

## A MAZE OF CONFUSING JARGON

By

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Over the many years that I have practiced local government finance, I have found that there are quite a few of us seasoned professionals, many of whom have worked in many countries, who have found it very difficult to help honest enquirers through what seems to be a maze of confusing jargon.

One important reason for this is that – over many years – a great deal of jargon has been promulgated about budgeting and accounting, in the public sector in general and for local and state governments in particular. Like most things in life, there have been partial truths in much of this jargon and some useful and interesting concepts have emerged. However, sometimes the definitive jargon has been pushed much too hard – as if its concepts were the latest thing in its field. Often, for some of us, on closer examination, what is being pressed on us – as already experienced professionals, I might add – are half-truths and fads or (even more confusing) mere re-statements of procedures and practices that we have already been doing, over many years. In other words, it was reinventing the wheel!

It gets worse than that. Some of the concepts have often been picked up and asserted, often in distorted form, by (sometimes) well-intentioned but ill-informed people who, especially, lack the professional competence to either explain or practice what they are asserting or requiring.

Thus, over the years, we have been assailed with terms like: “program budgeting”; “performance budgeting”; “planning, programming, budgeting systems (PPBS)”; “zero-based budgeting”; “modified accrual accounting”; “cash limits budgeting”; “best value”; and on and on. I am sure that you get the point! Moreover, the confusion and concern has been exacerbated because these things have often meant different things to different people, or in different countries.

Indeed, on more than one occasion, I have found myself confronted by people from the ranks of what I have termed the “well-intentioned but ill-informed” [to which I might sometimes add – the “ignorantly over-assertive and aggressive”.] They demand to know why I do not practice – nor even understand – one or more of the things that they assert. Often, I have never even heard of the procedure before and the assertive person, it will transpire, does not understand it either! It will have been something that he read in a book or heard at a seminar! Or else it has even been pressed upon him (or her) by an also well-intentioned but ill-informed supervisor or employing institution. I have then found myself at a loss for words. I have then scrambled to find out what is being talked about. On more than one occasion, I have asked myself “Am I stupid or what?” Perhaps I was! No-one, after all, is all-knowing or perfect – just like markets!

Or, just like one of the “well-intentioned but ill-informed” who, in my presence, in a developing country, was (if you will pardon the expression) “explaining” the complexities of performance or program budgeting. It was nonsense! I could barely conceal my personal embarrassment at being associated with the meeting I was attending.

Also, I well remember my first and daunting experience of this concern. In the mid-960s, I was working in Uganda, on technical assistance provided by the UK Government. Visiting (American) “experts” asked me – quite assertively – whether I practiced, knew about or understood “program budgeting.” Quite honestly, at that time, I had never even heard of it, so I thought that perhaps I had missed something or was just plain ignorant. Further enquiry convinced me that it was something that I had been doing all along – just called by another name!

Even more confusion has sometimes been added because of very different terminologies used in (say) the USA and the UK. One example of this, with which I have personally struggled, is the concept of “Program Budgeting.” We start with a very simple idea. This is as true today as it ever was, such as when I learned my craft over forty years ago. What the British refer to as a “Service” (e.g. education, road management, parks) the Americans have typically called a “Program.”

Left well alone, one could easily have lived with the differences in language. After all, we have other distinctions, such as: “lift” and “elevator”; “flat” and “apartment”; “transport” and “transportation.” Even in our own profession, we have “debtors” and “receivables”; “creditors” and “payables.” Indeed, Winston Churchill once described us as “two countries divided by a common language.” OK – so the UK delivers “services” and the USA runs “programs.” Not such a big deal, one might say!

However, come now the jargonizers. For example, over the years, the concept of (so-called) “program budgeting” has been distorted beyond recognition and then finally discarded for something else. What, exactly, I do not know! It all depended upon where you stand. Let us look, more carefully, at this particular piece of jargon. I have taken the following from another paper of mine on related topics.

The UK system of budgeting and accounting has now evolved into one that can (almost) be described as “full accrual at current value.” Moreover, although there are real and material differences between the UK and the USA systems, these have been made to appear greater than they need to be, because of significant differences in terminology<sup>[1]</sup>.

One example of this, which proves unnecessarily discomfoting, is the use of the term “program budgeting.” The term is used, mostly, by Americans. Unfortunately, this has been an over-used and ill-understood concept. It is among those most often urged upon others by those who, themselves, may not fully understand it. Moreover, it is frequently contrasted with that of “line-item” budgeting<sup>[2]</sup>. The latter is often spoken of, pejoratively, as a “less-preferred” alternative.

In over forty years of experience in public finance, I have *never* encountered a credible budget document that does not contain and use “line-items.” Thus, it must be concluded that the use of this term (line-items) is an “aunt sally,” to knock over, in an insistence that something called “program budgeting” is, in some way, superior to something else.

A quote from the book “Planning and Budgeting in Poor Countries,” published in 1974, by two American (very senior and well-known) budget specialists, Naomi Caiden and Aaron Wildavsky, is even now very apposite:

“...Although there is no evidence that program budgeting works in the United States (the federal effort was effectively terminated in June 1971) it has nonetheless been exported throughout the world. Its attractiveness has been easy to understand....

“...As each objective is identified, it is related to quantitative indicators which in turn are related to the amount of resources necessary to achieve varying levels of the objective. At the highest level of decision, major objectives are ranked so that it is possible to give priority to one expenditure over another...

“...The experience with program budgeting has been much the same in poor countries as in rich; *no one knows how to do it*. While words trip easily off the tongue, there are no corresponding operations which go along with them. The knowledge gap becomes clear when those who are supposed to supervise the installation of the system can't give specific advice on how to do it. No one understands how to put together the program structures that relate the objectives to one another. Consequently, many different things go under the name of program budgeting<sup>[3]</sup>. On occasion, it simply means naming, as a program, whatever a bureau is doing. Or it may mean devising a new system of accounts so as to discover the cost of particular activities that might interest decision makers.”

My own project experience, together with experience of the authors of this book, has tended to give credence to these comments. Firstly, although “program budgeting” is claimed to have been introduced in many different local government units, in various countries, it is often difficult to elicit from any one of these units a credible budget document reflecting this concept. Secondly, although the “program budget” concept is sometimes used in “citizen participation”, this is often more concerned with the form of presentation than with its content.

No one, naturally, can have objections to either “citizen participation” or “accountability” as valid concepts for local government finance. However, as often perceived, “program budgeting” incorporates a need for “devising a new system of accounts, so as to discover the cost of particular activities.”

My own critique of the concept of program budgeting is mainly concerned with the presentation of a stylized “package.” It is not intended to fault many – if not most – of the procedures and practices that “program budgeting” embodies. Indeed, I strongly support the idea that effective citizen participation cannot occur unless a budget is presented in useful and understandable formats. Such formats need separate emphasis on intended output expenditures for individual services and programs, such as “roads,” “education” and “parks,” rather than on inputs, such as “salaries,” “supplies” and “debt service.”

This last item, “debt service,” also provokes an interesting example, with respect to accurate accounting. “Debt service” although often shown as such, is not (wholly) a cost at all. Strictly, the “interest” component is only an accurate cost if it includes the “cost of capital” or “return on investment” on *all funds* deemed to be invested in fixed assets. The “amortization” component *is never a cost*. It is a cash-flow!

Strictly speaking, it has no business ever appearing in an “income and expenditure” statement at all. It has frequently done so, in fund-type accounting (e.g. in UK and USA) **only** as a surrogate for depreciation, and then only on those fixed assets that are funded by debt. However, it has always been inaccurate, to the extent that (a) debt maturities mismatch fixed asset life-cycles; and, (b) fixed assets, as is often the case, have been financed otherwise than from debt.

The situation is made all the more confusing because, at least until recently, American practice was to show “debt service” as a separate “program” – not attached to any particular service. British practice was to allocate it among (programs or) services, as a substitute for “depreciation and interest.” In retrospect, both approaches were wrong and have now been (at least partially) corrected in both countries.

So, where does all of this get us? Accounting, as I have said elsewhere, is NOT rocket science. With possible limited exceptions, there are **only 14** different types of cash flow and **only 28** different types of other accounting transactions. Forty-two types cover everything! [See the “Churchill Chart”] Accountants know how to marshal these so that **COSTS OF SERVICES** are determined. These are what I have called, elsewhere, the “**OMAR’s CAR RUNS**” costs. **Only** this categorization of transactions can be claimed to be COSTS. No other categorization can be so asserted. That is not to say that some of the other categorizations may not have value. They do! They are just **NOT COSTS**.

I now further assert that **only cost-based accounts** are useful measurements for the purposes of measuring **performance in service delivery**. These must be computed in accordance with standard practices. Thus the “**OMAR’s CAR RUNS**” principles are embodied, for example, in the UK “Chartered Institute of Public Finance and Accountancy Code of Practice on Best Value Accounting.” Under this code, local authorities will generally be accounting on the basis of “total cost”, including capital charges. Indeed, they are required to do so, by law. This is the only sensible basis of what has sometimes, currently, been referred to as “**Performance Budgeting**.”

There are slideshows available, together with the information in “Municipal Accounting for Developing Countries.” These show the extent to which current accounting practices are fully cost-based and how to get there if they are not. Local government accounts in the UK can now be said to be about “as close as one can get” to being cost-based. They are required to be so by law, as well as because their chief financial officers are required – by law – to be either Chartered Public Finance Accountants or to hold equivalent professional qualifications.

Cost-based Accounting is a necessary (although not sufficient) requirement for the correct assessment of two other aspects of Public Sector Accountability. These are “Accountability for Stewardship of Public Funds” and “Accountability for Security and Control.” In commenting upon assertions about the current format of presentation of accounts in many emerging or developing countries, one could, perhaps, assert that this format might go some way towards these latter two concerns for accountability.

However, when addressing the concern of “Performance Budgeting” I think that we would agree that much more work is required. Most importantly, the services need to be categorized into their “program” or “service” formats, depending upon whether one is drawn to US or UK English terminology. Although I am critical of the careless use of the term “Program Budgeting,” I still fully support the intention and necessity of presenting budgets and accounts in “program” or “service” formats. In English, we use the expression “Let us not throw out the baby with the bath water!” It is apposite here. Let us, therefore, take the good and discard that which is not useful for effective action.

In conclusion – and for the avoidance of further doubt – *performance budgeting* is basically preparing service (or program) based budgets as estimates of the service (or program) based accounts that will measure the costs of final output. The Annual Accounts (Financial Statements) of Birmingham City Council are a good example of this. Performance-based budgets and accounts are necessarily backed up by a variety of performance measurements and other data. However, unless the accounts (and the budgets) are cost-based and (just as crucially) consistent with one another, this information is relatively useless as a measurement of activity or policy outcome.

Lest you think that I am unduly criticizing countries other than the UK on this, I am not. When I was appointed as “Chief Accountant” to a British local government unit, in the late 1950s, my first major task was to bring about a transformation of the budgeting and accounting systems so that they would be consistent and comparable with one another. Sadly, in many cases in the world, this is still not the case.

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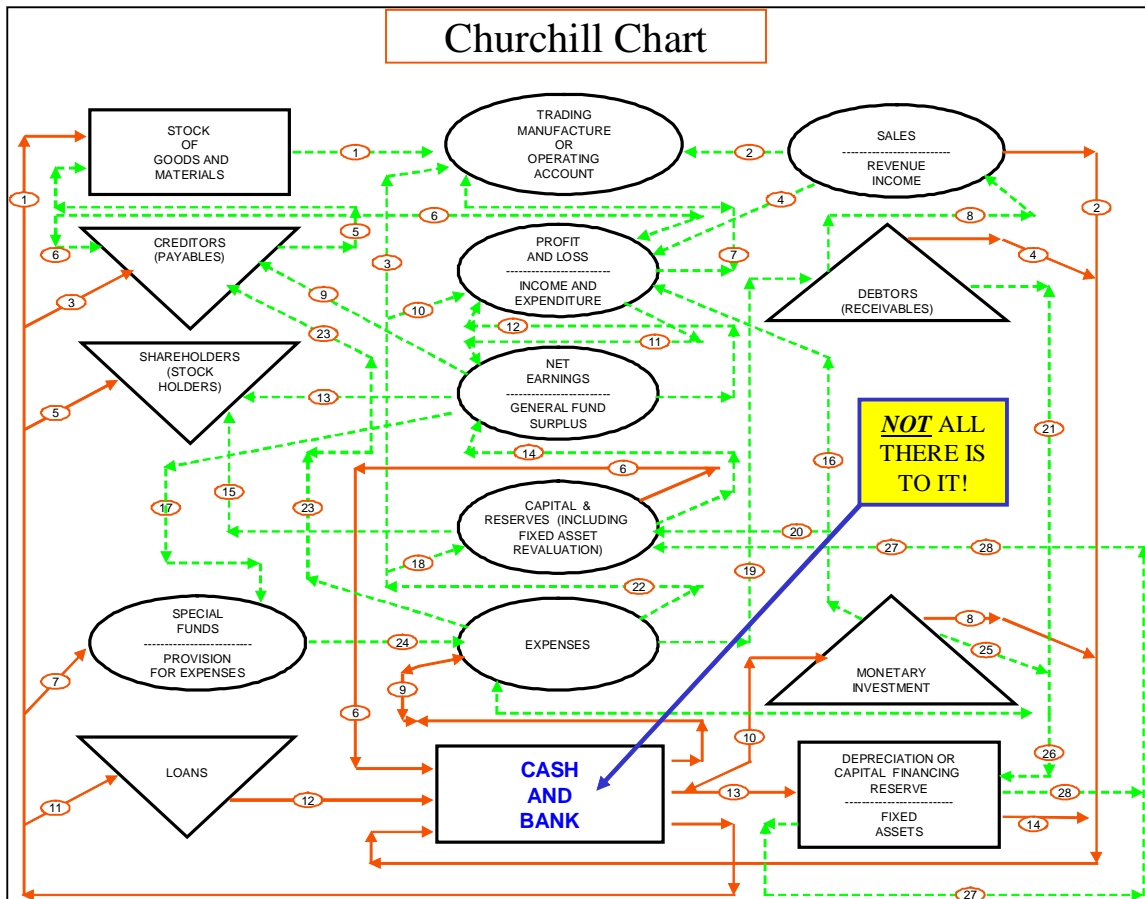
<sup>[1]</sup> By quirk of language, American budgetary jargon refers to the input expenditures as “objects of expenditure.” UK terminology refers to these as “subjective” analysis. To avoid confusion, it is perhaps more useful to recognize the most detailed levels as expenditure on “inputs” and the higher levels as expenditure on “outputs” or “activities.”

<sup>[2]</sup> A core policy-based concern of accounting is for it to report on actual outcomes as they relate to budgeting.

<sup>[3]</sup> For confirmation of this, try using a “search engine” for “program budgeting” on the internet.

## Fundamental Accountability Requirements

- Retain (real) net capital intact [*including non-monetary capital!*].
- Maintain inter-generational equity (current users bear their fair share of all costs, *including capital financing costs*)
- Compute “Omar’s Car Runs” costs
  - Operation
  - Maintenance
  - Aadministration & Taxes
  - Rent:
    - Consumption of capital (depreciation)
    - Aadjustment of value (asset valuation)
    - Return on investment (interest, dividends, retained earnings)
  - Surplus (to cover):
    - Risk
    - Uncertainty
    - New Activities
    - Stability
- Fully utilize “Churchill Chart” of accounts (see next page)  
*“Pray let me have, by this evening, on one page, the status of our tank deployment...”*  
*[Winston Churchill, British Prime Minister – World War II]*



## *Accounting Flow Chart*

1. The attached chart illustrates the working of the entire accounting system of any financially autonomous entity, keeping its accounts on an accrual basis. It can be applied to private sector, public utility, enterprise or municipal accounting systems.
2. It is probable that well over ninety-five percent of accounting entries, for any kind of business, are represented by the fourteen cash-flows and twenty-eight other book entries represented on the chart. Thus, forty-two entries cover virtually all transaction types.
3. Each class of account has been given a separate symbol. In the “Keys to Symbols” box, those on the left represent “personal” accounts (debtors and creditors). Those on the right represent “real” accounts (cash, stocks of goods / materials and fixed assets) and “nominal” accounts (gains and losses - income and expenditures). Furthermore, the symbols with *straight sides* (squares and triangles) represent **resources** (assets and liabilities), whilst the *circles* represent the analysis of **results** (gains and losses).
4. Each line represents a class of business transaction or a generally recognized accounting adjustment. Where a line touches the left-hand side of an accounting symbol, it represents a debit entry to that class of account. Conversely, a line touching the right-hand side represents a credit. *Solid lines* represent cash flows and *broken lines* represent accounting entries not directly related to cash transactions.
5. The arrows on the lines are somewhat arbitrary. However, they attempt to show the direction in which each transaction is normally understood to flow. The entries are conceptual, not legal. For example, the transfer of extra-ordinary losses (and fixed asset revaluations) direct to “Capital and Reserves” is regarded as bad accounting practice in many systems but is acceptable in others. In this chart, they have been shown as direct transfers to “Capital and Reserves,” merely for simplicity.
6. The chart indicates that an accounting system, whilst complex, is bounded and closed. For accountants, it may assist in systems and computer work. For non-accountants, it may be useful in understanding what accountants are doing (or supposed to be doing) and may also help to develop an appreciation of what can and should be expected from an accounting system. For students of accounting, the chart may represent a useful learning tool, to be used in conjunction with other teaching materials.
7. The chart covers most accounting procedures likely to be encountered. It includes, moreover, the two main entries concerned with the conversion of historical cost accounts to current values. This is still a matter of uncertainty and contention among accountants and is not practiced in all systems. However, unless recognized, especially where high rates of inflation exist, fixed asset (and other non-monetary asset) values, based only on historical costs, become increasingly meaningless. Furthermore, depreciation (and other capital charges) based of these historic values will cause the under-statement of costs and a corresponding over-statement of profits.

## Accounting Flow Chart

KEY TO SYMBOLS							
Cash Flows				Accounting Flows			
△	Legal Claims by the Entity	Debit	Amounts Claimed	□	Tangible Assets	Debit	Increases in Assets
		Credit	Amounts Settled			Credit	Decreases in Assets
▽	Legal Claims against the Entity	Debit	Amounts Settled	○	Gains and Losses  (Income and Expenditures)	Debit	Losses or Expenses
		Credit	Amounts Claimed			Credit	Gains or Income

### Cash Flows

- |   |  |
|---|--|
| <ol style="list-style-type: none"> <li>1. Cash Purchases - Stock (Inventories)</li> <li>2. Cash Sales or Revenue Income</li> <li>3. Cash Settlement - Creditors (Payables)</li> <li>4. Cash Settlement - Debtors (Receivables)</li> <li>5. Dividends or Share (Stock) Repayment</li> <li>6. New Share Capital</li> <li>7. Payment from Funds</li> </ol> | <ol style="list-style-type: none"> <li>8. Investment Withdrawal</li> <li>9. Cash Expenses</li> <li>10. Investment of Cash in Monetary Instruments</li> <li>11. Loan Repayments</li> <li>12. Loans Raised</li> <li>13. Capital Expenditure</li> <li>14. Sales - Fixed Assets</li> </ol> |
|---|--|

### Accounting Flows

- |   |   |
|---|---|
| <ol style="list-style-type: none"> <li>1. Use of Stocks (Inventories)</li> <li>2. Sales Income</li> <li>3. Expenses (Trading, Operations, Manufacturing)</li> <li>4. Revenue (Recurrent) Income</li> <li>5. Credit Purchases</li> <li>6. Cash Discount Received</li> <li>7. Gross Profit (Trading, Operations, Manufacturing)</li> <li>8. (Sales &amp; Operational) Income Recoverable</li> <li>9. Taxes Now Payable</li> <li>10. Expenses (Profit and Loss or Income and Expenditure)</li> <li>11. Net Loss or Net Expenditure</li> <li>12. Net Earnings or Net Income</li> <li>13. Allocated or Declared Dividends</li> <li>14. Transfers to Reserves</li> <li>15. Capital Repayable</li> <li>16. Surplus on Investments (Credited as Income)</li> <li>17. Future Income or Corporation Tax (Provision)</li> <li>18. Extra-ordinary Losses</li> <li>19. Expenses Paid in Advance</li> <li>20. Surplus on Investments (Credited as Capital)</li> </ol> | <ol style="list-style-type: none"> <li>21. Bad Debts or Discounts Allowed</li> <li>22. Transfer of Expenses<sup>1</sup></li> <li>23. Accrued Expenses</li> <li>24. Transfers to Special Funds/Provision for Expenses</li> <li>25. Investment Losses</li> <li>26. Depreciation (Commercial or Enterprise Accounts) &amp; Capital Discharged - by Loans Repaid, Revenue Contributions to Capital or Special Funds Applied (Municipal - Public Sector - Accounts)</li> <li>27. Revaluation of Fixed Assets</li> <li>28. Revaluation of Accumulated Depreciation</li> </ol> |
|---|---|

<sup>1</sup> There are a great variety of expenses but all are accounted for in the same way: an appropriate "expense" account is debited and either "cash" or "payables" is credited. Transfers, for final accounts, will depend upon types of expenditure.

