

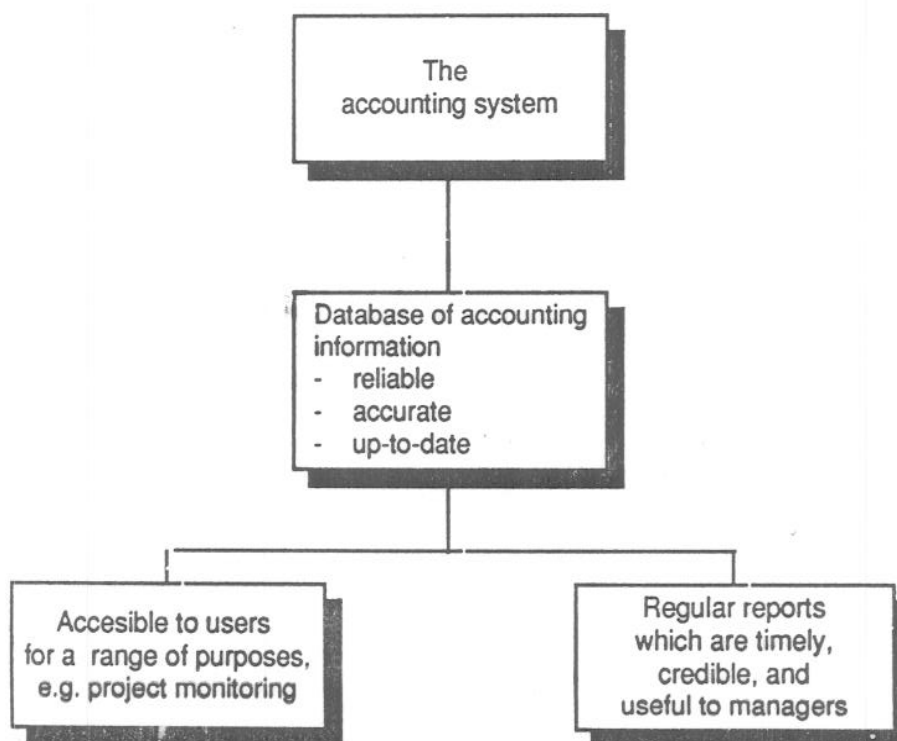
7. EXPENDITURE CONTROL, ACCOUNTING SYSTEMS AND PROCEDURES

7.1. Introduction

7.1.1. This section only identifies issues in relation to the existing systems, and does not include any detailed descriptions. These are provided in Technical Paper No. 4, "Accounting Systems".

7.1.2. The usual focus of the budget cycle tends to be the preparation and approval of budget allocations, with the process for disbursing and managing funds often ignored. However, unless such procedures exist and are effective, the policy objectives implicit in budget decisions will not be achieved. The most important tool in achieving fund disbursement combined with control is the accounting system. To be effective such a system needs to provide a credible and up-to-date database of accounting information which can be accessed for various purposes, and to produce accounting reports regularly, promptly, which can be relied upon, and which are useful to managers.

Figure 16: a model of the objectives of the accounting system



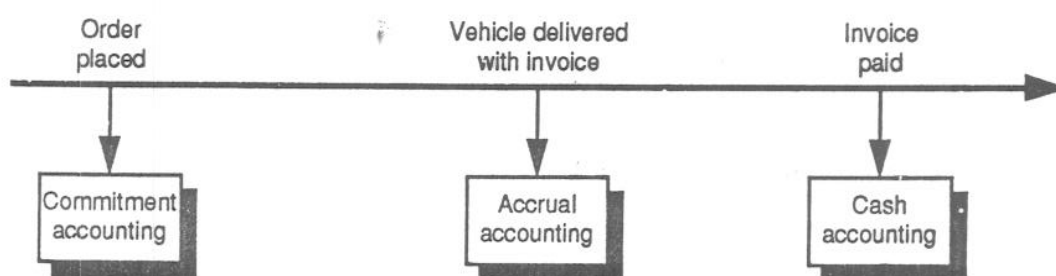
7.1.3. The existing accounting basis and accounting systems have served the country well over a long period of time but with the ever increasing volumes of transactions, arising mainly from the complexities of foreign aid receipts and a very large on-going development programme, modern technology is needed to counteract some of the problems being encountered with existing manual systems.

7.1.4. This section, therefore, deals firstly with the accounting basis used in Bangladesh and secondly the accounting systems and procedures, setting out the problem areas and how it is recommended they be overcome within the overall programme of reforms.

7.2. Accounting Basis

7.2.1. The form of accounting used by Government of Bangladesh is based on the concept of cash accounting, recording the transaction at the time cash is paid or received. This cash basis is also used for budgeting. Cash accounting is the traditional basis for government accounting, but in fact comprises one of three levels of transaction recording. These are best explained by reference to a transaction, for example, the purchase of a new vehicle. The first stage is when a *commitment* is made by placing the order. The second stage is when the vehicle and invoice are received from the supplier, when the item would be recorded under *accrual* accounting. The final stage is when the cash is paid, when the transaction is recorded under *cash* accounting.

Figure 17: alternative accounting basis



7.2.2. Cash accounting has the advantages of simplicity, certainty (accrual accounting gives rise to many alternatives: for example what if the vehicle and invoice are delivered at different points in time?), and direct linkage to the movement of funds. Particularly for the latter reason it is favoured by the IMF. Also on the receipts side of government accounting, it is extremely difficult to operationalise any approach other than cash accounting.

7.2.3. A major weakness of cash accounting is that it only captures the transaction at the last stage; from an expenditure monitoring viewpoint, the key stage is when the order is placed, since this is when the funds are committed. For this reason, a number of governments have tried to combine cash accounting with commitment accounting into a single system. However, experience has been that this approach is difficult to implement in practice - because transactions are not cancelled from commitments when they are paid in cash, the figures become unreliable.

7.2.4. Some governments have moved to accrual accounting. For example, in the USA it is a statutory requirement for all federal agencies. The advantages are those which have long been recognised in commercial accounting - capturing transactions when the substance of the transaction occurs, rather than the movement of funds, a more meaningful basis for recognising the cost of capital assets, and an approach to recognising the cost of the unfunded liabilities, such as pension or provident funds. However, the application of such a system to a Government's activities would cause a number of technical problems, not the least of which would be the valuation of assets for a Balance Sheet.

7.2.5. In our view it would be inappropriate for the Bangladesh Government to move to either an accrual basis, or to attempt to record commitments. Either of these approaches would increase complexity, and in view of the problems at present in generating accounting information, such added complexity should be avoided.

7.2.6. However, as pointed out in the Inception Report, there are already variations to a strict cash accounting basis which have been adopted for various reasons. These fall into three main categories:

(i) incorrect treatment of transactions	for example, project expenditures are incorrectly recorded as disbursed when paid to a project bank account
(ii) commercial operations maintaining memorandum accrual accounts	as long as these are outside the government accounting system, and the latter is on a cash basis, these present no problem
(iii) pragmatic solutions to specific problems	for example stocks are only charged as expenses when used, not when paid for

7.2.7. Effective financial management and control should be the main objectives of Government irrespective of the basis of accounting. Therefore, a pragmatic approach should be taken, adopting the system which is most suitable to the local needs. Whilst incorrect treatments should be corrected (specific recommendations on the example above are made below), we see no problems in the other modifications to a strict cash basis.

7.2.8. The main problems concern funds lapsing at the end of each financial year and the unofficial methods adopted to get around this, such as the misuse of personal ledger and suspense accounts, the recording wrongly as expenditures in the accounts the transfer of funds to certain development projects and the very long delays that occur with the use of the exchange account system and contra entries. A pragmatic solution adopted with success in some countries is to keep the accounts open for a period after the year end, and to treat payments for commitments made before the year end as being incurred within the year. This approach could minimise the problems associated with lapsed funds at the end of the financial year. This and the other variations are sometimes described as a "modified cash" approach, though there is no real definition of the term.

Recommendation

42 There should be no change from the present "modified cash" basis of accounting; this would allow the accounts to be kept open for a period after the year end.

7.2.9. A system should be established for development projects, except those programmes that are recurrent in nature, whereby funds allocated do not lapse at the end of the financial year. This could be achieved by a system of an automatic carry over of unspent development funds. Under this approach, four months before the start of the financial year (i.e. about February), Project Directors would estimate their likely spend for the year, and the amount (if any) they needed to carry forward. This would then automatically be included in the next years Development Budget, and at the same time the Project's budget for monitoring purposes would be amended to reflect the change. This is illustrated below.

Table 14: example of unspent budget carry forward for Project X

Year	Project X budget prepared in 1994	Estimated actual spend 1994/95 prepared February 1995	Estimated underspend 1994/95	Project X revised budget prepared in 1995
1994/95	10,000	6,000	4,000	6,000
1995/96	15,000			19,000
1996/97	12,000			12,000
Total	37,000	6,000	4,000	37,000

Note: the shaded value for 1995/96 indicates a budget change for historical accuracy only, since the period would have actually passed

7.2.10. This approach still relies on Project Finance Directors identifying the estimated underspend before the year end, and applying for it to be carried forwards. However, once this is done the carry over is automatic.

Recommendation

43. A system should be introduced for development projects to avoid unspent funds lapsing at the end of the financial year.

7.2.11. A policy decision is needed about the position of the Railway, Post, Telegraph and Telephone. As commercial types of operations they could be expected to operate as autonomous bodies either paying their net operating surpluses to the Government each year or receiving a subsidy, as the case may be, with just a one line entry in the book's of the Government. Therefore, the strategy recommended is that these organisations be made statutory autonomous bodies. Until this is done, memorandum accrual accounts showing profit and loss, together with a balance sheet, should be included for information and financial management purposes with the government accounts. The actual accounts, however, should only record net cash flows under a limited number of heads (see Section 5 above on classification).

Recommendation

44. The Railways, Posts Telegraph and Telephone operations should preferably be converted to Autonomous Bodies. If retained within Government they should keep memorandum accrual accounts and report to Government on a cash basis

7.2.12. In passing, it is noted that the inherited accounting treatment of refunds, whereby they are deducted from receipts, was questioned by CORBEC as being incorrect as well as causing problems in obtaining accurate figures of gross receipts. This, nevertheless, is an internationally accepted practice but should the Bangladesh Government wish to change the system it should not feel inhibited about doing so.

7.3. Expenditure Control, Accounting Systems and Procedures

Format and Classification

7.3.1. The Constitution of Bangladesh requires that all revenues received by the Government, all loans raised and all monies received in repayment of loans shall form part of one fund to be known as the Consolidated Fund. Other public monies received by or on behalf of the Government shall be credited to what is known as the Public Account. These and issues on classification have been discussed further in Section 5, above.

7.3.2. It is a requirement that an annual financial statement, being the estimated receipts and expenditure of the Government - the annual budget - shall be laid before Parliament for each financial year. The basic format of this statement is specified, and requires that it will show separately the sums required to meet expenditure "Charged" upon the Consolidated Fund by or under the Constitution, sums required to meet other expenditure from the Consolidated Fund and that it will distinguish expenditure on revenue account from other expenditure.

7.3.3. There are two completely different sets of published accounts in Bangladesh. The annual Finance Accounts which give to the minor code level the annual receipts and disbursements for the purpose of Government together with relevant supporting financial statements. This covers all accounting aspects of the Consolidated Fund and Public Account. In addition there are the annual Appropriation Accounts, which are defined in the Comptroller and Auditor General (Additional Functions) Act, 1974, as "accounts relating to expenditure brought into account during a financial year to the several items specified in the Appropriation Act". The latter is simply a comparison of actual out-turns to approved budget down to the level of analysis shown in the demands for grant in the budget, which is usually to sub codes.

7.3.4. The format of the accounts of the Government generally follow that of the budget and are split mainly into three parts. These are the Revenue Accounts, recording recurrent receipts and payments, Development showing expenditures relating mostly to projects and programmes and lastly the Public Account. The transactions are arranged into major heads, minor heads, sub-heads and detailed heads, though there are exceptions. The Development accounts have a similar system with main heads based on the same classification but then split into capital and revenue, depending principally on source of financing, followed by projects and detail.

7.3.5. The Finance Accounts and the Appropriation Accounts should be combined into one set of accounts serving both purposes. This can be done simply by incorporating budget allocations in the Finance Accounts, thus avoiding the duplication of work that presently happens in producing them separately. This would not preclude the audit office doing a separate Report with comments on variations. Also, limited publication of unaudited accounts at the earliest opportunity is recommended, if only for internal use.

7.3.6. The combination of the Finance and Appropriation accounts goes some way to improving presentation. However, positive action should be taken to design a presentation format which is comprehensible to non-technical readers. Also it is of great importance that the accounts are available in English as well as in Bangla, for use by external organisations.

Recommendation

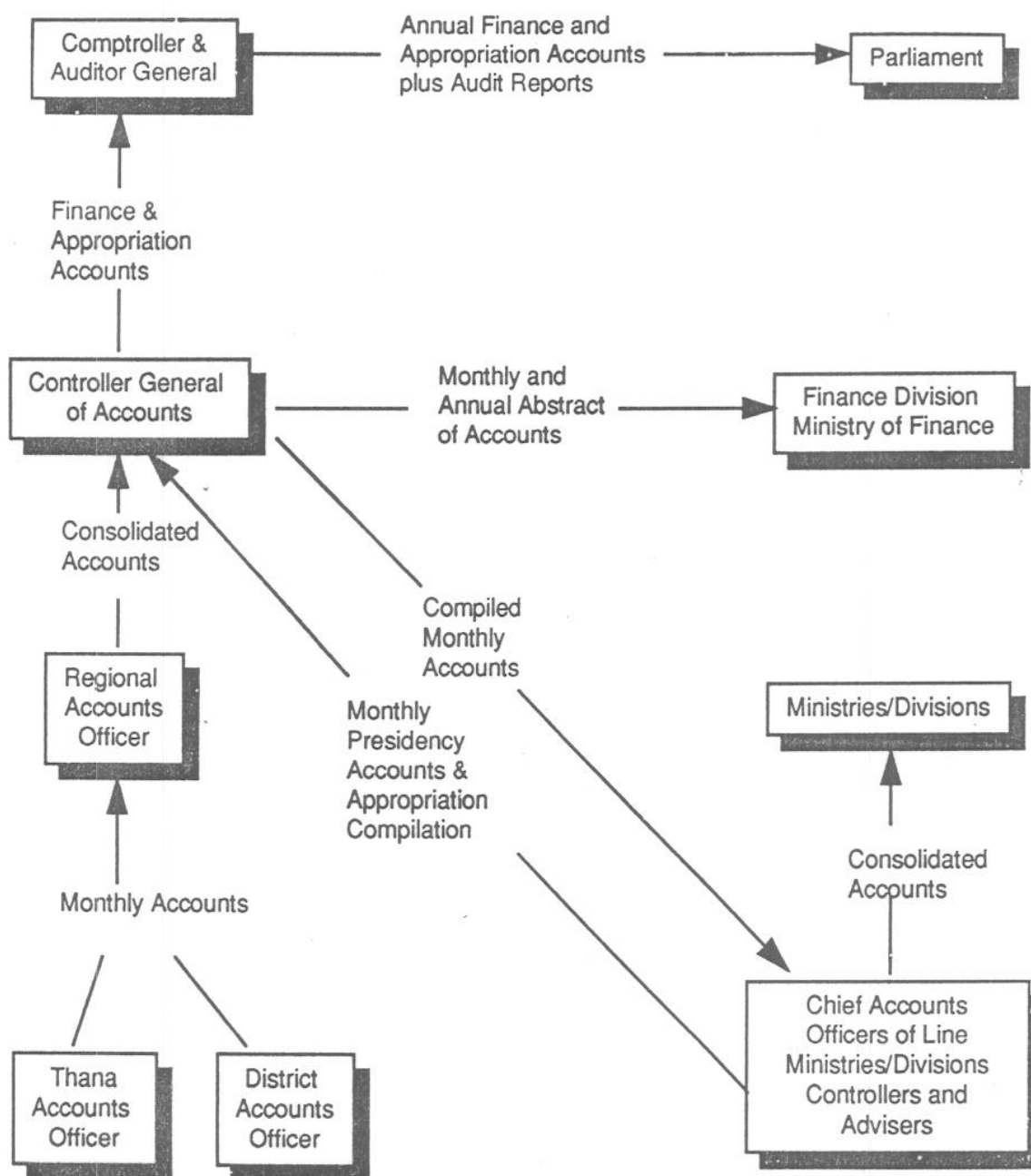
45 Finance Accounts and Appropriation Accounts should be combined into a single set of accounts, and presentation improved

Lateness and Unreliability of Accounts

7.3.7. It is the office of the Controller General of Accounts that has the immediate responsibility for the preparation and consolidation of accounts. This includes the production of the monthly and annual abstracts of accounts that are supplied to the Finance Division, Ministry of Finance, as well as preparing the Annual Finance Accounts and the Annual Appropriation Accounts for the Comptroller and Auditor General.

7.3.8. To effectively compile these accounts on a timely basis the Controller General of Accounts is dependent on the prompt submission from the Regional Accounts Offices of the consolidated accounts of the Districts and Thanas and from the Chief Accounts Officers of Ministries, their "presidency accounts". This flow of data and outputs is illustrated below.

Figure 18: flow of accounting information



7.3.9. Unfortunately, not only is the system failing to produce timely management information it is not even producing the annual accounts required by law. The latest publications of Appropriation Accounts and Finance Accounts are 1987/88. In theory the production of the monthly and annual abstracts of account is relatively up to date, being just a few months in arrears. However, they are not balanced properly because of the absence of proper bank reconciliation. This together with misclassification problems makes the reliability of any accounting data very questionable. This is why IMED's financial data on projects is frequently regarded as more reliable.

7.3.10. Many of the deficiencies that have contributed to the situation of lateness and unreliability could be attributed to the problem that *accounting personnel seem to have little or no idea of what they should be doing because of the lack of properly documented systems and adequate training.*

Major Accounting Weaknesses

7.3.11. Set out below is a brief summary of weaknesses that have been observed:

- (ii) Lack of expenditure control, with the budget being exceeded without authority or expenditure being incurred without any budget provision. Existing rules require that money be surrendered if the budgetary provision in a particular year cannot be used or is not needed for the purpose intended but *this is not being done*.
- (iii) Other than at the pre-audit stage there appears to be a total absence of effective budgetary control.
- (iv) Payments between Government departments using the exchange account system, which is simply book adjustment with no actual cash transaction taking place, frequently take months and sometimes years to settle. These transactions are not taken seriously as many people involved have the wrong notion that such book adjustments are merely ledger keeping without real financial implications because what is incurred as expenditure by one unit is a receipt by another with a net neutral effect. Hence there is frequently little or no sense of urgency to get them recorded so that they tend to drift into subsequent years' accounts.
- (v) Where works are undertaken on an emergency basis, without prior budgetary sanction, expenditure is booked temporarily under a suspense account. Subsequently the suspense account should be cleared by a transfer to the appropriate head of account. This follow up procedure is being neglected.
- (vi) The misuse of suspense accounts and the use of two types, also creates confusion. Apart from general purpose suspense accounts under the Public Account, which is the usual practice, others are kept as subsidiary heads of account to a major revenue accounting code. Revenue budget provisions against suspense heads are misleading as allocations for expenditures should have been provided for under the proper meaningful code.
- (vii) The number of personal ledger (PL) deposit accounts proliferated with the creation of Upazila Parishads, now Thanas, and is now estimated to exceed 2,700. These accounts are outside the pre-audit system and often the officers responsible for them do not render the required statements of expenditure. Furthermore, some have become non-operational, and even forgotten, and in other cases monies are believed to have been withdrawn and deposited with commercial banks.
- (viii) Lack of effective control over Government departments operating commercially within the civil budget, namely Railway, Post and Telegraph and Telephone. For banking purposes they use an account of the Government with the Bangladesh Bank to which all their receipts and payments are debited and credited. Under the present system they can finance any amount of expenditure by issuing cheques on those accounts regardless of budgetary provisions.
- (ix) The deposit of substantial sums of counterpart funds, generated from commodity and food aid, to commercial bank accounts whilst at the same time the Government is resorting to domestic borrowing.
- (x) The transfer of monies to autonomous bodies for the execution of development projects with little effective control over the subsequent expenditure. Forms of deviation include expenditure on purposes and items different from those stipulated in the project, funds being diverted to other projects and amounts not spent being added to other bank accounts. There are rules for controlling such deviant behaviour but these are not being used.

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Joint Secretary

Finance

Ministry of Finance

- (xi) Inaccuracies in compiled accounting data because of the absence of reconciliation, which means that mis-classification and sometimes misappropriation of funds frequently go undetected. The major part of reconciliation work of departmental figures, both for revenue and development accounts, should be done by the Chief Accounts Officer but he is unable to do this because of the absence of timely information from the Controller General of Accounts as well as apathy by some departmental officers.
- (xii) The accounting records of Chief Accounts Officers and the Controller General of Accounts frequently do not include direct disbursements for goods and services made from foreign aided grants and loans.
- (xiii) Because of the introduction of ad hoc arrangements to speed up the disbursement of aid funds for development projects, some monies are not being received into Government's accounts as is required by the Constitution. They are being passed direct to project bank accounts and being booked wrongly in the central accounts of Government as expenditure. This is dealt with more fully in a later section about project aid and development expenditure.
- (xiv) The Controller General of Accounts' cash balance reconciliation with the Bangladesh Bank is virtually non-existent. Though both sets of figures are compiled, no real effort to find an explanation for the difference appears to be sought. The standard comment made in the books each month is that "the figure is less than that shown by the bank". Furthermore the bank reconciliation completely ignores commercial bank accounts held in the name of the Government.
- (xv) There is an absence of pre-printed forms and registers for every day use. This has led to the introduction of forms and registers according to individual officers' understanding of requirements.
- (xvi) Interest being earned on Government's bank accounts outside the Bangladesh Bank is not being brought to account. This and the overall effects on effective cash management as a result of these accounts being outside the system are dealt with in a later section.
- (xvii) The absence of up to date accounting manuals of instruction coupled with the absence of trained staff aggravates these problems.

7.4. Summary of Issues

No.	Issue
1	<p><u>Accounting Basis</u></p> <p>The most suitable accounting basis for Bangladesh and the question of acceptance of certain variations where appropriate.</p>
2	<p><u>Expenditure Control, Accounting Systems and Procedures:-</u></p> <p>(1) the failure to produce reliable and up to date accounts and financial management information exacerbated by ineffective bank reconciliation and the absence of modern technology including computerisation;</p> <p>(2) the lack of accounting and expenditure controls arising from systems deficiencies due to the absence of up to date accounting manuals of instruction, trained staff and inadequate enforcement of rules;</p> <p>(3) the use of the exchange account system for the settlement of internal charges;</p> <p>(4) the use personal ledger accounts;</p> <p>(5) the way in which Railway, Post and Telegraph and Telephone should operate and be accounted for;</p> <p>(6) the depositing of counterpart funds in commercial bank accounts;</p> <p>(7) transfers of development funds to autonomous bodies and the absence of controls</p> <p>(8) misuse of suspense accounts and the confusion arising from there being two types;</p> <p>(9) difficulties in accounting for direct disbursements by aid donors;</p> <p>(10) aid receipts by-passing Government's bank accounts with the Bangladesh Bank;</p> <p>(11) interim measures needed to improve the manual accounting systems;</p> <p>(12) accounting for interest for monies held in commercial bank accounts.</p>

7.5. Conclusions and Recommended Strategies for Expenditure Control, Accounting Systems and Procedures Reforms

Expenditure Control, Accounting and Procedures

7.5.1. The major problems in Bangladesh associated with the accounting systems stem from the fact that the accounts are not produced on a timely basis, they are unreliable, they provide little or no financial management information and contribute little towards effective budgetary control.

7.5.2. Thus the main strategy should be to address the problem of the lack of up to date accounts. This should be achieved by the planned introduction of the computerisation of accounts as well as having simple mechanical aids, such as adding machines that list, in all accounting offices. Other interim measures should also be actioned. The elimination of unnecessary duplication of records and the availability of adequate supplies of pre-printed forms and stationery are essential.

7.5.3. As a priority there should be a crash programme to bring the accounts fully up-to-date, and reconcile them with the bank accounts and complete other reconciliations. This will undoubtedly lead to substantial unidentifiable differences. These will need to be written off, so as to provide a clean start up point for new systems and the accounts in future to be kept up-to-date and reconciled. The CGA will certainly need external assistance for this task.

Recommendation

46 A crash programme should immediately be initiated to bring the accounts up-to-date and to reconcile the balances. Any unidentifiable differences should be written off or transferred to a single suspense account.

7.5.4. A phased programme of computerisation must be a component within the strategy of resolving the accounting problems. This is dealt with more fully in the Section 9, below. In summary these proposals involve computerisation of the central accounts of the Controller General of Accounts' office, an interim system of providing CAOs with computers for consolidating the data from Thanas and Districts with their own accounts, and computerisation of payrolls.

7.5.5. Logically, the last link in the chain should be the computerisation of the work of the Thana and District Accounts offices. All the work in these offices is performed manually and full computerisation would speed up considerably the flow of work therefrom as well as perhaps minimising the many errors occurring from mis-allocations in these offices. Unfortunately, apart from a general absence of a constant and consistent electricity supply, the environment at most of these offices would not be acceptable for the introduction of computers. Dirt, dust and humidity, aggravated by inadequate storage facilities for records, are the common problems. A considerable amount of expenditure would be required for purpose built offices as well as the equipment, all of which would have to be properly maintained. Thus whilst desirable, to achieve computerisation in these offices as part of this project, which is concentrated mainly to technical assistance, could be a problem. In the circumstances, it is suggested that a pilot scheme be included in this project but that any wholesale computerisation of the work of these offices would have to be dealt with as a separate project. This would also give the Government the opportunity to introduce any structural reforms to the set up of these offices prior to computerisation. It should be noted that no reference has been made to Regional Accounts offices as elsewhere in this report it is being recommended that they be abolished in order to speed up the flow of work.

7.5.6. To simplify accounting and reconciliation work, separate bank accounts should be used for receipts and payments. In addition, there should be separate accounts for each Ministry; this has already taken place where CAOs have been appointed. This would also allow the introduction, where appropriate, of imprest bank accounts.

Recommendation

47 Each Ministry/Division should have two bank accounts, one for receipts and one for payments.

7.5.7. The use of exchange accounts for settlement of internal payments should cease. For security, either non encashable non-negotiable cheques or special pre-printed warrants should be used for this purpose.

7.5.8. Ideally, all personal ledger (PL) accounts and suspense accounts maintained under the Public Account, except those for unallocated stores, should be immediately closed with the balances being transferred to the revenue account. New requests should then be made for such accounts and where justified a system of close monitoring and stringent control would have to be a condition of their operation. Unfortunately, it is felt that the immediate closure of these accounts could present unforeseen difficulties such as a flood of applications to have new ones without the ability to properly appraise and control. Thus it is recommended that a small team of independent officers be assembled to carry out this task on a systematic basis, starting with a pilot project covering a few Ministries, Districts and Thanas. As the accounts need extensive scrutiny those involved will have to have stamina, for every office throughout the country would have to be visited, ultimately, in order to establish the exact position on each account so as to decide the action to be taken.

7.5.9. The practice of using suspense codes as revenue expenditure should be discontinued. Apart from these codes being misused, having them causes confusion with the more accepted use of Suspense under the Public Account

Recommendation

48 The use of exchange accounts should be stopped, and the use of suspense and personal ledger accounts should be severely curtailed, with a programme to quickly review all existing accounts and close down almost all of them.

7.5.10. A proper accounting system must be introduced for all transactions related to foreign grants and loans including debt charges. Responsibility for this work, within the Finance Division of the Ministry of Finance, should also be clearly established. This is dealt with further in Section 8, below, on specific issues.

7.5.11. Because of the concerns expressed about the lack of budgetary control the following action is needed:-

- (1) Where responsibility to write cheques without pre-audit has been authorised, a complete review of internal check procedures and control within all offices is needed.
- (2) In addition a system has to be established whereby the monthly accounts and statements, being compiled and consolidated at all levels, have included the pro-rated approved budgeted figures so that they can be used by managers for effective expenditure control purposes. To achieve this a review will be necessary to decide how such statements are to be used and by whom.

7.5.12. A new independent budgetary control unit should be set up within the Finance Division. It should report directly to the Additional Secretary and have authority to take remedial action where expenditure control is being ignored or even deliberately flaunted.

Recommendation

49 In order to achieve effective budgetary control, internal check procedures should be reviewed, management reports should include budget figures, and a Budgetary Control Unit should be established in the Finance Division.

7.5.13. In most countries it has been recognised that qualified accountants from the commercial sector have much to contribute to government accounting, in that the core of accounting expertise is the same whether for both commercial and government accounting. Commercial accountants receive rigorous technical training which is presently not available for government accountants. Also there is considerable merit in cross-fertilisation of accounting developments between the public and private sector. At present there are no qualified accountants working in government accounting in Bangladesh (though a number are employed by the autonomous bodies).

7.5.14. A core of qualified accounting specialists is needed on the permanent staff of the Controller General of Accounts' office so as to provide the necessary expertise for all aspects of accounting work that today's modern and sophisticated offices have to deal with. A team of at least three recruited directly is recommended. These could be recruited on contract if they could not be attracted on Government salaries.⁵

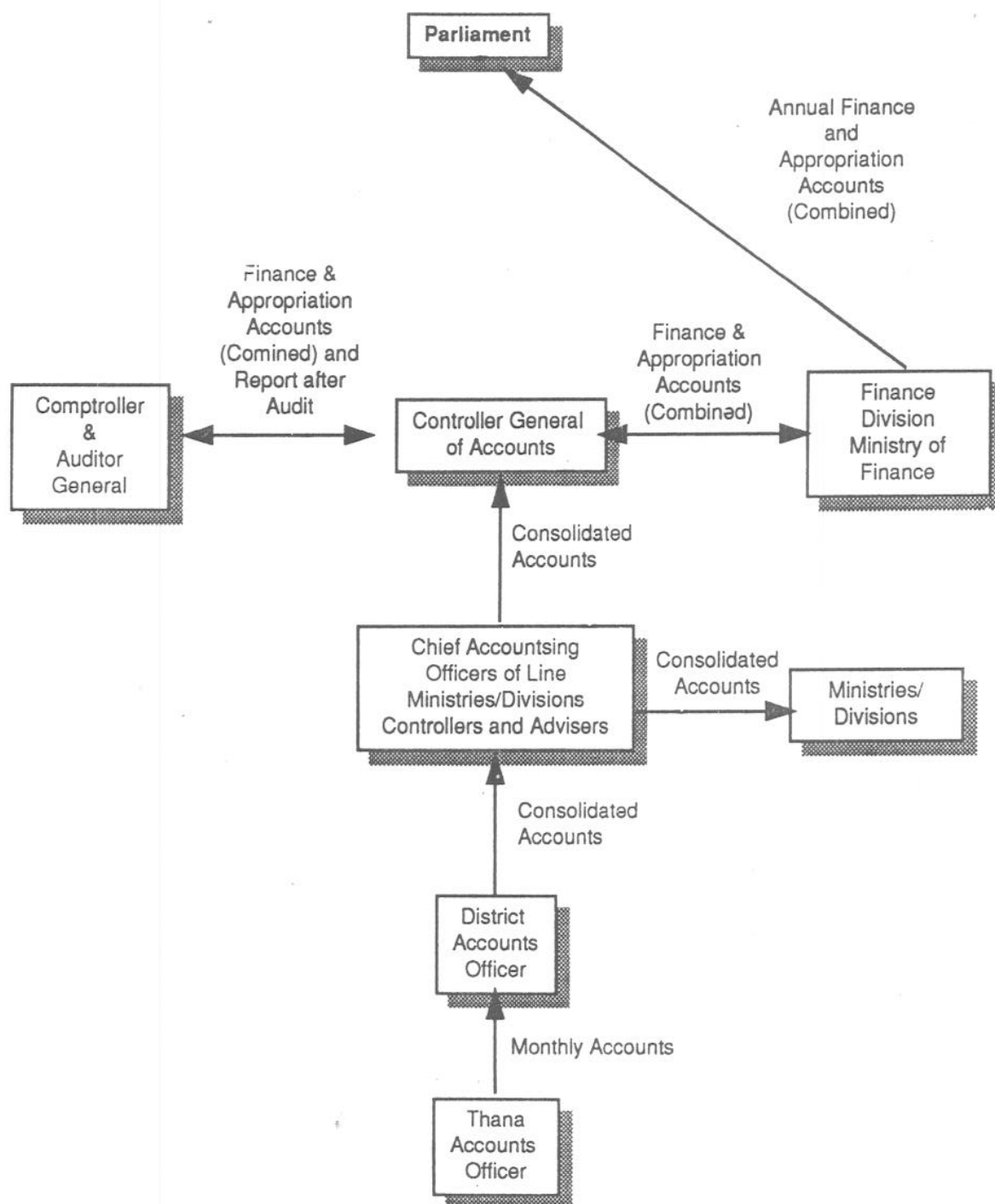
Recommendation

50 A core team of qualified accountants should be recruited directly to assist with the implementation of the various programmes.

7.5.15. Arising from the above recommendations the chart shown on the following page illustrates the desirable flow of accounting data and outputs that should be the long term objective of the Government.

⁵ Our discussions revealed much opposition from government personnel to this idea, and a lack of enthusiasm from the private sector accountants. In our view, this is because of a failure in Bangladesh to recognise the commonality of accounting skills, and the benefits of such inter-change of ideas. Therefore we have retained this recommendation.

Figure 19: projected flow of accounting information



7.6. Summary of strategies

No.	Strategy	Comment
15	A crash programme should be undertaken to bring the accounts up-to-date and complete all reconciliations	This is the starting point for all other reforms in the Government accounting system, since it will provide a clean starting point. Unidentifiable differences should be written off.
16	A system should be developed to provide for the carry forward of unspent development funds	This could be achieved by the system outlined in the text of allowing Project Directors in February to estimate their underspend and have this automatically transferred to the next years budget
17	The Finance Accounts and appropriation Accounts should be merged	The existence of two documents substantially increase the accounting workload, and there is no major reason for their continued separate existence
18	The use of exchange accounts should be discontinued, and suspense and personal ledger accounts severely restricted	These measures are designed to stop the excessive use of accounts intended to have only limited specialised use
19	Actions should be undertaken to make budgetary control more effective, including the establishment of a Budgetary Control Unit in Finance Division	These steps include reviewing pre-audit, including budget figures in accounting reports, and the establishment of the new monitoring unit.