Public Finance

Control of Expenditure

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Budget : Economics

- A budget is an estimate of income and expenditure for a future period as opposed to an account which records financial transaction.

- Budget is an essential element in the planning and control of the financial affairs of a nation and is made necessarily because income and expenditure do not occur simultaneously (i.e., income or revenue receipts and expenditure flows do not always coincide).

Budget : Government

- "A Government budget is an **Annual Financial Statement(AFS)** showing item-wise estimates of expected revenue and anticipated expenditure during a fiscal year."
- Government budget is a **statement of its income and expenditure.** In the beginning of every year, government presents before the Lok Sabha an estimate of its receipts and expenditure for the coming financial year.

- The **national budget** sets out estimates of government expenditure and revenue for the financial year and is normally presented by the Finance Minister to the Indian Parliament on February 28, every year.
- In his/her statement the Finance Minister reviews economic conditions and **government expenditure** for the past year, makes forecasts for the coming year and announces changes in taxation.

- The Central government **budget is in balance** when current receipts are equal to current expenditure, means when taxes on income, expenditure, etc. are sufficient to cover payments for goods and services, interest on the national debt, etc.

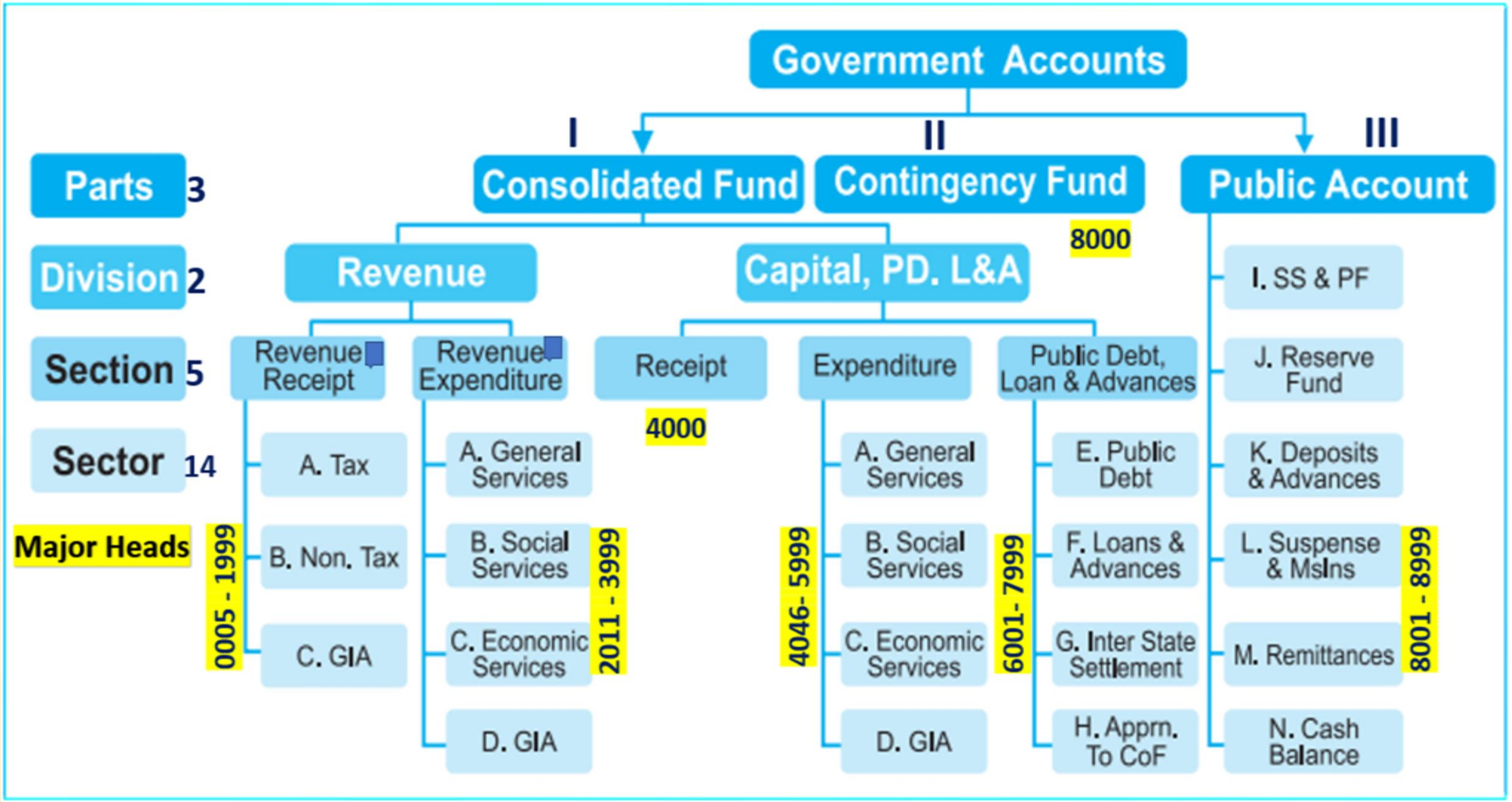
- In practice, the Indian budget has **generally been in deficit** throughout the plan period.

- A **budgetary deficit** refers to excess of total budgetary expenditure (both on revenue and capital accounts) over total budgetary receipts (both on revenue and capital accounts).

- **Budgetary surplus** is the opposite of the deficit, i.e., an excess of government receipts over expenditure in an accounting year.

Structure of Account in which Budget presented (Except Part III)

Article 226 & 267



भारत सरकार GOVERNMENT OF INDIA | वित्त मंत्रालय MINISTRY OF FINANCE

केन्द्रीय बजट
UNION BUDGET

Union Budget 2020-2021

LIST OF BUDGET DOCUMENTS PRESENTED IN PARLIAMENT

1. Key to Budget Documents
2. Budget Highlights (Key Features)
3. Budget Speech
4. Budget at a Glance
5. Annual Financial Statement
6. Finance Bill
7. Memorandum
8. Receipt Budget
9. Expenditure Budget
10. Customs Notifications
11. The Macro Economic Framework Statement
12. Medium Term Fiscal Policy cum Fiscal Policy Strategy Statement
13. Output Outcome Framework 2020-2021
14. Implementation of Budget Announcements 2019-2020

Why expenditure?

- Expenditure is **a payment**, in money or credit, for goods or services.
- Businesses **use expenditure to acquire** assets, repair or upgrade existing ones or reduce liability.
- For business, it's **useful to understand** the dynamics of expenditures, the different types and **how to manage** expenditure in the day-to-day running of the organisation.

Types of Expenditure

Types of Expenditures in Accounting

- Expenditures in accounting comprise two broad categories: **capital expenditures and revenue expenditures.**

1. Capital Expenditure

- An Organization incurs a **Cap**ital **Ex**penditure (**CapEx)** when it purchases an asset with a useful life of more than one year (a non-current asset).
- Investment is a capital expenditure, the benefits to the business will come over several years. As a consequence, it cannot deduct the full cost of the asset in the same financial year. Therefore, it spreads these deductions over the useful life of the asset.

Types of Expenditures in Accounting

2. Revenue Expenditure

- A revenue expenditure occurs when a Organization spends money on a short-term benefit (i.e., less than one year).
- These expenditures are used to fund ongoing operations – which, when they are expensed, are known as **Op**erating **Ex**penses**(OpEx)**.
- It is not until the expenditure is recorded as an expense that income is impacted.

What is Government Expenditure?

- Government expenditure refers to the money the government spends on goods and public services such as General, Social, Economic and Grant-in-aid Services.

  Examples are, expenditures on operational activities and investments in public services such as defence, police, education, agriculture, irrigation, medical and public health, social security etc.

- In addition, some expenditures may not involve the exchange of goods and services, such as transfer payments.

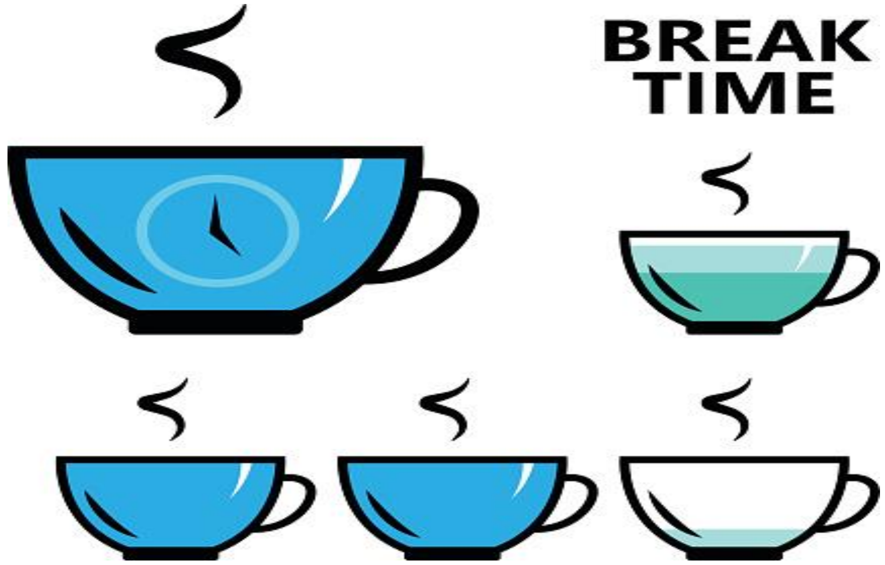
Voted Expenditure

- The Votable part is actual Budget. The expenditures in the Budget are in the forms of **Demand for Grants**. There Budget also presents ways and means – how the Government would be recovering the expenditures.
- Generally, the demands for Grants of each and **every ministry are made separately** in the Budget documents and each demand for grant has the provisions under its different heads.

Charged expenditure

- These expenditures are quite important to pay the allowances to the Indian **"judiciary or constitutional bodies".**
- The **"Consolidated fund of India"** can work independently without taking permission from the "Lower house of the Parliament" to select the required expenses.
- However, these expenditures need to be declared under the supervision of the Presidents during the presentation of the **"annual budget".**

Take a break and relax



Causes of Public Expenditure

Following are the main causes of Public Expenditure**:**

1. **Welfare State**
2. **To meet the Defence Needs**
3. **Development of Agriculture and Industries**
4. **Rising Population**
5. **Urbanization**
6. **Public Debt and Interest Charges**
7. **Price Rise**
8. **Burden of Democracy**
9. **Development Schemes and Projects**
10. **Economic Development**

Importance of controlling expenditure

- **Controlling expenditure is important because it helps**:
  - **Maintain control** over an organization's financial situation
  - Keep operating **costs down**
  - **Limit the amount of money** different employee levels can spend, keeping more money from going out the door
  - **Lower** a organization's overall expenses
  - Make better **financial decisions**

Expenditure Control – as a tool in PFM

- Effective expenditure control is the **pre-requisite** of good Public Financial Management (PFM).
- Fiscal rules, medium-term budget plans, and annual budgets are meaningless **if expenditure cannot be controlled** during execution.
- **Lack of effective expenditure controls** not only threatens macro-economic stability and fiscal discipline, but can also call into question the integrity of the Public Financial Management System(PFMS) and undermine trust in a government's stewardship of public resources.
- While the institutional arrangements for **raising government revenue** are typically quite centralized in a national revenue authority, the expenditure of those resources involves a wide array of public entities at various levels of government, even in countries with relatively centralized PFM systems.

KEY STAGES OF EXPENDITURE CONTROL FRAMEWORK

- The **objective of expenditure contr**ol is to ensure that public resources are spent as intended, within authorized limits, and following sound financial management principles.
- A distinguishing feature of a government's budget, unlike the budget of a typical business entity, is that it is **funded primarily via compulsory taxation of citizens and authorized via an act of Parliament.**
- The **role of an expenditure control system** is to ensure that the level and allocation of government expenditure reflect the will of the legislature as voted for in the budget.
- Expenditure controls should also **reflect sound financial management principles**, ensuring that public resources are utilized efficiently, incurred obligations are cleared in a timely manner, abuse/ misappropriation of public money is prevented, and private actors compete on a level playing field for government contracts.

Seven stages of Expenditure

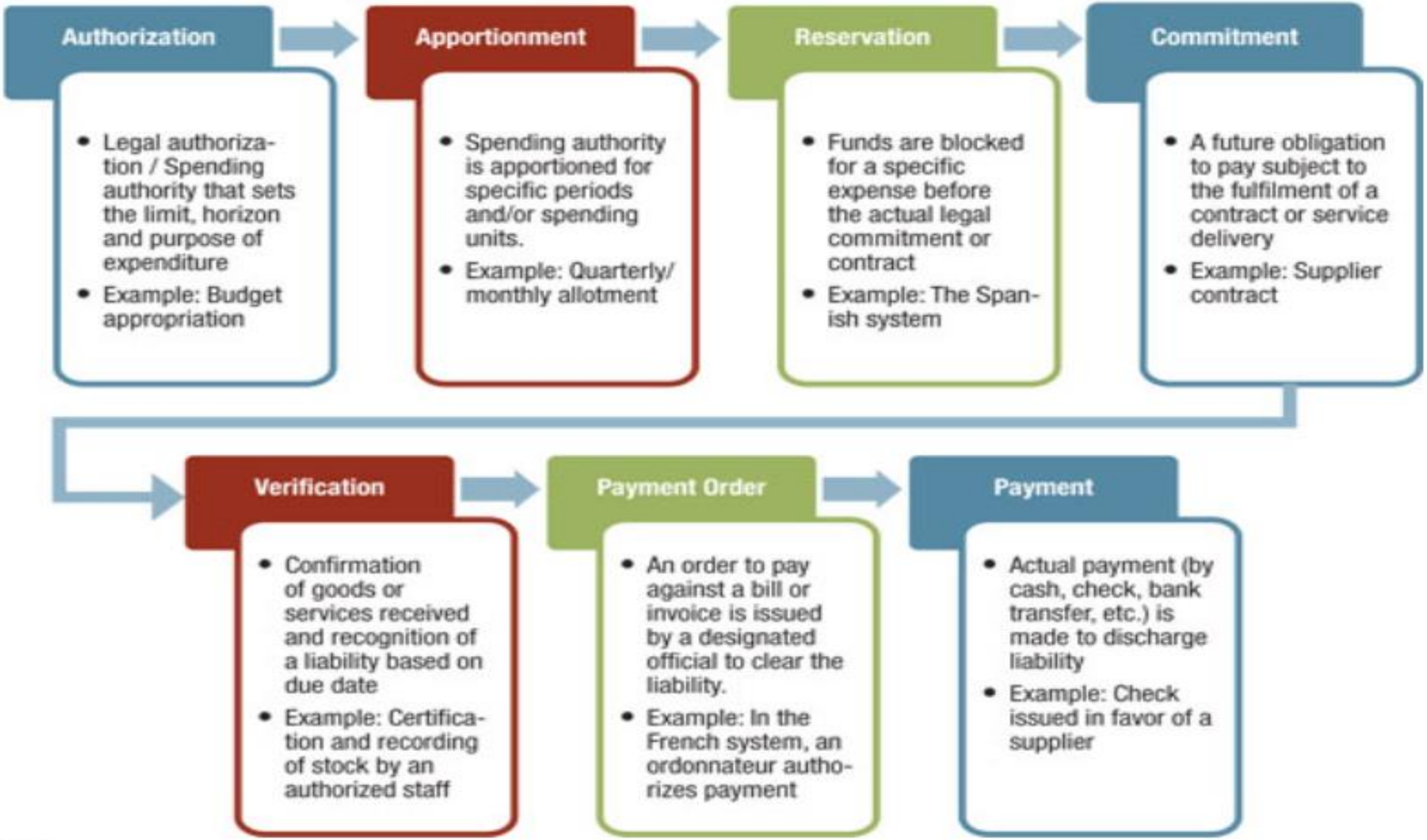


Figure 4.

Seven Key Stages of the Expenditure Chain

Seven key stages of Expenditure

1. ***Authorization of expenditure***. A fundamental principle of public finance is that expenditure and revenue proposals must be legally authorized to ensure accountability.

   The authorization for expenditure is usually given through the budget law which defines the time horizon for, limits on, purpose of, and administrative unit accountable for government expenditure

2. ***Apportionment of authorization for specific periods and spending units***. The purpose of apportionment is to prevent spending agencies from incurring obligations at a rate which would require the authorization of additional funds for the fiscal year in progress.

   Once expenditure authorization is in place, it is apportioned for specific periods and/or specific spending units

Seven key stages of Expenditure

3. ***Reservation***. Once the apportionment of expenditure authorization is made and the spending authority has been released, some countries' PFM systems include a stage at which funds are reserved for a specific known expense but for which no contract has yet been issued.
4. **Commitment.** The commitment stage is the point at which a potential future obligation to pay is established. A commitment occurs when a formal action, such as placing an order or awarding a contract, is taken that renders the government liable to pay at sometime in the future when the order or contract is honored by its counterpart.

Seven key stages of Expenditure

5. ***Verification (or certification)***. At this stage, after goods have been delivered and/or services have been rendered by a supplier, an authorized officer within the spending unit concerned verifies their conformity with the contract or order, and that a liability and due date of payment are recognized.

   Assets and liabilities of the government are increased and recorded in the books, if an accrual accounting system is established.

6. **Payment order.** Once checks are made to ensure that all previously stipulated controls have been performed and documented, a payment order is issued.

   A payment order is an authorization for payment (usually against a bill or invoice) made by officials of line ministries, other spending agencies, or the Ministry of Finance(MoF).

7. **Payment.** Once a payment order has been issued, payments are made through various instruments including cheques, electronic fund transfer (EFT), and sometimes cash, in favour of a supplier or other recipient to discharge the liability.

Authorization for Public Expenditure

- ***Limit on amount of expenditure***. Government's expenditure must be within the amounts that the budget appropriations have established, with some flexibility allowed through virements and contingency reserve mechanisms. The nature of those expenditure limits depends on the accounting basis (cash, commitment, or accrual) used in the budget
- ***Limit on time horizon of expenditure***. The expenditure must occur within the time limits applicable to the expenditure authorization.
- ***Authorized purpose of the expenditure***. The authority for expenditure is given for a specific pre-defined purpose. The budget classification (which may be organized by programs, sub-programs, projects, economic categories, or line items) usually specifies the purpose for which the expenditure can be made.
- ***Administrative unit accountable for expenditure***. A unit of government, typically a line ministry, department or agency, is assigned the responsibility to ensure that the appropriated resources are spent as intended within the authorized limits.

Types of controls of expenditure cycle

Controls applied at different stages of the expenditure cycle

- **The various controls applied during the expenditure cycle can be grouped into six main categories**. These are,
  - (i) appropriation control;
  - (ii) commitment control;
  - (iii) aggregate cash control;
  - (iv) control of regularity;
  - (v) accounting control; and
  - (vi) other specific controls.
- **Other specific controls** relate to specific types of transactions and are designed to either reinforce macro-fiscal discipline and sustainability *(e.g., controls on payroll, pensions, and incurrence or liquidation of liabilities or guarantees)* or safeguard the integrity and efficiency of public procurement and payroll systems.

Other Controls Specific to Particular Types of Transactions

Controls on liabilities or guarantees

- This control is applied on the incurrence of a liability or guarantee and again at the payment stage when the liability is extinguished or guarantee is paid. It seeks to verify:
  - (i) the existence of budget cover or space within the authorized limits; and
  - (ii) that the payment is being made to extinguish the liability to a real creditor and for a claim that was not paid earlier.

Payroll controls (a subset of commitment control):

- The objective of payroll controls is to control personnel expenditures and staffing numbers. This requires that personnel database (where personnel information files are kept) and payroll records be linked, regularly updated, and reconciled.
- Payroll audits should also be undertaken regularly to identify weaknesses in the control system

Other Controls Specific to Particular Types of Transactions

Pension controls:

- The liability and associated expense for pensions and other retirement benefits should be recognized at the time the employee's services are rendered. Any part of that cost unpaid at the end of the period is a liability.
- To be able to exercise upfront control over the future resource requirements related to pensions countries implementing accrual budgeting (e.g., the UK, Australia and New Zealand) include the accruing cost and any unfunded liabilities of pension schemes within budgetary limits for each government department.

Verification of goods and services: This control involves:

(i) verification of the goods and/or services delivered by a supplier to ensure that these conform to the specified quality and quantity; and

(ii) a calculation of the liability incurred by the government to the supplier

Other Controls Specific to Particular Types of Transactions

- **Control of procurement**:

  Significant public spending takes place through the public procurement system. The main objective of the government as a purchaser is to obtain high-quality goods and services at a competitive price.

  Procurement procedures should provide a fair opportunity for all bidders to compete for government contracts, and be designed to get good value for money and to minimize risks of corruption and patronage.

- **Manual processing controls**:

  Key manual processing controls for purchasing, payment, and confirmation of receipt of goods and services are performed outside the typical information systems (e.g., FMIS) environment and should be subject to periodic internal control checks and audit.

Thank you