Ministry of Finance SR

Project: Providing advisory services for improving accounting and reporting systems of public finance

Report on strengths and weaknesses of the existing financial and fiscal reporting framework

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1 Executive summary

1.1 Accounting

Our review of the existing accounting system and accounting principles used by Ministry of Finance has resulted in the identification of several weaknesses when used to present the financial position and results for the period of public sector entities. The weaknesses have been analyzed according to the individual type of entity, separately for budgetary organizations, municipalities and higher territorial units and contributory organizations.

Most of the identified weaknesses, such as the recognition of defined expenses, non-recognition of revenues in budgetary organisations etc., will be removed by the adoption of a new accounting regulation for the public sector, based on International Public Sector Accounting Standards ("IPSAS). The determination of new content for the notes to the financial statements will lead to disclosure of additional information necessary for improving the assessment of the entities' operational effectiveness and asset management.

In cooperation with the Ministry of Finance of the Slovak republic ("MF SR"), we continue our work on the draft of the new accounting regulation for the preparation of individual financial statements, guidance on accounting principles, procedures, as well as the structure of the balance sheet, income statement and notes to the financial statements. The outcome of this part of our work is not included in this report on strength and weakness of existing accounting system, but will be a part of our next progress report, which will be submitted to you in October 2006 in accordance with the approved schedule.

We expect that our work will be finalized in September 2006 after which we will devote ourselves to the draft of the new accounting regulation for the preparation of consolidated financial statements.

1.2 Consolidation

An accounting consolidation process for the general government sector does not presently exist which, in itself, is a weakness in the financial reporting system of the country. However, there is a strength in one positive aspect lies in the fact that the process of data collection and aggregation for statistical consolidation already operates and is strongly supported by the existing IT function. On this basis, it is possible to begin creating the accounting consolidation process. When the amendment to Act Nr. 431/2002 Z.z. on Accounting and new accounting procedures for budgetary organisations, state funds, contribution organisations, municipalities and local governments will have been passed, which is expected no sooner than January 2007, the legislative preconditions for accounting consolidation will have been created. Our work on the consolidation methodology will be carried out even before this amendment, concurrently with the accounting trainings.

1.3 Fiscal Reporting

Improvement opportunities for the fiscal reporting process identified in the process analysis in the progress report 1 have been analysed by us in relation to process strengths and weaknesses. We have identified two strengths:

1. Centralised data collection in electronic form.
2. Continuity and gained knowledge and experience of the working team providing the financial reporting process.

It is primarily important to use the strength of the centralised data collection system which is able to transfer and process sufficient quantities of information satisfying statistical reporting needs. This should be preceded by generating needed information by the accounting entities. For this purpose, we have proposed a set of tables for notes to the financial statements which would satisfy the accounting and statistical reporting requirements. At the same time, we regarded the key weak points of the process so that the tables can serve as an improved control tool over the risk of providing false source data.

We have identified nine weaknesses in the fiscal reporting process as listed in section 4. We consider them to be manageable, however, attention should be made to maintaining a logical consistency between the financial and budgetary financial statements. As mentioned in progress report 1, one of the main problems in preparing statistical reports is that the Balance Sheet ("B/S") and the Report on Budgetary Compliance ("VPR") do not reconcile in the continuity of opening balances, movements and closing balances of budgetary cash accounts. The rule is that the VPR should explain the development of budgetary cash account balances. However, this does not always hold in the case where errors have been identified. Similarly, we have identified errors in the reporting of financial liabilities where the budgetary flows are not correspondingly reflected in the B/S.

In order to address these weaknesses, we have applied an approach in the proposed tables for the notes to the financial statements that reconciles the economic classification items with the framework chart of accounts, broken-down into analytical accounts as needed. Each item of the economic classification can include financial flows related to the current accounting period or other periods. These flows are shown in the tables separately. This is a important principle which, if adopted, will facilitate creation of a common database for accounting and statistical reporting, which is an objective of the MF SR, and whose creation is supported also by our project by the IT workstream. Where deemed necessary, the proposed tables can be included in a separate regulation, i.e. they will not be only a part of the notes to the financial statements, but they will be collected by a particular process.

1.4 Organisation

We have mapped the existing (ie “as-is”) accounting processes separately for funds accounting, MF SR Office Administration accounting and accounting in the chapter of General Treasury Management ("VPS"). We tabulated our findings into strengths and weaknesses and opportunities for development / improvement. The key strength is a support to the accounting process by a system with a wide functionality. We have found that some parts of the functionality are not used for any relevant reason. These include, for example, the automatic posting of payments in bank statements where a liability or asset has already been recorded.

There is a significant number of such payments and using this functionality would facilitate the work of accountants. It is also possible to use system algorithms for automated recognition and posting of bank fess or exchange losses/gains. This development opportunity is common for Funds Accounting, the MF SR Office and VPS.

For MF SR Office accounting, we have identified significant improvement opportunities in the areas of:

- involving budgetary control in the accounting process
- fixed assets ("F/A") recording.

Budgetary control is involved in the accounting process in two ways: when approving purchase invoices and when approving petty cash expenditures. In both cases, we have identified process streamlining opportunities that necessitate neither additional work nor cost. In the case of petty cash expenditures, it is also possible to replace the work of a skilled accountant by a less skilled one, which is further discussed in sections 5.2.5 and 5.2.6.

Regarding the FA register, we found that the system of recording F/A is configured to the minimum extent required by the accounting legislation. An organisation the size of MF SR with a large quantity of F/A needs more detailed filtering criteria, especially where the economic contents of the synthetic accounts per the framework chart of accounts is too wide. We recommend to develop further the filtering capabilities of the F/A recording system. More on this finding, and others are presented in sections 5.2.2, 5.2.3, 5.2.4.

Regarding the VPS accounting system, we have found there to be missing functionality in the existing IS. Financial assets and liabilities of the MF SR are recorded directly in the GL. VPS, when not using any specialised functionality for recording assets and liabilities, e.g. neither subledgers nor an asset management or finance module are used, is in a difficult position when controlling its assets and liabilities. For example, in order to find a current asset balance per the VPS system, it is necessary to find an expenditure increasing balance of the given asset in the GL and manually add it to the opening balance. If an asset recording functionality were used, the current balance would be available immediately in the IS. The existing status poses a problem especially for documentary reviews of balances. This is discussed further in section 5.3.1.

1.5 Information technologies

Our work on identifying strengths and weaknesses of the existing system has been directed by the Office Head Advisor for IS and Accounting, Mr. Kotian. We have been informed by him that the IT and IS maturity at the MF SR far exceeds the maturity of similar systems at other general government organisations. The existing systems are run-in and appear to be sufficiently reliable, including the connectivity of RIS, the accounting system and ISŠP. Our analysis of IS and IT strengths and weaknesses at the MF SR would not therefore bring added value to the IPSAS Project, since the areas exposed to increased risk are located outside the MF SR, primarily in smaller budgetary or contribution organisations of state administration and self-administration. We have concluded that, unless there is a change in the IPSAS Project scope, we will not analyse IS and IT strengths and weaknesses at the MF SR and we will focus our activities on analysing information needs for the common database of accounting and statistics.

We held two meetings with representatives of the project Architecture of IS of State Accounting. We presented to them our potential contribution to the creation of a common database of accounting and statistics which will consist of tables for notes to the financial statements. Our cooperation in this area will continue further after these tables will have been approved within the IPSAS Project.

2 Accounting

Our analysis of the current system of financial reporting in the public sector was based on the different legal treatment afforded to the accounting of public administration entities, from which specific fiscal and financial statements are derived. This part of our analysis presents our findings concerning the financial statements. Other fiscal statements are discussed in seciton 4 "Fiscal accounting".

2.1 Analysis of the current system of financial reporting in public sector

The current system of financial reporting by public administration entities, which are the subject of this project, i.e. budgetary and contributory organizations, municipalities, higher territorial units and state funds, is regulated by the following legal pronouncements:

- Act No. 523/2004 Coll. on Budgeting rules for state administration,
- Act No. 583/2004 Coll. on Budgeting rules for territorial self-administration entities,
- Act No. 291/2002 Coll. on the Treasury,
- Act. No 431/2002 Coll. on Accounting,
- Act N. 501/2001 Coll. on Financial control and internal audit and on amending several acts,
- Regulation of the Ministry of Finance of the Slovak Republic dated 8 December 2004 No. 11251/2004-42 providing detailed guidance on management of budgetary and contributory organizations, changing the Regulation of the Ministry of Finance of the Slovak Republic of 25 February 2004 No. 2252/2004-44
- Regulation of the Ministry of Finance of the Slovak Republic No. 1407/2003-92 providing detailed guidance on the arrangement, form and content of items of the financial statements, timing and extent of data determined for publication of the financial statements of budgetary organizations, state funds, municipalities, contributory organizations, and higher territorial units and certain other legal persons, with core activities other than entrepreneurship,
- Regulation of the Ministry of Finance of the Slovak Republic No. 24501/2003-92 providing detailed guidance on accounting principles, procedures and the chart of accounts for

budgetary organizations, state funds, municipalities, contributory organizations, and higher territorial units.

The accrual principle has been applied differently by some public administration entities, depending on the type of entity and progressively only in certain areas.

To provide a better understanding of the current situation, strengths and weaknesses of the accounting and financial statements, public administration entities have been divided into three groups:

- Budgetary organizations,
- Municipalities and Higher territorial units,
- Contributory organizations.

Within these groups we have focused, from the accounting point of view, on the following five key areas:

- Determination of the result for the period, accounting for expenses and revenues
- Accounting for transfers
- Reporting of net assets
- Accounting for non-current assets
- Financial statements

2.1.1 Budgetary organizations

A budgetary organization is a legal person of the state, municipality or higher territorial unit, which is connected to the state budget, municipality budget or higher territorial unit budget through its receipts and payments. It operates independently based on an approved budget. Budgetary organizations are established to fulfill various social, non-production functions and they have a different profile and specialization, which is based on the intention of their founder, e.g. management of the economy, culture, social and administration tasks.

Accounting by the budgetary organization

Budgetary organizations manage budgeted funds and funds received from other entities, and prepare a budget of receipts and payments.

According to the Act on Accounting, budgetary organizations must keep their accounts using the double-entry bookkeeping system.

Determination of the result for the period, accounting for expenses and revenues

The budgetary organization should primarily ensure the monitoring of budget fulfillment. Specifically, it has to account for actual budgetary payments and actual budgetary receipts. The accounting represents the basis for the financial and fiscal statements on budgetary payments and budgetary receipts, which in turn establishes the basis for control over budget fulfillment.

The budgetary organization does not account for revenues, it only accounts for and reports defined expenses. The creation, use and release of provisions, as well as the recording of accruals, deferred expenses and revenues is not performed by the budgetary organizations.

Budgetary receipts are divided into collected budgetary receipts and accounted budgetary receipts. These items are recognized during the financial year as balance sheet items.

At the balance sheet date, closing balances of payments, given transfers and expenses are accounted for on the Balance of budgetary payments and expenses. Closing balances of the collected and accounted receipts are accounted for on the Balance of budgetary receipts and revenues. Closing balances of these two budgetary balances are finally disclosed in the balance sheet as the result for the period. In addition to these two balances, the result of the period also includes the result from business activities, if the entity performs such activities.

Consequently the receipts and payments are accounted for separately in the accounting by the budgetary organization. Receipts and payments are not compared, and the budgetary result for the period is not calculated by a comparison of receipts and payments.

Although the above described balances are disclosed in the balance sheet as the result for the period, in fact, they do not reflect the actual financial result for the period of the budgetary organization, but provide answers to the following questions:

- whether all components of current assets acquired for the main activities (mostly material), paid from budgetary payment accounts, were actually consumed until the balance sheet date (i.e. they were recognized as expenses of the budgetary organization) or sold (i.e. they were accounted for on the specific account of the budgetary organization),

- whether all recognized expenses, which were supposed to be paid from the budgetary payment account, have already been paid, and subsequently the expenses are matched to budgetary payments,

- whether all prepayments to employees for business trips and for minor purchases were recognized in the relevant period,

- whether all accounted budgetary receipts (approved receipts, budgetary receipts claims) were actually collected and,

    - in budgetary organizations linked to the state budget, accumulated on budgetary receipt accounts,

- in budgetary organizations linked to municipality budget or higher territorial unit budget, accumulated on the budgetary receipt accounts and subsequently transferred from this account to the municipality or higher territorial unit account.

Accounting for transfers

We understand the term "transfers" to comprise mostly contributions to the contributory organizations, state funds, transfers to civic associations and foundations, grants to non-financial entities (legal or natural person – entrepreneur), operational transfers on different levels and operational transfers to international organizations.

These transfers are recorded on a separate account during the year, but are transferred to the Balance of budgetary payments and expenses at the period-end balance sheet date. These transfers, irrespective of whether the transferee is an own entity (e.g. own contributory organization) or a third party (e.g. entrepreneur), or whether it is an operational or capital transfer, are recorded on the Balance of budgetary payments and expenses, but are not recognized concurrently as expenses.

Reporting of net assets

Net assets in a budgetary organization comprise the following items:

- Funds of the accounting unit and Special funds of the accounting unit (specifically, the non-current assets fund and current assets fund)
- Result for the period (described above)
- Funding sources of budgetary funds resources (which are disclosed in the balance sheet prepared during the financial year and represent mainly the relations from budgetary management)

Accounting for non-current assets

The acquisition of non-current assets is credited to the account "non-current assets fund", which is part of net assets, irrespective of the manner of acquisition, i.e. free of charge or via purchase, and which entity it was acquired from

Depreciation of non-current term assets has no impact on the budgetary organizations' result for the period from main activities. Although the depreciation expense is recorded indirectly through accumulated depreciation, a decrease in the non-current assets fund is recorded concurrently. This transaction is disclosed in the balance sheet as a decrease in the non-current assets fund and an increase in the funding of the budgetary organization's payments.

Financial statements

According to the Act on Accounting, budgetary organizations must prepare financial statements which consist of a balance sheet, income statement and notes to the financial statements.

The budgetary organizations present defined assets and defined items of net assets and liabilities in prescribed format in the balance sheet, as set by the Regulation of the MF SR.

Although the income statements consist of three parts, budgetary organizations prepare only the first two parts, as follows:

- part A – Income statement, where expenses, revenues and result for the period from business activities are disclosed in the prescribed format "before taxation" and "after taxation", when the budgetary organization conducts also business activities,

- part B – Budgetary organization's expenses, in which expenses of the budgetary organization for the main activities are disclosed in prescribed format.

2.1.2 Municipalities and Higher territorial units

Municipalities and higher territorial units (self-governing regions) are legal persons established according to special acts.

A municipality is defined by the Act as an independent self-governing unit of the Slovak Republic, which, under the rules set by the Act, independently governs its own property and its own income. In this respect, the municipality cannot be perceived as a budgetary organization, even though its management is based on the budget. In contrast to a budgetary organization, the municipality's budget is self-prepared and approved and it possesses its own property which is governed by its own decisions.

Similarly, the higher territorial unit is a legal person, which, under the rules set by the Act, independently governs its own property and its own income, providing and securing the rights and interests of its inhabitants. As with the municipality, the higher territorial unit also cannot be perceived as a budgetary organization.

Accounting of the municipalities and higher territorial units

The main instrument of financial management of the municipalities and higher territorial units is their budget. In accordance with the Act on Accounting, the municipalities and higher territorial units must keep their accounts using the double-entry bookkeeping system.

Determination of the result for the period, accounting for expenses and revenues

The municipalities and higher territorial units account for actual budgetary payments and actual budgetary receipts. The accounting represents the basis for the fiscal statements on budgetary payments and budgetary receipts in prescribed format – by budgetary classification and by other groupings, providing the basis for further budgetary control of the municipality or higher territorial unit. Likewise, the municipalities must account for movements in assets and net assets in prescribed format, determining the result for the period by comparing budgetary receipts and budgetary payments of the municipality.

The primary function of the municipality and higher territorial unit is the monitoring and control of budget fulfillment. Revenues are not recognized by them; they account for and report defined expenses. The creation, use and release of provisions, as well as the recording of accruals, deferred expenses and revenues is not performed by municipalities and higher territorial units. This is similar to the budgetary organizations.

Budgetary receipts are classified into collected budgetary receipts and accounted budgetary receipts, which are disclosed as balance sheet items during the financial year.

The municipalities and higher territorial units determine their result for the period, which might be a surplus or deficit (i.e. positive or negative difference between receipts of the municipality or higher territorial unit and payments of the municipality or higher territorial unit), using the cash basis of accounting. The surplus or deficit is determined on a separate account as part of the fiscal closing process and is disclosed separately on the face of the balance sheet as part of the budgetary result for the period.

Other balance sheet items disclosed under the result for the period include the Balance of budgetary payments and expenses and the Balance of budgetary receipts and revenues, together with the result for the period from business activities. Similarly to budgetary organizations, these balances do not present the result for the period of the municipality or higher territorial units. By including these balances with the budgetary result for the period, a modified result for the period can be determined, which does not reflect all relevant expenses of the municipality or higher territorial unit, impact of capital expenditures and depreciation expenses. It also includes payments relating to the financing of budgetary and contributory organizations established by the municipality or higher territorial unit, together with other provided transfers.

The impact of capital expenditures and depreciation expenses is reflected in the Non-current assets fund as a separate item of net assets.

Accounting for transfers

As with budgetary organizations, transfers in municipalities and higher territorial units, are recorded on a separate account during the year, but are transferred to the Balance of budgetary payments and expenses at the balance sheet date. These transfers, irrespective of whether the transferee is an own entity (e.g. own contributory organization) or a third party (e.g. entrepreneur), and whether it is an operational or capital transfer, are recorded in the same way and are disclosed on the Balance of budgetary payments and expenses (they are not recognized as expenses).

Reporting of net assets

The net assets in municipalities and higher territorial units comprise the following items:

- Funds of the accounting unit and Special funds of the accounting unit (specifically the non-current assets fund and current assets fund)

- Result for the period (as described above and it also includes the receipts and payments of the budgetary organizations established by the municipality together with provided transfers to the budgetary and contributory organizations established by the municipality)

- Funding sources of budgetary funds resources (which are disclosed in the balance sheet prepared during the financial year and represent mainly the relations from budgetary management)

Consequently, the result for the period, which is part of the net assets of municipalities and higher territorial units, also includes items related to the assets of budgetary and contributory organizations established by the municipalities.

Accounting for non-current assets

The accounting for long-term assets by municipalities and higher territorial units is principally similar to the accounting by budgetary organizations. Depreciation of non-current assets does not impact the result for the period from main activities. Depreciation expense is recognized by the municipality or higher territorial unit indirectly through accumulated depreciation, together with a decrease in the long-term assets fund. This is reflected in the balance sheet as a decrease in the non-current assets fund and an increase in the funding of payments.

Financial statements

The municipalities and higher territorial units prepare financial statements, comprising the balance sheet, income statement and notes to the financial statements.

These entities present defined assets and defined items of net assets and liabilities in prescribed format in the balance sheet, as set by the Regulation of the MF SR.

Although the income statements consist of three parts, municipalities and higher territorial units prepare only the first two parts, as follows:

- part A – Income statement, where expenses, revenues and result for the period from business activities are disclosed in prescribed format “before taxation” and “after taxation”, when municipality and higher territorial unit conduct also business activities,

- part B – Budgetary organization’s expenses, in which expenses for the main activity are disclosed in prescribed format, which is the budgetary management of municipalities and higher territorial units

Although the municipalities and higher territorial units determine the result for the period, the financial statements do not include a separate statement which would present such result. Rather, it is included as part of the Statement of budget fulfillment and fulfillment of selected financial ratios of the municipality, higher territorial unit or budgetary organization in their control, which does not form part of the financial statements.

2.1.3 Contributory organizations

Contributory organizations provide services similar to those of budgetary organizations, and are compensated partially for such services. Contributory organizations are legal persons established by the state, municipality or higher territorial unit, where less than 50% of production expenses are covered by business revenues. They are linked to the state budget, municipality budget or higher territorial unit budget through the contribution. Contributory organizations must apply the financial rules set by their founder within its budget.

Accounting of the contributory organizations

According to the Act on Accounting, contributory organizations established by municipality or higher territorial unit, which do not conduct business activities and their yearly payments budget does not exceed SKK 500.000, can keep their accounts using the single-entry bookkeeping system. The contributory organization accounts for expenses and revenues (or for receipts and payments if using single-entry bookkeeping system) relating to its main activities and separately for its business activities.

Determination of the result for the period, accounting for expenses and revenues

As with budgetary organizations, municipalities and higher territorial units, contributory organizations recognize only defined expenses and revenues. In contrast to budgetary organizations, municipalities and higher territorial units, contributory organizations apply the accruals basis of accounting when recognizing expenses and revenues in their books. However, expenses and revenues do not include those related to the creation, use and release of provisions. Provisions are not recorded in a contributory organization's accounts.

Contributory organizations account for expenses and revenues as split into main and business activities. Received contributions for current payments are recognized as revenue, however the matching principle in respect of related expenses does not need to be applied. Contributions for the acquisition of non-current assets is recorded in net assets.

Contributory organizations determine the result for the period as the difference between their expenses and revenues. The result for the period is calculated on a separate account as a part of the book closing process, and is disclosed separately on the face of the balance sheet as part of the result for the period.

Accounting for transfers

According to fact that contributory organization can establish budgetary or contributory organization in rare cases only, the accounting for provided transfers has no content. Received transfers are accounted for as described above.

Reporting of net assets

Net assets of contributory organizations comprise the following items:

- Funds of the accounting entity and special funds of the accounting entity (specifically the long-term and current assets fund, reproduction fund, and reserve fund)

- Result for the period (described above)

Accounting for non-current assets

Accounting for non-current assets by contributory organizations differs somewhat in comparison with budgetary organizations, municipalities and higher territorial units. Contributions for acquisitions of long-term assets are recorded in net assets, specifically on the reproduction fund. After the capital expenditure is made, the relevant amount is derecognized from the reproduction fund and recorded into the long-term assets fund.

Self-constructed non-current assets are recognized in the books within revenues as "Capitalization of non-current assets". Non-current assets acquired free of charge are credited to the long-term assets fund.

Depreciation expense is posted into the expenses, impacting the result for the period of the contributory organization, whereas the amount of depreciation expense is reflected in the transfer between the non-current assets fund and the reproduction fund.

Financial statements

Contributory organizations must prepare financial statements consisting of a balance sheet, income statement and notes to the financial statements (if using the double-entry bookkeeping system) or a Report on receipts and payments and a Report on assets and liabilities (if using the single-entry bookkeeping system).

Contributory organizations present defined assets and defined items of net assets and liabilities in prescribed format in the balance sheet, as set by the Regulation of the MF SR.

Although the income statement consists of three parts, contributory organizations prepare and present only the following two parts:

- part A – Income statement, where expenses, revenues and result for the period are disclosed in prescribed format "before taxation" and "after taxation" for the financial year, as split between main activities and business activities.

- part C – Revenues and production expenses of the contributory organization, where defined expenses and revenues of the contributory organization are disclosed in prescribed format.

2.2 Strengths and weaknesses of the current system of financial reporting

2.2.1 Strengths of the current system of financial reporting

We have identified the following main strengths of the current system of financial reporting:

The cash basis of accounting ensures fiscal control and supervision over public finance.

The limits on budgetary payments are approved by the state authority annually, which ensures control over and responsibility for yearly provided cash funds. The cash funds cannot be used unless previously approved by the state authority within the budgetary payments limits.

Financial statements prepared using the cash basis of accounting usually present financial resources and their utilization within particular programs, sources, groups, levels and items and offer a comparison of actual payments to budgeted amounts.

The accuracy of the accounting and reporting can be controlled easily due to the characteristic features of the cash basis of accounting, such as annual approval of budgetary payments limits and the predominant focus on cash based operations.

Simplicity

The cash basis of accounting is simple and straightforward to apply, and has been used within the public administration sector for several decades in various countries. This basis of accounting also involves relatively cheaper operational costs.

Higher transparency

The accounting records and resulting financial statements are more transparent under the cash basis of accounting than under the accrual basis, which results from a lower need of using the judgment and decisions making on estimates, provisions and accruals.

2.2.2 Weaknesses of the current system of financial reporting

We have identified the following principal weaknesses in the current system of financial reporting:

Weakness	**Possible solution**
1 Limited comparability of financial statements betweenpublic administration entities	1 Harmonization of accounting principles, guidelines and financial statement formats of public administration entities
2 Recognition of defined expenses only	2 Implementation of the accrual basis of accounting and use of the prudence principle in accounting guidelines valid for public administration entities
3 Non-recognition of revenues	3 Preparation of a new accounting regulation for accounting for revenues from exchange and non-exchange transactions.
4 Limited differentiation between transfers to controlled entities and third parties	4 Preparation of a new accounting regulation which would differentiate between transfers to controlled entities and transfers to third parties

Weakness	**Possible solution**
5 Insufficient emphasis on recognition and/or disclosure of commitments and other contingent liabilities	5 Definition of the exact form of reporting of commitments and contingent liabilities
6 Absence of consolidated financial statements for public administration entities	6 Implementation of an accounting regulation relating to consolidated financial statements for public administration entities
7 Capability to influence budget fulfillment	7 Implementation of the accrual basis of accounting and requirement to prepare a cash-flow statement, which will make clear the change in liabilities?
8 Lower emphasis on operating effectiveness	8 Implementation of the determination of the result for the period by comparing expenses with revenues recognized using the accrual basis of accounting
9 Lower emphasis on non-current assets management	9 Disclosure of detailed information about useful lives of non-current assets, their movements and measurement basis in the notes to the financial statements
10 Poor understandability of financial statements for the public	10 Implementation of an accounting regulation for the public sector, reflecting their specifics and securing consistency with accounting procedures for business entities.

Limited comparability of financial statements of public administration entities

In section 2.1 we have described certain particularities of the accounting and reporting of selected items and other accounting matters, which are barely comparable due to the particularities of the individual public administration entities. Although these entities are required to prepare an income statement, such a statement does not provide sufficient information about the result for the period from main activities as it is prepared only for business activities. In the case of budgetary organizations, state funds, municipalities and higher territorial units, financial statements do not include a statement that would explain the generation of the result for the period for all activities of the entity.

Recognition of defined expenses only

As discussed in section 2.1, public administration entities recognize only defined expenses. As a result some expenses, such as those relating to the creation of provisions, accruals, deferred expenses and revenues (except for contributory organizations) are not reflected in the current system of accounting, as these items do not represent actual cash outflows. However, such transactions can significantly influence the financial position and final outcome from operations of public administration entities.

Non-recognition of revenues

According to the Act on Accounting, "revenues" are defined as an increase of economic benefit of the accounting entity during the accounting period, which can be reliably measured, whereas under the term "receipt" an increase in cash or cash equivalents of the accounting entity is understood. Under the current system, public administration entities (such as budgetary organizations, municipalities, higher territorial units and state funds) do not account for any revenues – they only account for budgetary receipts as split between collected and accounted receipts.

Limited differentiation between transfers to controlled entities and third parties

In the current system of accounting and reporting the differentiation of transfers from the perspective of transferees is not sufficiently dealt with. Transfers between mutually controlled public administration entities (e.g. between municipalities and their contributory organizations) are disclosed in the same way as transfers between public administration entities and third parties (e.g. from municipalities to entrepreneurs).

Insufficient emphasis on recognition and/or disclosure of commitments and other contingent liabilities

The current legislation requires public administration entities to disclose their existing and contingent liabilities in the notes to the financial statements. Considering that no exact format for disclosure of these liabilities is prescribed, even if they were accurately presented, it would be hard to use them for public finance purposes due to their complex processing and evaluation.

Insufficient emphasis on the recognition and disclosure of liabilities does not provide sufficient information from which the impact of such existing liabilities on future finance sources. That is, it does not provide important information for the state as to whether it can provide services on the existing level and on what level they can be provided in the future.

Absence of consolidated financial statements for the public administration entities

The current legislation does not address the preparation of of consolidated financial statements by public administration entities. For example, in case of municipalities, part of a municipality's equity includes receipts and payments of budgetary organizations established by that municipality. However, the assets and liabilities of the municipality do not include the assets and liabilities of their budgetary organizations, ans such omission can significantly influence the financial position and result of operations of municipalities. The same principle is applicable also for other public administration entities.

The current legislation does not address the issue of consolidation of state budget chapters and consolidation of state administration.

Capability to influence budget fulfillment

The current system of financial accounting and reporting emphasizes the objective of budgetary compliance, i.e. budgeted receipts and payments, which theoretically creates an opportunity to influence the compliance with budget by cash movements at the end of the financial period, e.g. by postponing the payments to reach lower deficit or avoid funds overdraft.

Lower emphasis on operating effectiveness

In certain circumstances, the current system of accounting and reporting can lead to lower operating effectiveness. This stems from the possibility that the motivation of public administration entities can be reduced to a single aim of obtaining the biggest possible budget and sustaining its use before the end of the financial period, with the further goal to obtain approximately the same budget for the next period.

Lower emphasis on non-current assets management

Appropriate management of non-current assets in public sector is very important as the most valuable asset in the public sector is infrastructure, which is a long-life asset that creates the basis for sustainable growth of the country. It ensures a more appropriate assets renewal policy, identification and disposal of excessive assets and better risk management. Identification of assets and accounting for their wear and tear helps users of financial statements to understand better the impact of usage of long-term assets for provision of services and encourages them to consider the alternative methods of their use. The current system does not create sufficient conditions for applying this principle, because depreciation does not influence the result for the period in many public administration entities. It leads to a lack of motivation to determine appropriate depreciation rates so as to fairly reflect the wear and tear of these assets.

Weak understandability of financial statements for the public

The general public is not capable of analyzing the financial situation and result for the period of public administration entities as they are not aware of the specific accounting rules for the public sector,. These are significantly different from the accounting principles used in the business sector.

3 Consolidation

An accounting consolidation process for the general government sector does not presently exist which, in itself, is a weakness of the financial reporting system of the state. However, there is a strength in the fact that the process of data collection and aggregation for statistical consolidation already operates and is strongly supported by the existing IT function. On this basis, it is possible to begin creating the accounting consolidation process which will result, for self-administration, in consolidated financial statements ("CFS") of municipalities and local governments, for the state administration, in CFS of the State Budget chapters and of the state administration as a whole, and for the general government, in summary financial statements for the entire public administration. The accounting consolidation process will include, for example, elimination of receivables and payables within the consolidation field. This is an activity carried out also during the statistical consolidation process, however, it does not provide the level of detail needed in the accounting.

The general government consolidation process described in progress report 1 has been adopted in the amendment to the Act Nr. 431/2002 Z.z. on Accounting. Passing of this amendment into law, as well as of the new accounting procedures for budgetary organisations, state funds, contribution organisations, municipalities and local governments is expected no sooner than January 2007. Our work will continue without interruption by proposing consolidation procedures and forms. A pre-condition for this work is a definitive consent on the new accounting methodology procedures. The work on consolidation methodology will therefore be carried-out in the coming reporting period concurrently with the accounting trainings.

4 Fiscal reporting

In our analysis of fiscal reporting strengths and weaknesses, we have built on our understanding of the fiscal reporting process documented in progress report 1. We have identified process strengths and weaknesses and focused on related opportunities for development and addressing the weaknesses. We provide an overview in the table below:

Strengths	**Development opportunities**
1 Centralised data collection in electronic form.	1 Extending the level of detail of electronically provided information from summary financial and budgetary statements to tables in the notes to the financial statements. adjusted to the specific needs of statistical reporting, see section 4.2.
	2 Improving logical consistency checks between financial statements or within transactions reported for a period, see section 4.2.
2 Continuity and gained knowledge and experience of the working team providing the financial reporting process.	3 Creating internal guidelines / manuals for statistical reporting, see section 4.3.

Weaknesses	**Remedy opportunities**
1 Missing data on establishing and closing of organisations, activity delimitations, see section 4.1.1.	4 Reporting the prior period both gross and net. The tables proposed in section 4.2 have the same structure for both the current and prior accounting period.

Weaknesses	Remedy opportunities
2 Missing accrual data, see section 4.1.2.	5 Harmonisation of recognition criteria and calculating remaining differences. We consider the harmonisation of the accounting and statistical reporting presented in the tables per section 4.2 for the maximum practically attainable harmonisation level. Unsatisfied statistical needs will be solved by separate statistical investigations.
3 Missing information on market prices, see section 4.1.3.	6 As in the point 1. Reporting entities will provide market valuation information where practicable.
4 Missing information for calculating statistical superdividends, see section 4.1.4.	7 As in the point 1.
5 Missing information for assessing capital injections, see section 4.1.5.	8 As in the point 1.
6 Missing information for splitting an accounting transaction into transaction and holding gain/loss, see section 4.1.6.	9 As in the point 1.
7 Difference in movements of cash per B/S and per VPR, see section 4.1.7.	10 As in the point 2.
8 Inconsistencies in financial assets and liabilities per B/S and VPR, see section 4.1.8.	11 As in the point 2.
9 Complicated elimination process for intra-sector receivables and payables for statistical consolidation see section 4.1.9.	12 Statistical consolidation will use confirmation of balances within the general government sector during the preparation of summary financial statements for public administration.

4.1 Detailed description of weaknesses

4.1.1 Missing data on establishing and closing of organisations, activity delimitations

Problems with reporting the prior period can arise in the statistical consolidation process during establishing or terminating budgetary organisations ("RO") / contribution organisations ("PO") or delimitations of activities to another RO / PO. This is because the financial statements show only net figures for the prior period, both gross and net figures are shown for the current period. Accurate t statistical reporting requires both gross and net figures to be presented for the prior period. We have investigated the following opportunities to remedy this weakness:

1. Reporting the prior period both gross and net in the financial statements. This would be a non-traditional solution from the accounting point of view, however, not impossible.
2. Reporting the prior period both gross and net in the notes to the financial statements for all categories of assets and liabilities.
3. Expanding the data providing to the Department by ISŠP and Datacentrum.
   In case of expanded functionality of aggregating systems or in case of direct connection of the Department to these systems, the Department would have available not only the aggregated data for subsectors, but also the option to "drill down" to individual items (e.g. to the level of organisations constituting a subsector). This would automatically eliminate a need for many questions.

We have applied the approach described in point 2 above to the tables proposed in section 4.2, i.e. the tables have the same format for the current and prior accounting period. This appears to be the optimum approach also from the point of view of the solution 3 as the tables can be used to create a common database of accounting and fiscal reporting as a data source for aggregation. We discuss this topic in section 6.1.

4.1.2 Missing accrual data

Key information for statistical reporting is gained from the VPR. This report reflects cash movements while statistical standards require accrual information. Missing accrual data are obtained by statistical investigations. Among the most significant accruals are tax receivables and receivables for social insurance.

The implementation of accruals-basis accounting will significantly remove the need for additional investigation into information for such accruals because they will already be recognised in the accounting records. This can be illustrated with tax receivables where for the September notification of the Maastricht debt, a method of actual tax receipts adjusted for the time shift of tax maturity against tax period will be used. This complies with the accrual accounting approach which recognises as a receivable only virtually certain future receipts. If using this approach, we assume that the role of VPR in preparing statistical reports will decrease in exchange for increased use of financial statements data, especially the notes to the financial statements. The future solution rests in:

1. attaining maximum possible harmonisation of accounting recognition criteria with statistical reporting criteria, e.g. as in the case of the tax accrual discussed above,
2. documenting all remaining methodological differences between the accrual basis of accounting and the statistical basis of reporting, e.g. in the form of internal procedures. Additional differences identified by us in this phaseare presented in the following sections;
3. calculating the differences per item 2 each time a statistical report is prepared.

We believe that the harmonisation of the accounting and statistical reporting presented in the tables per section 4.2 will allow for the maximum practically attainable harmonisation level. Unsatisfied statistical reporting needs will be addressed by separate statistical investigations in terms of points 2 and 3.

4.1.3 Missing information on market prices

According to the statistical basis of reporting, assets and liabilities are valued at market values, or if these are not available, at replacement costs. The proposed new accounting methodology, as well as the current methodology, prefers valuation in terms of historical costs. Market values are applied only for selected short-term financial assets and liabilities.

To date, the Separate Department for Implementing Statistical Standards ("Department") has not revalued assets and liabilities from historical cost to market values/replacement costs. If the accounting records did not already provide fair values, historical costs were used also in the statistical reports. It is the task of the Department for the current year to comply with the statistical basis of reporting and to find an appropriate way of valuing assets and liabilities.

We have considered the following approaches to address this issue::

1. In the accounting records, assets and liabilities will be measured at fair values in all cases where allowed by IPSAS. These include, in principle, all assets and liabilities except for inventories and deferred tax. The disadvantage of this approach is that
   - The criteria for revaluing to fair value are more strict in the accounting system than in the statistical reporting system, and applying such stricter criteria could lead to increased costs, e.g. for expert valuation of real estate,
   - the accounting entities currently may not dispose of sufficiently qualified accountants, especially during the running-in period of the accrual basis of accounting. Consequently, the valuation data provided may not be reliable for items where an accounting entity itself would perform the valuation,
   - this would result in inconsistencies with accounting procedures for other types of accounting entities where historical costs are still applied,
   - fiscal reporting still needs to provide information on historical costs, see section 4.1.6.
2. Assets and liabilities will be measured at historical costs in the accounting records and fair value information will be presented in notes to the financial statements. The advantage of this approach in comparision to the approach 1 is that
   - even in cases of possible valuation errors, a reliable basis at historical costs remains,
   - the accounting records can provide data on historical costs to the fiscal reporting function.

   One disadvantage of this approach is the increased size of notes to the financial statements.
3. Assets and liabilities will be measured at historical costs in the accounting records and fair values will not be determined beyond the requirements of the existing accounting procedures. The obligation to provide for any valuation adjustment will be left to the Departments.

Currently, a combination of the approach 2 and 3 appears to be the most plausible. The accounting entities will provide information on fair values in the notes to the financial statements as at the reporting date where such reliable data can be expected to be obtained, e.g. traded securities. Recalculation of interest expense using the effective interest rate method will not be needed. This approach has been reflected in the proposed tables in section 4.2. The accounting entity will disclose fair market values as at the beginning and end of the period, if practicable. The accounting entities will perform neither expert valuations nor carry-out revaluations of inventories at replacement costs. The statistical revaluation will be performed by the Department.

4.1.4 Missing information for calculating statistical superdividend

ESA95 methodology provides more detailed rules for reporting such dividend than does the current accounting methodology. Some accounting transactions considered in the accounting for those generating a realised profit/gain are not recognised by statistical bases as an income justifying distribution of dividend. These include proceeds from F/A disposals and gains from accounting revaluations of assets/liabilities. Dividends attributable to this type of accounting income are classified as a transaction which decreases net assets per ESA95, thus having an impact on the EDP. In the same way, dividends distributed from reserves of a company, even though created from profit, if these were not specifically determined for smoothing-out dividends between years, are also considered as a decrease of net assets.

We have investigated the following options:

a) additional statistical investigation on profit on disposal of fixed assets for significant dividend income,
b) the reporting general government entity will be made aware of ESA95 requirements for reporting dividends and will be obliged to report in the notes to the financial statements those dividends which statistically decrease net assets.

Option b) appears to be more appropriate. The duty to report a statistical superdividend can be limited by a regulation specifying the contents of the notes to the financial statements for a relevant set of entities. For this reason we have included a table on the statistical superdividend to the proposed tables.

4.1.5 Missing information for assessing capital injections

This concept is relevant for Eurostat even though it is not defined by ESA95 methodology. A broad definition of it is provided in the ESA95 manual for government deficit and debt: "many types of payment from government to a public corporation which in national accounts have to be classified under quite different headings as capital transfers or as financial transactions. For example, it includes transactions that might be described in public accounts as investment grants, capital grants, commutation grants, loans, equity injections, acquisition of share capital or public dividend capital."

In principle, it holds that grants, loans, capital contributions including in-kind contributions, are taken for non-financial transaction if return is not expected on such a transaction, having impact on the deficit. The first indication of a need to apply such an approach is when a recipient of such funds is a public corporation that accumulated significant losses.

Due to a need to assess each capital injection individually, we believe the most appropriate solution is where accounting entities provide in the notes to the financial statements sufficient details on borrowed funds, loans, acquired securities and ownership interests, including identification of the debtor, issuer and entity in which the ownership interest was acquired. Additional details will be obtained by the Department by statistical investigation. The tables proposed in section 4.2 are a suitable starting point for gaining this information since they capture in detail all transactions in the area of financial assets and liabilities.

4.1.6 Missing information for splitting an accounting transaction into transaction and holding gain/loss

Assets are reported at market values/replacement cost in the statistical reporting process. However, there is a need to maintain historical cost information also. On sale, disposal, delimitation of an asset etc. such a transaction should be reported from the view t of fiscal reporting separated into

- The entire transaction (non-financial or financial), valued at current market value/ replacement cost,
- The holding loss/gain measured as the difference between the current market value/replacement cost and historical cost of the asset.

A similar approach should be applied also for liabilities. To achieve this,the required details could be provided in the notes to the financial statements. The proposed tables for financial assets, liabilities, tangible and intangible fixed assets include details needed for calculating holding losses/gains. The reporting entity does not calculate the amount of such loss/gain but provides data for aggregation only. The loss/gain will be calculated by the Department after having received the aggregated data.

4.1.7 Difference in movements of cash per B/S and per VPR

Frequently the Department, when analysing the aggregated data, identifies occurrences where the following consistency relationship does not hold between the B/S and the VPR:

$$OB_{BS(BA)} + R_{VPR} - E_{VPR} + BFT_{VPR} = CB_{BS(BA)}$$

where:

$OB_{BS(BA)}$	Sum of opening balances of bank accounts in the B/S
R_{VPR}	Receipts per VPR
E_{VPR}	Expenditures per VPR
BFT_{VPR}	Balance of financial transactions per VPR
$CB_{BS(BA)}$	Sum of closing balances of bank accounts in the B/S

We recommend to add this inter-statement consistency relationship to the obligatorily checked inter-statement relationships as defined in Instruction 1, appendix 5, section Checks and consistency relationships in budgetary and financial statements. The relationship is valid by analogy also for ISŠP clients and their budgetary accounts where opening balances are Nil.

4.1.8 Inconsistencies in financial assets and liabilities per B/S and VPR

There are instances, especially in the statements of municipalities, where the VPR includes a transaction with loans or financial investments and, either there is no corresponding change in the B/S, or they are not reported at all. We recommend to check the relationship between the VPR and the accounting information for financial assets and liabilities using the notes to the financial assets and liabilities. The notes should not only explain in sufficient detail the changes in volume of financial assets and liabilities and changes in their valuation as explained in section 4.1.3, they should also separate the changes in volume between cash and non-cash accounting transactions. For example, if part of a loan is repaid in non-cash form in exchange for land of a municipality, or if a receivable is forgiven or written-off, it is useful to report in the notes the cash and non-cash transaction separately. The cash transaction can then be checked to the VPR using a relevant economic classification, e.g. expenditures on repayments of bank loans (economic classification 821004 + 821005), or when drawing a loan, receipts from received bank loans (economic classification 513). Movements in shares, etc. can be controlled by analogy.

For purposes of checking the logical consistency between the VPR and the accounting records, we have designed the tables for financial assets, liabilities, tangible and intangible fixed assets to document in detail the consistency between relevant items of the economic classification, separating the financial flows into those related to the current accounting period and those related to other periods, with the accounts per framework chart of accounts, broken down further to analytical accounts as needed. If such tables are used to collect data for aggregation, it should be possible to automate these checks. We recommend to include them in the obligatorily checked inter-statements relationships, as the control in section 4.1.7.

4.1.9 Complicated elimination of intra-sector receivables and payables for statistical consolidation

Since no accounting consolidation is performed in the existing accounting systems of RO/PO, it follows that no confirmation of mutual receivables and payables is carried out.. This represents a significant problem for the statistical consolidation. The intra-sector receivables and payables are determined by the Department by statistical investigation. Since the general government entities will be subject also to performing the accounting consolidation, this problem will be solved by confirming receivables/payables as part of the accounting consolidation process. It is appropriate in this regard that the accounting consolidation form distinguish between entities within the general government sector and those outside of it, since the accounting consolidation will include also entities outside this sector, business entities of municipalities and local governments.

4.2 Proposed tables into notes to financial statements from the point of view of statistical reporting needs or other legislation on reporting

As ISŠP and Datacentrum can aggregate electronically submitted data of financial statements and notes, this allows them to require accounting entities to submit detailed information in tabular form in the notes to financial statements. If required, the proposed tables can be included in a separate regulation, i.e. they will not be a part of the notes to the financial statements, but they will be collected by a particular process.

Currently, rows of financial and budgetary statements are aggregated. From an IT point of view, it is conceivable to aggregate GL accounts of accounting entities, or even movements on these accounts. The extended level of detail will make possible to meet most of the statistical reporting needs t and, at the same time, use the detailed information to check the consistency between financial and budgetary statements, or between transactions (movements) reported for a period and related balances. We have proposed the following tables: 1. Dividend income, 2. Statistical superdividend, 3. Financial assets, 4. Financial liabilities, 5. Tangible fixed assets, 6. Intangible fixed assets.

4.2.1 Connection between budget and accounting

The above-mentioned tables have been designed to meet both accounting and statistical reporting needs concurrently. The emphasis is on logical consistency between financial and budgetary statements. The key principle is the relationship of budgetary receipts and expenditures to accounting costs, income, receivables and payables. This principle has been applied in the tables so that a budgetary receipt / expenditure is allocated to an accounting transaction relevant by economic substance. Such an accounting transaction can, however, relate to

- a current accounting period, as expected in most cases, or

- a prior or future accounting period especially for accounting transactions recorded close to a period cut-off date.

This matter has been incorporated into the proposed tables, although it contributes to expanding their size. We believe this tabular format will facilitate understanding of the accrual basis of accounting to reporting accountants and will contribute to proper recognition of accruals in the submitted data.

4.2.2 Break-down into the accounts per framework chart of accounts

For each proposed table, we have provided a breakdown of reported economic category into the accounts per the framework chart of accounts per the proposed accounting methodology, or into analytical accounts if needed. A minimum structure of analytical records has been created in this way that is sufficient to meet statistical reporting needs.

The minimum structure of analytical records is presented in the form of a minimum chart of accounts. From the reporting point of view it is understood as an information specification, not as a requirement on a reporting entity to open an analytical account with the shown description. The reporting entity may decide to use other grouping keys available in its IS to separate the recording of accounting transactions belonging to one row of the minimum chart of accounts. However, from the point of view of the future IT solution, the format of the minimum chart of accounts appears to be more appropriate.

4.3 Internal guideline / statistical reporting manual

We recommend collating the knowledge and gained experience and using it to produce a set of internal guidelines / statistical reporting manual. An appropriate example may be internal guidelines for the accounting, or manuals of working procedures for EU aid implementation. With regard to the high importance of statistical data submitted to international institutions, a formalised process of statistical reports preparation would increase the ability to control such data from a procedural point of view, i.e. whether or not all activities needed to prepare reliable statistical reports have been performed. We recommend to begin production of such internal guidelines / manuals following approval of the new accounting methodology..

5 Organisation

Our task in the current reporting period was to map the “as-is” accounting processes of MF SR. We have performed the mapping for three relatively independent internal accounting entities: funds accounting, MF SR Office Administration accounting and accounting in the chapter of General Treasury Management ("VPS").

Identifying process improvement opportunities has been an important part of process mapping. They relate either to identified strengths that can be further developed and used, or to weaknesses that can be remedied or mitigated. We have presented the improvement opportunities in tabular form outlining strengths / weaknesses tables with the combined development / remedy opportunities.

We note that apart from weaknesses related to individual accounting entities within MF SR, there are also weaknesses related to MF SR as a whole, i.e. MF SR as a legal entity

- has neither created a process for preparing financial statements as a single accounting entity, nor assigned responible persons and units. This weakness is solved by the working group for consolidation.

- has no central coordination for the accounting, i.e. for MF SR as the single accounting entity. This weakness will be regarded when designing the future accounting process.

5.1 Funds accounting

Within funds accounting, we include the accounting for pre-accession and post-accession EU aid, financial envelopes, own sources of EC, Norwegian financial instrument and Solidarity Fund, as performed by the Separate Department of Accounting at the Section of European Affairs. The accounting is maintained on the system ISUF (Information System for Funds Accounting) being an adapted implementation of SAP R/3 system.

Strengths	Development opportunities
1 Accounting process is supported by a system with large functionality.	1 Automated posting of bank statements, see section 5.1.1.

Strengths	**Development opportunities**
2 Accounting process is documented in detail by manuals to individual aid types.	2 Detailed documentation will facilitate the transition to accrual accounting by formalising the process according to the new accounting methodology. From the funds accounting point of view, we do not anticipate significant changes in this area.

Weaknesses	**Remedy opportunities**
1 Some system capabilities are not fully used.	3 See point 1.

5.1.1 Automated posting of bank statements

The accounting system provides a standard functionality for automated accounting of bank statements, i.e. of payments and receipts, on the basis of identification strings in payment orders or in receivables. The algorithm can distinguish bank fees on the basis of the relevant constant symbol and post them automatically. It is also possible to set up an automated posting of foreign exchange gains / losses. Manual control can be retained if needed so that the system will offer a default algorithmic solution that can be overwritten. We recommend to use the functionality for automated bank statement posting.

5.2 MF SR Office accounting

The accounting is maintained by the Accounting Department of the MF SR Office on a SAP R/3 system denoted as IS ESO.

Strengths	**Development opportunities**
1 Accounting process is supported by a system with large functionality.	1 Automated posting of bank statements. The recommendation described for ISUF in section 5.1.1 is also valid for the MF SR Office accounting.

Weaknesses	**Removal opportunities**
1 Some system capabilities are not fully used.	2 See point 1.
2 Lower level system support than currently needed, see section 5.2.1.	3 Expanding fixed assets register grouping criteria, see section 5.2.2.
	4 Expanding fixed assets register functionality for registering persons in charge of individual assets, see section 5.2.3

Weaknesses	Removal opportunities
	5 Expanding functionality for FINFAP report generation, see section 5.2.4
3 Complicated involvement of budgetary control into accounting process.	6 Budgetary approval of purchase orders rather than invoices, see section 5.2.5.
	7 Indication of budgetary classification code as output of budgetary control for petty cash expenditures, see section 5.2.6.

5.2.1 Process of maintenance and further development of accounting system

The process of maintenance and further development of accounting system is governed by Internal Regulation of MF SR Nr. 33/2005 Decision of Minister of Finance on issuing the Statute of Steering Committee for the IS ESO project ("Regulation"). The Regulation obliges users to submit requests for IS ESO maintenance and development to a responsible quality manager.

MF SR uses an application Open View Service Desk ("Service Application") since beginning of 2006 to collect and manage requests for development of its IS, including IS ESO. Access to the Service Application was granted to each IS user at MF SR via intranet interface. We have found that there are opportunities to improve the IS ESO functionality, see sections 5.2.2, 5.2.3 and 5.2.4 that are not recorded in the Service Application.

According to the valid Regulation wording, neither user not quality manager are obliged to input identified change requests or IS development opportunities into the Service Application. We consider for useful to record into the centrallised system for collection and management IS development requests also such functionality development requests that pose no immediate priority but have to be solved at least in mid-term. This would bring benefit at least in the following areas:

- for complaints of system users on complicated work with the system or of system output recipients on lower than requested information quality. It will be possible to look up retrospectively who, when and whether anyone has asked for implementing the requested functionality,
- documented database of system functionality requests facilitates planning of funding for application support by the system vendor.

From this reason, we recommend to amend the Regulation for the obligation of users to input into the Service Application identified change requests or IS development opportunities. At the same time, it is necessary to assign a responsibility to evaluate them. This can be assigned to the existing quality manager function or to a, for the IS ESO so-far non-existing but proposed, professional guarantor function. The function of professional guarantor has been already used in the ISUF change process. The solution to be adopted shoud reflect the need to:

- maintain consistency of changes in the IS ESO accounting clients,

- create a knowledge base from performed changes to the system.

5.2.2 Fixed assets register grouping criteria

Fixed assets are grouped in the system into classes defined per synthetical accounts of the framework chart of accounts. Analysis per economic classification per the Slovak Statistical Office is also supported. The system does not provide an option to define user-defined grouping codes.

The existing assets grouping capability is insufficient for an organisation with a large quantity of assets, such as the MF SR. For example, the synthetical account 022 maintains together heterogeneous assets such as IT and office furniture. The system does not include a filtering key enabling the filtering out and separate reporting of a requested subset of assets. We believe that when implementing the system, a time-saving approach of minimum configuration has been adopted, in this case the approach of compliance with the requirements of the framework chart of accounts, however, future needs of the organisation have not been taken into account. The framework chart of accounts represents only minimum requirements on asset grouping that are common to large and small organisations, where small organisations can analyse their assets on an item-by-item basis. Large organisations can, in contrast, rely only on reporting capabilities of their own systems. We recommend expanding the grouping criteria of the FI-AA module on the basis of information needs analysis.

5.2.3 Registering materially responsible persons

The system has not been customised for registering the names of persons to whom responsibility for assets has been allocated.. This hinders work with personnel, e.g. checking the return of assets at employment termination or for assigning asset damages to persons. Currently, this information is recorded in an alternative spare field on the asset card. However, there is no report available on this field. Ata minimum, we recommend developing a report reading this alternative field, i.e. providing an assets overview including a materially responsible person.

5.2.4 FINFAP report generation

The report on sectoral classification of financial assets and liabilities or on sectoral classification of increases / decreases in financial assets and liabilities ("FINFAP") is prepared outside the IS. Only one financial investment is reported. We believe that the FINFAP report does not include all requested items, e.g. in column 10 “Other receivables and paid advances”, all receivables and paid advances should be reported in order to reach consistency with the B/S rows according to the MF SR Instruction of 20 Dec. 2005 published in Finančný spravodajca 1/2006, page 57. We recommend expanding the IS functionality for generating this report which will systematically ensure consistency with the B/S rows.

5.2.5 Budgetary approval of order instead invoice

A standard purchasing process has been set up in the IS which begins by issuing and approving an order. The system checks agreement of a purchase invoice to the approved order. A funding reservation is generated in the budgeting module by approving an order, i.e. an "obligo" of orders arises including respective budgetary classification ("RK"). RK is applied also to potential advances paid. However, the proper RK code is determined by the accountant without the involvement of the budgetary clerk at the time of generating the obligo of orders.

After a purchase invoice has been received, the process of its approval begins. Within the budgetary control process, the budgetary clerk verifies availability of funding per budget and assigns an RK code to the invoice. The approved invoice is registered in the budgetary module as obligo of invoices.

We believe that the budgetary clerk performs the budgetary control too late in the process. Availability of funding from budget has already been provided for by reserving such funds on the order, and at this moment, an RK code has also been assigned. Therefore we recommend to perform the budgetary control at the time of order generation. Where the invoice agrees to its related order, budgetary control for this invoice need not be repeated. We consider this improvement opportunity as a quick win.

5.2.6 Indication of budgetary classification code as output of budgetary control for petty cash expenditures

An important element of petty cash expenditure recording is to provide a correct RK code. Due to personnel capabilities of the accounting function at the MF SR Office, petty cash is not administered by cashiers reliably recognising budgetary expenditures immediately in the moment of issuing a cash expenditure slip. As a result, cashiers record the expenditures on technical accounts wherefrom they are reallocated by a knowledgeable accountant.

Budgetary control by a budgetary clerk also forms part of paying out an expenditure. The clerk provides information as to whether budgetary funding is available for this expenditure. However, the output information from the budgetary control does not include the RK code. This is unexpected given that the budgetary clerk must have already identified the proper code when performing the funding availability check. Indicating relevant RK codes does not present any further work for the responsible budgetary clerk. At the same time, indicating the RK code is important information for a cashier, on which basis proper recording of the cash expenditure slip can be attained.

If the budgetary clerk indicated the respective RK code as a component of his/her budgetary control, the cashier would be able to accurately record the cash expenditure slip. In this way, the subsequent activity of reallocating the cash expenditure by a knowledgeable accountant could be eliminated. We consider this improvement opportunity for a quick win.

5.3 VPS accounting

VPS accounting is maintained by the Accounting Department for Specific Transactions of State ("VPS") on a SAP R/3 system.

Strengths	Development opportunities
1 Accounting process is supported by a system with large functionality.	1 Automated posting of bank statements. The recommendation described for ISUF in section 5.1.1 is also valid for VPS accounting.
2 Accounting process documented in detail in the form of an internal guideline.	2 Detailed documentation will facilitate transition to the accrual basis of accounting by formalising the process according to the new accounting methodology.

Weaknesses	Remedy opportunities
1 Some system capabilities are not fully used.	3 See point 1.
2 Missing functionality for managing financial assets and liabilities.	4 Implementing the missing functionality, see section 5.3.1.
3 Insufficient accounting control over tax and customs assets and liabilities	5 Implementing adequate accounting controls, see section 5.3.2.

5.3.1 Functionality for managing financial assets and liabilities

The VPS accounts for financial assets and liabilities governed by the MF SR. Acquisitions and disposals of assets or an increases, changes and settlements of liabilities are recorded on the basis of supporting documentation obtained from a relevant specialised division, (e.g. Division of managing selected assets and liabilities) or from an external entity (e.g. ARDAL, NBS, ČNB a ČSOB). The VPS does not have a specialised module for registering assets and liabilities and individual transactions are posted directly into the GL on separate analytical accounts.

The VPS experiences difficulty in controlling its assets and liabilities as it does not use any specialised functionality for registering assets and liabilities Neither subledgers nor asset management or finance modules are used, and posting is made directly to the GL analytical accounts. For example, in order to find a current balance of an asset per the VPS system, it is necessary to find an expenditure increasing balance of the given asset in the GL and manually add this amount to the opening balance. If using a functionality for asset registration, the current balance would be available immediately in the IS.

The existing status poses a problem especially for documentary reviews of balances when trying to establish a closing balance for each asset / liability item. For assets and liabilities managed by ARDAL, the problem of determining closing balances can be overcome during the accounting period by electronic connection, however, the data from ARDAL alone will not solve the problem of a complicated reconciliation process of potential differences in the closing balances per ARDAL and per VPS. We recommend considering the implementation of a specialised functionality.

5.3.2 Accounting control over tax and customs assets and liabilities

Tax and customs assets and liabilites are accounted for by Tax Offices and Customs Directorate of SR on a contractual basis. These institutions send closing balances of tax and customs assets and liabilities electronically via ISŠP. The MF SR accounting system takes over these balances and includes them automatically into the balance sheet of VPS or MF SR. Neither detailed accounting records nor closing balance bread-downs for individual accounts are sent. In such a system, MF SR has not a sufficient control over assets and liabilities recognised in its balance sheet. We recommend to ensure that the involved institutions send break-downs for the tax and customs assets and liabilities accounts to VPS. A control is needed when preparing financial statements by reconciling the electronically transferred balances to the balances per accont closing balance break-downs.

6 Information technology

6.1 Common database of accounting and statistical reporting

We continued with our work of analysing information requirements for the common database of accounting and statistical reporting. We held two meetings with representatives of the project Architecture of IS of State Accounting ("Architecture Project") We were informed by them that, with the use of proper technology, tables fed by source data generated by accounting entities will be a substantial element of a future solution. These tables would be aggregated further per reporting needs.

During our last meeting, we presented the tables proposed by us for the notes to the financial statements from the point of view of statistical reporting, see section 4.2. Since these tables have not yet been approved by the IPSAS Project, we were not able to make them available to the Architecture Project representatives. We informed them that they could request such tables from MF SR representatives who will have access to these tables when commenting on this Report. On the basis of the presentation of these tables and the principles applied therein, an agreement has been reached that the tables created using these principles could satisfy the Architecture Project needs. More exact feedback would be provided after analysing the tables. The Architecture Project representatives were interested in presenting their findings at regular Project IPSAS meetings.

6.2 Strengths and weaknesses of existing IS

The key event in this area was a meeting with the Office Head Advisor for IS and Accounting, Mr. Kotian. We were informed by him that IS and IT maturity at MF SR far exceeds maturity of similar systems at other general government organisations. The existing systems are run-in and appear to be sufficiently reliable, including the connectivity of RIS, the accounting system and ISŠP. Our analysis of IS and IT strengths and weaknesses at MF SR would not therefore bring added value to the IPSAS Project, since the areas exposed to risk are located outside the MF SR, mainly in smaller budgetary or contribution organisations of state administration and self-administration. Such organisations often use obsolete accounting solutions, e.g. on the DOS platform, without a possibility to set up sufficient logical security and connectivity.

We have concluded that, unless there is a change in the IPSAS Project scope, we will not analyse IS and IT strengths and weaknesses at the MF SR and we will focus our activities on analysing information needs for the common database of accounting and statistics. The work of statistics and IT workstreams will overlap in this area. If needed, however, we can deepen our involvement into more technological details.