transfers of budgeted expenditure are made from one item of expenditure to another within the same BI.

Once the approved budget is adjusted for additions and / deductions, it is considered as revised Budget. The revised budget is the benchmark for budget control, as an item of expenditure must not exceed its revised budget.

##### **Payments Received for Budgeted Expenditure**

Treasury funds are the primary source of domestic expenditures for most BIs. MoFED transfers amounts to Public bodies monthly based on requests made by the PBs at federal level.

In addition, MOFED may make payments on behalf of a BI. When this happens, a non-cash transfer is recorded and considered as a payment received by the BI to meet budgeted expenditure.

As indicated in Manual 3 Volume I accounting for modified cash basis transactions which is prepared by MOFED and DSA Project manual, January, 2002, a Public Body also receives cash for budgeted expenditure in a variety of other ways depending on the source as follows:

***Retained revenue:*** Retained revenue is revenue earned and collected directly by the BI that it is allowed to keep and expend for its own purposes.

***Assistance:*** various donors using one of three channels provide Assistance.

Channel 1: Some donors provide assistance through MOFED. These funds are requested and distributed from MOFED to the BI like treasury funds. The processes for requesting donor funds from MOFED differ.

Channel 2: Some donors provide assistance directly to the BI. These funds are requested and distributed from the donor to the BI in a manner prescribed by the donor.

Channel 3: Some donors provide assistance without cash movement. The donor maintains control over these funds. When a budgeted expenditure is incurred, the donor pays the invoice directly to the provider on behalf of the BI. Channel 3 funds are not requested or received.

***Loan:*** Donors provide loan funds using Channel 1 or 2 as described for assistance.

***Aid in kind:*** Any goods received by a PB as assistance or loans are also considered as payments received by a BI to meet budgeted expenditure.

##### **Procedures to achieve budget control**

Budget control is achieved through a combination of *commitmen*t accounting and *expenditure approvals* at the Budget Section. Each of these processes is described below.

##### **Commitment Accounting**

A commitment is a way of marking part of the budget that has not yet been spent but that is obligated for a specified expenditure. After the budget has been approved, the BI may enter into contracts or issue purchase orders. These obligations to spend money are treated as commitments; that is, before the good or service is ordered and before the payment is actually made, the amount of the purchase order is subtracted from the BI's approved budget. A commitment is a tool that prevents overspending by identifying amounts committed to pay for items that have been requested but not yet ordered and to determine the budget that is available (uncommitted) for expenditure (MOFED and DSA Project manual, January, 2002).

If the uncommitted balance is reduced to zero or if the budget is not available to meet planned expenditure, no further spending will be approved. Commitments are a budgetary control device. Because the Budget Section must approve spending requests, they also serve as a budgetary control measure (MOFED and DSA Project manual, January, 2002).

Example:

A BI has an approved budget for Birr 300,000 for stationery. The Procurement Section approves a purchase order for Birr 200,000 for purchase of stationery. The purchase order of Birr 200,000 represents a commitment although it has not been paid. The remaining budget available for expenditure after incorporating the commitment on stationery is Birr 200,000.

Further, assume that the procurement section approves another purchase order for Birr 200,000 for purchase of stationery from another supplier on the same day. The purchase order of Birr 200,000 represents another commitment. However, as the remaining budget available for expenditure on stationery is only Birr 100,000, the Budget section will not approve the expenditure as the Budget section has already recorded a commitment for Birr 200,000 from the previous purchase order.

##### **Recording Commitment**

Each time expenditure is to be incurred as evidenced by any one of the source documents mentioned below, it is taken to the Budget section to ensure that the commitment is recorded in the budget ledger card and to obtain confirmation from the Budget section that there is an available budget to meet the expenditure (MOFED&DSA Project, January, 2002).

The Budget section records the commitment and signs the source document as evidence of recording the commitment in the budget ledger card and confirming that budget is available for spending .In the same manual, it is indicated that the evidence of a commitment is either one or combination of the following forms:

* Pro forma invoice
* Purchase order
* A contract
* A letter or minutes of a meeting
* Journal Voucher
* Payment Voucher

Occasionally, a commitment may be cancelled or revised. In such cases, the Accounts Section must inform the Budget section of the changed to ensure that the budget ledger card is updated to amend the commitment and the uncommitted balance. If the Budget section is not informed about a cancelled or revised commitment, the balance available in the budget will not get updated. Consequently the budget section will disapprove a valid purchase order for want of an available budget (MOFED&DSA Project manual, January, 2002).

Example:

Assume the preceding example, and Procurement Section cancelled the purchase order for Birr 200,000 for purchase of stationery a week later. The purchase order will be marked "void" to indicate that it is cancelled.

The cancelled purchase order is returned to the Budget Section to ensure that the commitment is cancelled in the budget ledger card and the remaining budget available for expenditure (uncommitted balance) is updated to Birr 300,000 in the budget ledger card.

If the cancelled purchase order is not taken to the Budget Section through an oversight, the commitment would not get cancelled and the remaining budget available for expenditure (uncommitted balance) would incorrectly remain as Birr 100,000 instead of Birr 300,000.

##### The Expenditure Approval Process

As an additional control measure, when expenditures are to be incurred by a BI, all payment vouchers are verified by the Budget Section prior to approval for payment by the Accounts Section. The Budget Section approves all expenditures to verify that expenditure remains within the budget.

Prior to signing the payment voucher, the Budget Section verifies that:

* the amount of the purchase order for the expenditure has been committed in the same amount as the actual expenditure,
* if the amount of the expenditure has not been committed,
* the available (uncommitted) budget is sufficient to cover the expenditure,
* the commitment is recorded, and
* the uncommitted balance is updated.

If the commitment is already recorded, the Budget Section verifies the recording of the commitment and signs the payment voucher. If the commitment is not already recorded, the Budget Section records the commitment and signs the payment voucher. The signature on the commitment line of payment voucher by the Budget Section indicates that the budget for the item of expenditure has been recorded as a commitment and that there is an available budget to meet the expenditure (MOFED and DSA Project manual, January, 2002).

##### Budget Ledger Card

The purpose of the budget ledger card is to maintain a continuous and updated record for each budgeted item of expenditure by BI and source of finance with respect to:

* Approved budget
* Revised budget
* Payments received for budgeted expenditure.
* Amount remaining to be requested.
* Commitments
* Balance in the revised budget that is not committed.

The budget ledger card is divided into two parts:

A. The top of the card contains information to identify the

* BI,
* Type of budget, and
* Item of expenditure.
* The table on the card contains detailed information about each budget transaction.

B. The Budget Section maintains a budget ledger card for each individual item of        budgeted expenditure by BI and source of finance. The appropriate budget ledger        card is updated each time a transaction occurs. Figure 3.1 shows the Budget Ledger        Card

**Figure 4.1: Budget Ledger Card**

Me/He 16 Page No:\_\_\_\_\_

Name of Public Body: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Code: \_\_\_\_\_\_\_\_

Name of Program: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Code: \_\_\_\_\_\_\_\_

Name of sub Agency: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Code: \_\_\_\_\_\_\_\_

Name of Sub Program \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Code: \_\_\_\_\_\_\_\_

Type of Budget: \_\_\_\_\_\_\_\_ Code: \_\_\_\_\_

Name of Project \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Code: \_\_\_\_\_\_\_\_

Source of Finance \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Code: \_\_\_\_\_\_\_\_

(Donor/Lender\_\_\_\_\_\_ Item of Expenditure: \_\_\_\_\_ Code: \_\_\_\_

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **NO** | **Date** | **Description** | **Reference No.** | **Approved Budget** | **Addition to Budget** | **Reduction to Budget** | **Revised Budget** | **Payment Received** | **Unpaid Balance** | **Commitment** | **Balance Not Committed** |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |  |  |

(**Source**: MOFED&DSA Project manual, December 2002)

**Purpose of Each Field in the Budget Card**

##### **Upper part of the Budget Ledger Card**

* Name of Public body and Public Body code: the field is to identify the PB to which the budgeted expenditure is related.
* Name of Program and program Code: the field is to identify the Program to which the budgeted expenditure is related.
* Name of sub agency & Sub Agency Code: the field is to identify the BI to which the budgeted expenditure is related.
* Name of Sub Program and Sub Program Code: the field is to identify the Sub Program to which the budgeted expenditure is related.
* Name of Project & Project code: the field is to identify the BI to which the budgeted expenditure is related.
* Source of Finance & code: the field is to identify the source of funding that is recorded on the ledger card.
* Page Number: the field identifies the page number of the budget ledger card.
* Type of Budget and Code: the field is to identify whether the item of expenditure is a part of the recurrent or capital expenditure budget.
* Item of Expenditure & Code: the field is to identify and describe the item of expenditure by its budget code.

##### **Lower Part of the Budget Ledger Card**

* Number, Date, Description & Reference Number: the purpose of these fields is to respectively identify:
* The sequential number of the transaction.
* The date of the transaction.
* A brief narrative of the description of the transaction.
* The reference number of the source document to the transaction.
* Approved Budget: the field identifies the amount of the original approved budget for the item of expenditure.
* Additions/Reductions to approved Budget*:* the fields are used to track changes to the approved budget and provide information to compute the revised budget.
* Revised Budget: the field contains the approved budget adjusted for any additions or reductions. The revised budget is key for budget control. An item of expenditure must not exceed its revised budget.
* Payment Received for Budgeted Expenditure: the field is used to record payments received (Whether as cash or non-cash from the appropriate source of funding and assists in keeping track of the amounts of money received for the item of expenditure.
* Unpaid Balance: the field is the difference between the revised budget and the amount of funds received (whether as cash or non-cash) to meet the budgeted expenditure and assists in keeping track of the remaining amounts of money that may be requested for an item of expenditure.
* Commitment: the field is used to record current commitments and assists in identifying the balance available in the budget for expenditure.
* Balance not committed: the field contains the difference between the revised budget and the commitments. The balance not committed is the available budget for future spending. Once the uncommitted balance is reduced to zero, the Budget Section will approve no further spending.