

## **CHAPTER 5: INTERNATIONAL REFORM INITIATIVES IN GOVERNMENT FINANCES AND PUBLIC FINANCIAL PERFORMANCE MANAGEMENT**

### **5.1 INTRODUCTION**

The increasing complexity of the public administration environment and the continuous need to align the needs of society with limited resources require that funds are made available for a specific purpose and used for that purpose. Government institutions all rely on the citizens of the country for their income and are therefore subject to relevant public-sector legislative and administrative processes in dealing with revenue and expenditure. Internationally, poor performance of governments has a common origin, namely weak public financial management practices and accountability requires adequate capacities for managing public finances.

The aim of financial management in the public sector is to manage limited financial resources to ensure economy and efficiency in the delivery of outputs required to achieve desired outcomes that will serve the needs of the community. A sound public financial management system allows government to make the best use of all available resources, including international development assistance, to improve the quality of life of society. This includes managing expenditure and raising revenue and is not merely an issue of spending more, but of maximising the impact of public resources.

This chapter is an analysis of current international reform initiatives in public finances and financial performance management. The focus of the analysis is on international reform initiatives and possible best practices in government finances and financial performance management. This allows the opportunity for future alignment in order to provide world-class public services in the South African context. Theoretical models and different approaches to public financial performance management will be analysed with the aim of finding cross-cutting issues, evidence of practical applications and also for capacity development.

### **5.2 AN OVERVIEW OF PUBLIC FINANCIAL MANAGEMENT**

The complex of problems that centre around the revenue-expenditure process of government is referred to traditionally as public finance. However, Musgrave

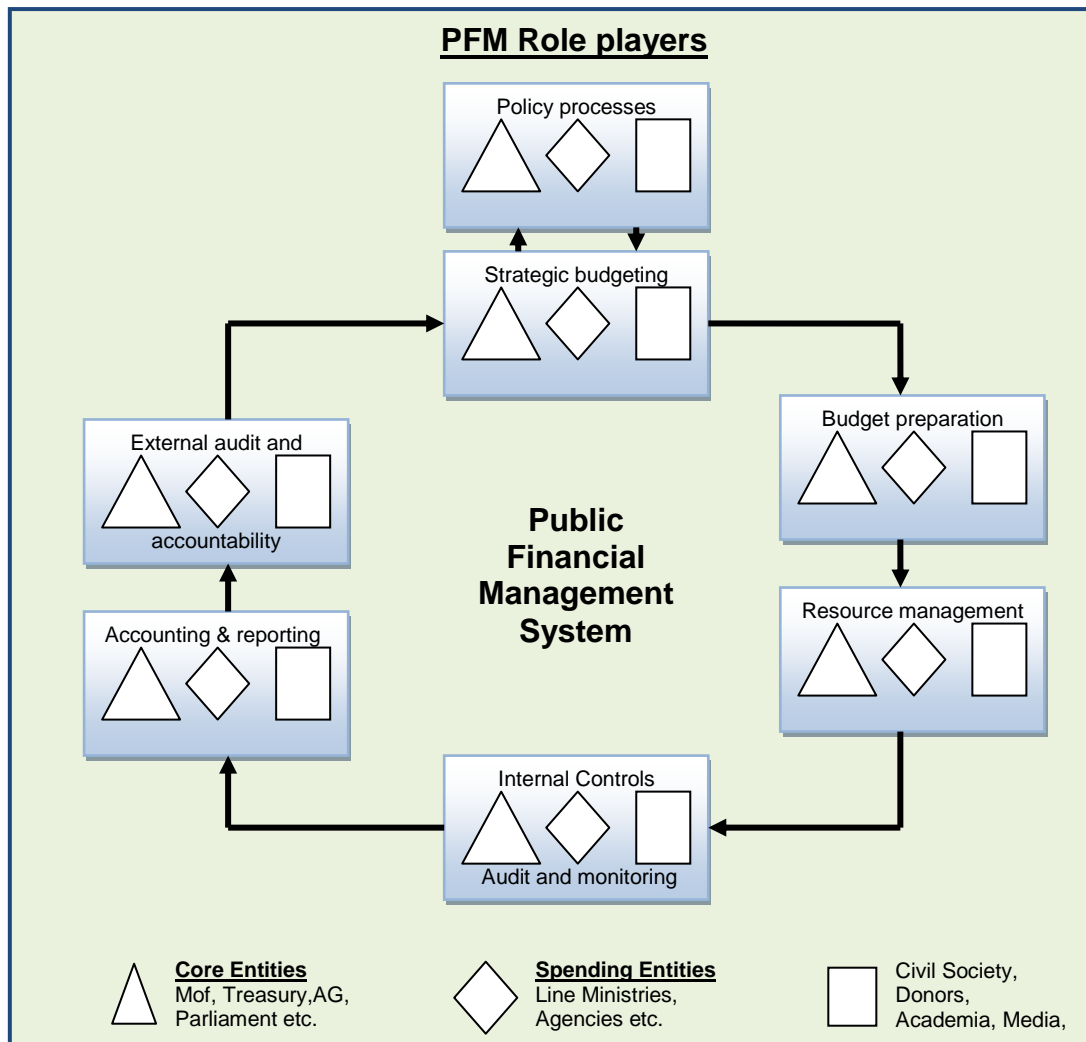
(1959:3) contends that although operations of government involve money flows of revenue and expenditure, the basic problems are not issues of finance or concern about money, liquidity or capital markets. Rather, these problems are related to resource allocation, the distribution of income, full employment, and price level stability and growth. Musgrave (1959:3) further suggests that one thinks of the task of government as an investigation into the principles of public economy; or more precisely, into those aspects of economic policy that arise in the operations of the public budget.

According to Herber (1971:5), *Finance* as such, suggests “monetary flows” as represented by the revenue-gathering and expenditure activities of the governmental budgetary process. The “basic” economic functions of the public sector are those which influence resource allocation, income wealth and political voting distribution, aggregate economic performance, and the rate of economic growth. Although Herber (1971:5) sees this as the direct results of public-sector economic activity, he suggests that “...out of respect to the orthodox nature and well-engrained popularity of the term ‘finance’ the terms ‘economy’ and ‘finance’ can be used interchangeably”.

Although there is a consensus on generic stages of a budget cycle, a review of the literature on public financial management reform shows that there is no universally agreed definition of public financial management (Pretorius & Pretorius, 2008:2). The narrowest definition confines *public financial management* to the downstream activities of budget execution, control, accounting, reporting, monitoring and evaluation (Allen, Schiavo-Campo & Garrity, 2004:11).

As an alternative definition, Rosen (2002:4) describes *public financial management* as the taxing, spending and debt management of government, which influences resource allocation and income distribution. The spending portion covers the budget cycle, including budget preparation, internal controls, accounting, internal and external audit, procurement, and monitoring and reporting arrangements (Witt & Müller, 2006:6). The complexity of public financial management relationships and multiplicity of public financial management role players are best illustrated in Figure 5.1.

Figure 5.1: The multiplicity of public financial management (PFM) role players and PFM relationships



Source: Andrews, M. 2007. *What would an ideal public financial management system look like?* In Shah, A. (ed.) *Budgeting and budgetary institutions*. Washington: World Bank, page 24.

A strong public financial management system is critically important in achieving the strategic goals and objectives of government and requires a series of realistic steps or platforms to accommodate multiple role players and to manage relationships. Each platform is defined in terms of improved outcomes and is the basis for launching the next stage. The PFM system in Figure 5.1 provides for improved outcomes in terms of:

- 1) improved linkage of policy priorities to budget planning;
- 2) a credible budget delivering predictable resources;
- 3) improved internal controls to hold managers to account; and
- 4) integration of accountability and review processes for both financial and performance management.

The PFM system highlights the relationships of various role players in the different components, which create the opportunity for good governance with the emphasis on public financial management capacity, accountability and responsiveness. The system provides for collective decision-making, for citizens to express their preferences and accountability. The PFM system makes provision for aggregate fiscal discipline, strategic prioritisation in composition of expenditure with the budget as a key instrument to implement government policies, operational efficiency in use of resources and fiscal transparency. The result of this financial management process is a credible budget that is a reflection of the government's policies and priorities, it is comprehensive by covering all government activities and there is full transparency of budget processes and information. The internal control system should ensure that the budget appropriations are not exceeded, that funds are spent as intended and that reliable information is produced. Finally, accounting systems provide for timely and reliable reporting at all levels of decision-making; and the ex post systems of external scrutiny by the legislature and by external audit, by holding political executives and management accountable, should help keep the budget on track and improve performance (Shand, 2006:1).

### **5.2.1 Components of public financial management**

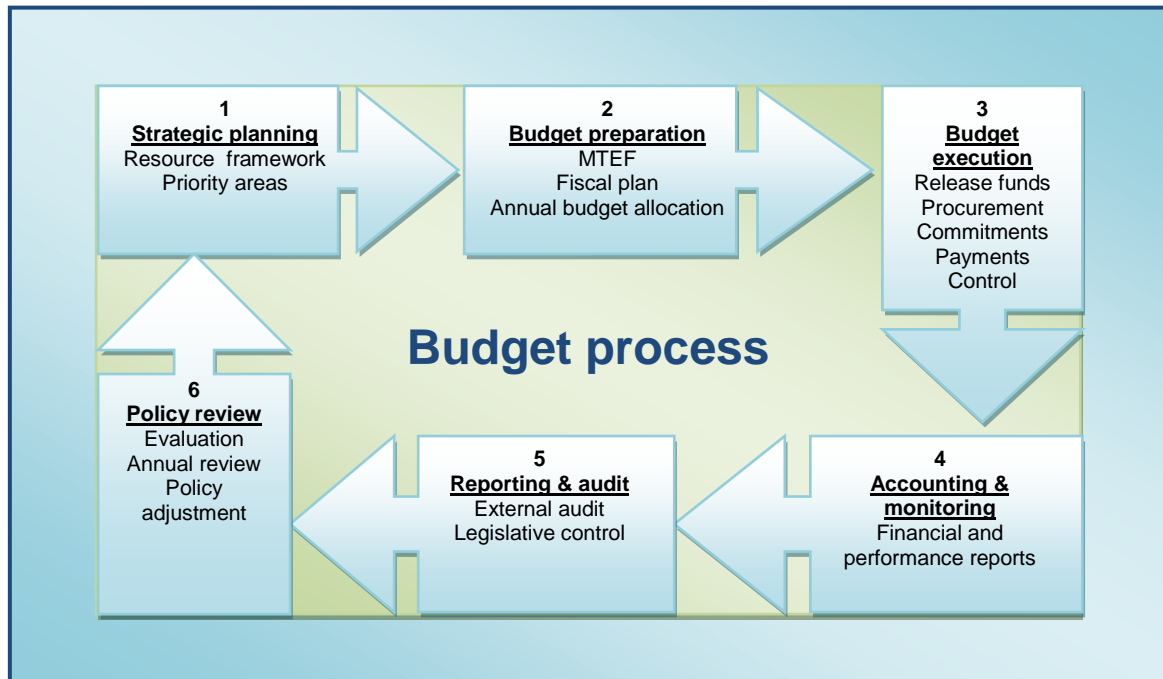
Olander (2007:11) lists four objectives for the management of public expenditure: firstly, the control of aggregate expenditure of public resources in line with available resources; secondly, the effective allocation of resources to different areas of concern in pursuit of objectives; thirdly, the efficient operational use of resources, such as service delivery, to ensure maximum value for money; and finally, fiscal transparency through social control. These objectives are mutually interdependent and interact with each other. All these objectives are realised through the budget process. The budget, the centrepiece in any country's public activity, is both a political and technical document. It is through the budget that policies are implemented, leading to service provision, among other things. Therefore, the budget process, through a sound public financial management system, is one of the most important democratic arrangements. There is a need for budget ownership where both political and administrative role players take greater responsibility for their own finances (Olander, 2007:10).

The World Bank's Public Expenditure and Financial Accountability (PEFA) agency highlights a number of key components for effective public financial management (Public Expenditure and Financial Framework, 2005:2). The budget must be credible, realistic and implemented as intended. The budget and fiscal risks are comprehensive and the information should be available to the public. The budget process is predictable, there are control mechanisms in place and the budget is prepared with the country's policies in mind. An effective accounting, reporting and recording mechanism for the implementation of the budget is in place and finally, all public finances should be open to scrutiny and audits.

### 5.2.2 The budget process

The budget is the centre of the public financial management process and starts with the preparation of a comprehensive medium-term strategic framework (MTSF), which reflects the political priorities. Planning involves priorities that are linked to the budget and costing is aligned with a time frame attached to activities. In the preparation of the budget, the fiscal plan, annual budget and the medium-term expenditure framework (MTEF) must be taken into consideration (see Figure 5.2). After approval of the budget, it should be executed through financial management systems and with the appropriate controls in place. The public financial management process depends on a sound reporting system, reporting on both financial and performance activities. Audits depend on the information gathered throughout the budget process and external audits ensure quality and transparency. The final element in the budget process is policy review, where evaluations and review outcomes are used to update and adjust policies. Then the whole process starts again with the planning activity (Olander, 2007:10).

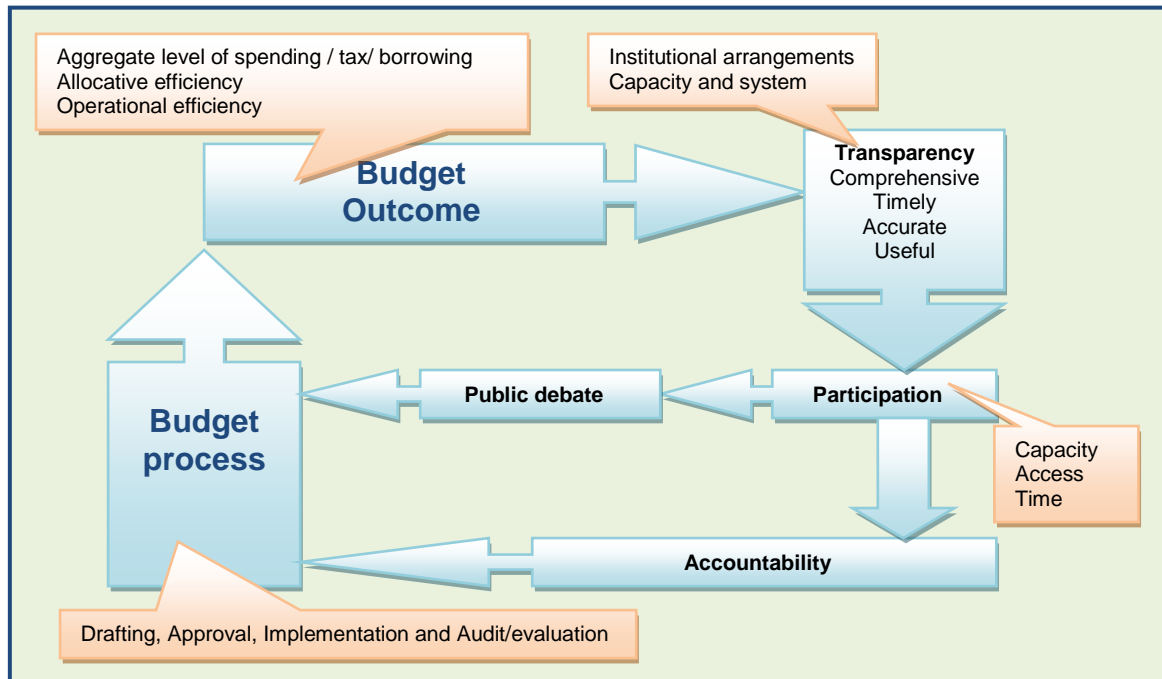
Figure 5.2: The budget process



Source: Adapted from Olander, S. (ed.) 2007. *Public financial management in development cooperation*. Stockholm: Sida. page 12.

The major actors in the public financial management system are the political executive for finance, government departments, institutions and entities in all spheres of government, and the legislative authority with its constitutional institutions such as the auditor-general and financial oversight committees. Fiscal transparency is important in a budget system for oversight, accountability, participation and sanction to ensure good economic practices. The requirements for successful fiscal transparency practices are political will and commitment; commitment to fight corruption; a strong legal framework and enforcement mechanisms and citizen participation. Figure 5.3 emphasises the relations that exist between the public financial management system and the budget process and highlights the fact that various role players in different relationships are key to successful budgeting and specifically the budget outcome and financial performance (Economic Commission for Africa, 2005a:6).

Figure 5.3: The budget process relations



Source: Adapted from Economic Commission for Africa. 2005. *Assessing public financial management and accountability in the context of budget transparency in Africa*. Addis Ababa: UNECA, page 6.

The primary concern for public financial performance management is the economic, efficient and effective utilisation of public resources in order to meet the needs of society in an equitable manner. According to Olander (2007:10), a budget that reflects all public resources available, is transparent and makes it possible to follow up how resources are actually being used, will contribute to good governance as efficiency increases and possibilities to misuse public resources are controlled. Well-structured information on the ways in which public resources have been used and the results that have been achieved will significantly strengthen the accountability process within the legislature and other public audit institutions. Transparent information will increase the legitimacy of the government's fiscal policy in the eyes of the citizens. Democratic governance is a prerequisite for the citizens to influence the state budget and ensure that the budget has a pro-poor profile. (Economic Commission for Africa, 2005:56).

### 5.3 Background and evolution of public financial management reforms

Research conducted by Pretorius & Pretorius (2008:4) found no evidence of any single event from where the need for public financial management reforms originated and the attribution of cause and effect would be hard to prove. However, there is a consensus that circumstances such as a fiscal crisis, political change, changes in public expectations and public pressure, post conflict, new technology, regional requirements and donor pressures have provided the impetus for change to enhance financial performance (Vani & Dorotinsky, 2008:2).

In general, public financial management reform has been a long-term process, which varies according to individual country or regional situations. Since the mid-fifties donor assistance for developing countries has become evident and continued during the late eighties. In order to enhance sustainable economic growth, management knowledge and skills became part of technical investments with assistance of public financial management issues high on the agenda of donor countries and organisations. Throughout the nineties, the majority of assistance was provided by donors to developing countries through isolated projects, and frequently included complex interventions such as medium-term expenditure frameworks (MTEF), performance budgeting, gender budgeting and integrated financial management information systems (IFMIS) (Vani & Dorotinsky 2008:2).

Since the start of the new millennium, the recognition of aid fungibility (exchangeable), greater acknowledgement of the negative effects of corruption and an increase in policy-based lending all led to an increased emphasis on governance issues including open and orderly public financial management systems. In 2005, government and donor commitment to improved public financial management systems was formalised in the Paris Declaration. Under the declaration, targets were established to strengthen governance and improve performance in public financial management (OECD, 2005/2008:1).

The Monterrey Conference also specifically called on development co-operation agencies to intensify their efforts to: “Harmonise their operational procedures at the highest standard so as to reduce transaction costs and make Official Development Assistance (ODA) disbursement and delivery more flexible, taking into account national development needs and objectives under the ownership of the recipient country” (OECD, 2003:3). One of the key factors that determine the willingness to



provide donor funding is whether the partner country has an effective public financial management reform programme in place and can provide evidence of financial performance (Pretorius & Pretorius, 2008:4).

#### **5.4 THEORETICAL MODELS AND APPROACHES TO PUBLIC FINANCIAL MANAGEMENT REFORM**

As analysed in Chapter 2, during the late 1960s and early 1970s, the new public administration surfaced as a reaction to various factors and the client-centred approach and service delivery became the focus of public administration. The models of reform in the new public administration, namely reinventing government, business process re-engineering and the new public management of the Organisation for Economic Co-operation and Development (OECD), all shaped the discipline and provided a framework for analysis of ideas and lessons learnt (Hood, 1995:104–117). Since the 1980s, physical evidence of this new approach was public-sector reforms in countries such as Britain and the United States to make government organisations more performance-based and customer oriented (Moe, 1994:111). Many countries around the world (developed and developing countries) started with the restructuring of public services, the application of various business management techniques to improve efficiency along with the introduction of market-based mechanisms and as indicated in Chapter 4, some influential international organisations, such as the World Bank, promoted these initiatives by reviewing its own approach to providing assistance to budget reforms and developed the public expenditure management (PEM) approach (Auriacombe, 1999:125-128).

By the beginning of 2000, both developing country governments and donor organisations began to question why public financial management interventions to improve expenditure management had only achieved limited success. The ensuing search for answers led to the development of methods to improve country ownership, establish a more realistic pace of change, enhance donor harmonisation and recognise the importance of political context (OECD, 2005/2008:1).

##### **5.4.1 New public financial management (NPFM)**

NPFM introduced not just a different way of managing public services, but also the need for different financial management tools and techniques. Introduced initially in response to widespread public criticism of the public service, the overall ethos of the

reforms is greater public-sector efficiency and, as Manning (2001:297) explains, has two key tenets: allowing managers to manage and making managers accountable.

The financial management measures associated with the introduction of the NPM model are often referred to as NPFM, a term that cannot be explained by a single application. Indeed Olson, Guthrie and Humphrey, (1998:2) describe it more as a reforming spirit aimed at increasing financial awareness in public-sector decision-making and therefore an integral part of the broader public service reforms. Guthrie, Humphrey, Jones and Olson (2005:37) identify five key dimensions of NPFM:

- 1) changes to financial reporting systems (cash to accrual);
- 2) devolution of budgets;
- 3) market-based costing and pricing systems;
- 4) a performance measurement approach; and
- 5) performance-based (internal and external) auditing.

In terms of the progress and impact of the overall NPFM reform process, Olson, Humphrey and Guthrie (2001:515-516) note that several authors have questioned the adequacy of the reform evaluations. This is somewhat ironic, given the emphasis on performance evaluation in NPFM itself. In a move to remedy this, the OECD's *Government at a Glance* publication is being developed to help governments monitor the progress of their reform agendas (Lonti & Woods, 2008:7).

What is clear from available literature on NPFM reforms in OECD countries is that social, political and organisational issues affect public-sector accounting and management, and influence the direction and speed of reforms. How things have progressed in northern Europe is different from southern Europe, in Sweden from the United States (Guthrie *et al.*, 2005:15). Newberry and Pallot (2005:27) conclude that while there has clearly been progress, initial expectations have not been met and some concerns have been raised about the increasing complexity of the financial management systems, actually reducing rather than enhancing political accountability and control.

#### 5.4.2 Concepts related to financial performance management

Research by Jantz (2008:6) indicates that performance measurement and performance management methods have been growing in importance since the

beginning of the 1990s, as public management in the age of new public management reforms has increasingly become oriented towards output management via contracts. Australia and New Zealand were pioneers as the first major countries to adopt this approach in response to the need to restore fiscal balance in the early 1980. In addition, the United Kingdom National Health System (NHS), some states in the United States and some public-sector entities in Canada introduced variations on this theme. There is evidence to suggest that this led to clear improvements in cost-effectiveness and budgetary control.

Given that resources in the public sector are mostly generated through taxes and taxes create distortions in the allocation of resources and thus constrain economic growth, it is essential that public expenditures are used to improve long-term growth perspectives and take equity considerations into account. Improved efficiency and effectiveness of public spending not only helps maintain the fiscal discipline, but also is instrumental in promoting structural reform agendas. It alleviates budget constraints as it allows achieving the same results at lower levels of spending or increases value for money by achieving better outcomes at the same level of spending (Mandl, Dierx & Ilzkovitz, 2008:2).

The Wikipedia Free Encyclopedia (2011) describes *performance* as a measure of the results achieved. *Performance improvement* is the concept of measuring the output of a particular process or procedure, then modifying the process or procedure in order to increase the output, increase efficiency, or increase the effectiveness of the process or procedure.

In Organisational Development, *performance improvement* is the concept of organisational change in which the managers and governing body of an organisation put into place and manage a programme which measures the current level of performance of the organisation and then generates ideas for modifying organisational behaviour and infrastructure, which are put into place in order to achieve a better level of output. The primary goals of organisational improvement are to improve organisational effectiveness and organisational efficiency in order to improve the ability of the organisation to deliver its goods and/or services and prosper in the marketplaces in which the organisation competes. A third area of improvement which is sometimes targeted for improvement is organisational efficacy, which involves the process of setting organisational goals and objectives (Van Thiel & Leeuw, 2002:268).

*Performance efficiency* is the ratio between effort expended and results achieved. The difference between current performance and the theoretical performance limit is the performance improvement zone. Another way to think of performance improvement is to see it as improvement in four potential areas:

- 1) the resource input requirements (goods and services e.g. reduced working capital, material, replacement/reorder time and set-up requirements);
- 2) the throughput requirements, often viewed as process efficiency; this is measured in terms of time, waste and resource utilisation;
- 3) output requirements, often viewed from a cost/price, quality, functionality perspective; and
- 4) outcome requirements, whether it made a difference in the end (Wikipedia, 2011).

Performance is an abstract concept and it should be represented in concrete, measurable phenomena or events in order to be measured. For example, baseball athlete performance is abstract, covering many different types of activities. Batting average is a concrete measure of a particular performance attribute for a particular game role, batting, for the game of baseball (Afonso, Schuknecht & Tanzi, 2003:6).

Performance assumes an actor of some kind but the actor could be an individual person or a group of people acting in concert. The performance platform is the infrastructure or devices used in the performance act. There are two main ways to improve performance:

- 1) improving the measured attribute by using the performance platform more effectively, or
- 2) improving the measured attribute by modifying the performance platform, which, in turn, allows a given level of use to be more effective in producing the desired output.

For instance, in several sports such as tennis and golf, there have been technological improvements in the apparatuses used in these sports. The improved apparatus, in turn, allows players to achieve better performance with no improvement in skill by purchasing new equipment. The apparatus, namely, the golf club and golf ball or the tennis racket, provides the player with a higher theoretical performance limit (Afonso *et al.*, 2003:7).

#### 5.4.3 Financial performance management challenges in public administration

Farrell (1957:11) already investigated the question of how to measure efficiency and highlighted its relevance for economic policy-makers. "*It is important to know how far a given industry can be expected to increase its output by simply increasing its efficiency, without absorbing further resources*" (Farrell, 1957:11). Since that time, techniques to measure efficiency have improved and investigations of efficiency have become more frequent, particularly in industry. Nevertheless, the measurement of efficiency and effectiveness of public spending remains a conceptual challenge. Problems arise because public spending has multiple objectives and because public-sector outputs are often not sold on the market, which implies that price data are not available and that the output cannot be quantified.

However, performance management, while becoming a standard topic in the reform agenda of many countries, has also come in for some tough criticism in recent years. On the one hand, critics say it creates bureaucratic complexity, but on the other, they assert performance management has pragmatic implementation difficulties in the public sector. One observer suggests that "*... most objectives in public management cannot be presented in precise figures, because they always emerge multi-dimensionally and frequently require compromise. Performance measurements, especially those provided by management ratio systems, tend to fall ruin to the myth of quantitative measurability*" (Bogumil, 2004:392).

*Performance management* in a public sector context refers to commissioning or oversight using performance-oriented objectives that are expressed in terms of defined activities (outputs). The core assumption is that policy-makers and deliverers learn from performance information and make continuously better decisions on the basis of empirical evidence, with performance in the public sector increasing accordingly.

The foundation of any performance measurement system is its definition of *performance*. Government programmes often have multi dimensional objectives, many of which are rather vaguely formulated. Furthermore, there are sometimes several different groups being targeted. As a result, articulating what 'good performance' is can be challenging. While it is relatively easy to determine both inputs (resources such as human resources, money, materials) and outputs (goods and services produced, deliverables), it is often less easy to determine the impact

that the outputs have on the desired high-level policy objectives (outcomes). A qualitative estimation is often required when the time comes to evaluate the effects of state programmes and policies in a society. This can be because there are many factors that government cannot influence, which may affect the outcomes. Or it may be that the causality linking outputs to outcomes is complicated and impacted by a number of different government outputs. It may also be that there is a long time lag between delivering the output and when its effect on outcomes becomes apparent or simply that the policy objectives are couched in such broad terms as to make measurement difficult (Hood, 2007:96).

It is important to differentiate between performance measurement and performance management. *Performance measurement* is to be understood here as the regular collection, recording and evaluation of performance data. Hood (2007:97-98) identifies two different performance measurement systems: target systems, which measure current performance of a period (using previously defined performance metrics); rankings, which measure current or past performance in relation to other comparable entities also known as benchmarking. The objective here is to inform customers about an entity's performance or to provide political decision-makers with starting points for increasing performance.

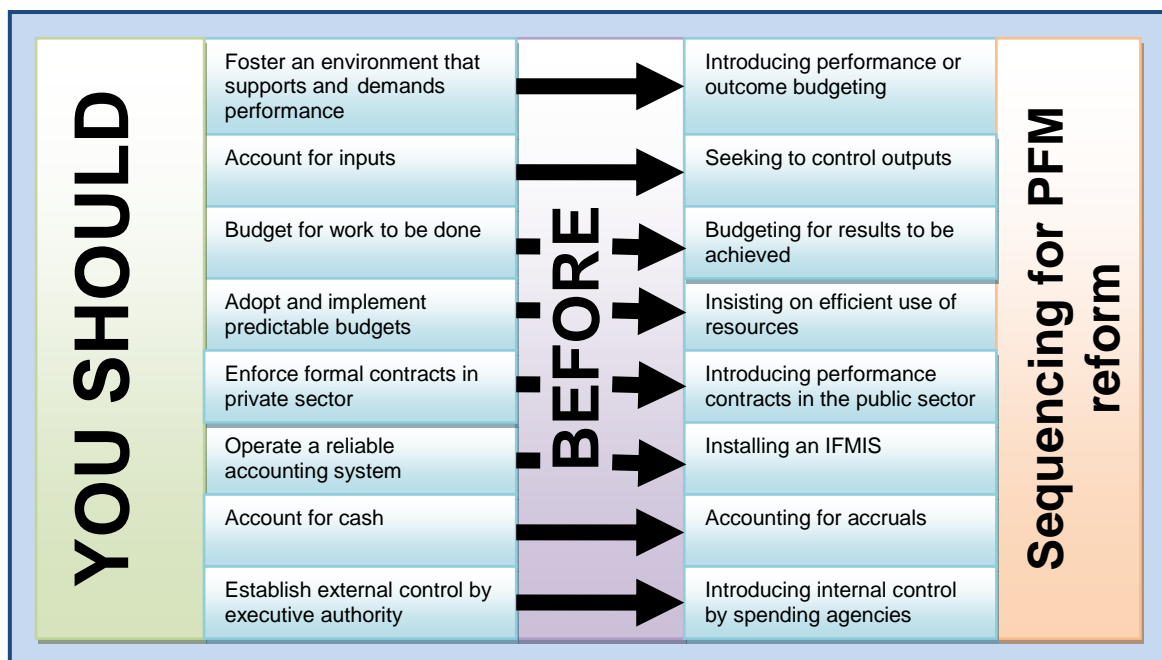
*Performance management*, on the other hand, is an integrated strategy with the goal of improving the performance of organisations and the individuals in them. Performance management therefore consists of systematic recording and tracking of performance of public organisations in order to promote a continuous improvement process. Due to the increasing challenge around funding public services, in addition to measuring and managing the quantity and quality of public-sector goods and services, much more emphasis is being brought to bear on measuring and managing the cost thereof (Manning, 2001:297).

Effectiveness relates the output to the final objectives to be achieved, i.e. the outcome. The outcome is often linked to welfare or growth objectives and therefore may be influenced by multiple factors (including outputs but also exogenous environment factors). The effectiveness is more difficult to assess than efficiency, since the outcome is influenced political choice. The distinction between output and outcome is often blurred and output and outcome are used in an interchangeable manner, even if the importance of the distinction between both concepts is recognised (Afonso *et al.*, 2003:8).

#### 5.4.4 A fundamental approach to public finance basics

“This philosophy appears simple: focus on the basics on which reform is built, not on particular techniques”, according to Pretorius and Pretorius (2008:9). Schick (1998a:21) argues that the lesson for developing countries from some of the radical reforms of OECD countries is to “get the basics right”. Figure 5.4 illustrates the issues that he considers important when sequencing reforms.

Figure 5.4: Getting the basics right



Source: Adapted from World Bank. 1998. *Public expenditure management handbook*. Washington: World Bank. page 8.

The emphasis of “getting the basics right” is based on a progressive approach and not a selection between variables. This approach is aligned with the public financial management system (Figure 5.1) as a series of realistic steps or platforms to accommodate multiple role players and to manage relationships. Each platform is defined in terms of improved outcomes and is the basis for launching the next stage. In dealing with the “you should” components as first priority, the basics, then the foundation or platform requirement for progress to the next component within the financial management system is ready. The result is a financial system that provides the opportunity for financial performance management.

Stevens (2004:4) asserts that ignorance for getting the basics right has led to the implementation of advanced solutions, which have often proved ineffective and inappropriate. In terms of budgetary outcomes, the argument is also that a government needs a realistic sustainable budget (aggregate fiscal discipline) before it can achieve the other objectives of allocative efficiency (doing the right things not merely doing things right) and operational efficiency (Schick, 1998a:2).

Based on the basic approach of what should happen before any advanced solutions could be found but with a more holistic approach to the public financial management reform process is the so-called platform approach. It aims to implement a package of measures or activities designed to achieve increasing levels (platforms) of public financial management and accountability competence over a manageable time frame. Each platform establishes a clear basis for launching to the next, based on the premise that a certain level of public financial management and accountability competence is required to enable further progress to take place. Each platform is defined in terms of improved outcomes (e.g. delivering a credible annual budget) rather than just focusing on the completion of individual short-term measures or activities (e.g. implementing a new chart of accounts). Defining the platforms in this way helps to provide strategic direction (DFID, 2005b:2).

The hypothesis behind the platform approach is that it can help facilitate genuine government leadership, a politically acceptable pace of change, donor harmonisation and greater levels of trust. These were all problems identified as the main reasons for lack of progress toward public financial management reforms. Once the platforms are defined, the approach then proposes a series of iterative steps to develop the action plan for that particular platform, including initial activities required for subsequent platforms (DFID, 2005b:3).

#### **5.4.5 The public expenditure management approach**

As discussed in Chapter 3, in order to perform the roles assigned to the state by its people, the state needs, among other things, to collect resources from the economy, in sufficient and appropriate manner; and allocate and use those resources responsively, efficiently and effectively. The reorientation from conventional budgeting to public expenditure management (PEM) has been driven by unsatisfactory public expenditure outcomes in many developing and developed countries. The problem is the allocation of public money through collective choice



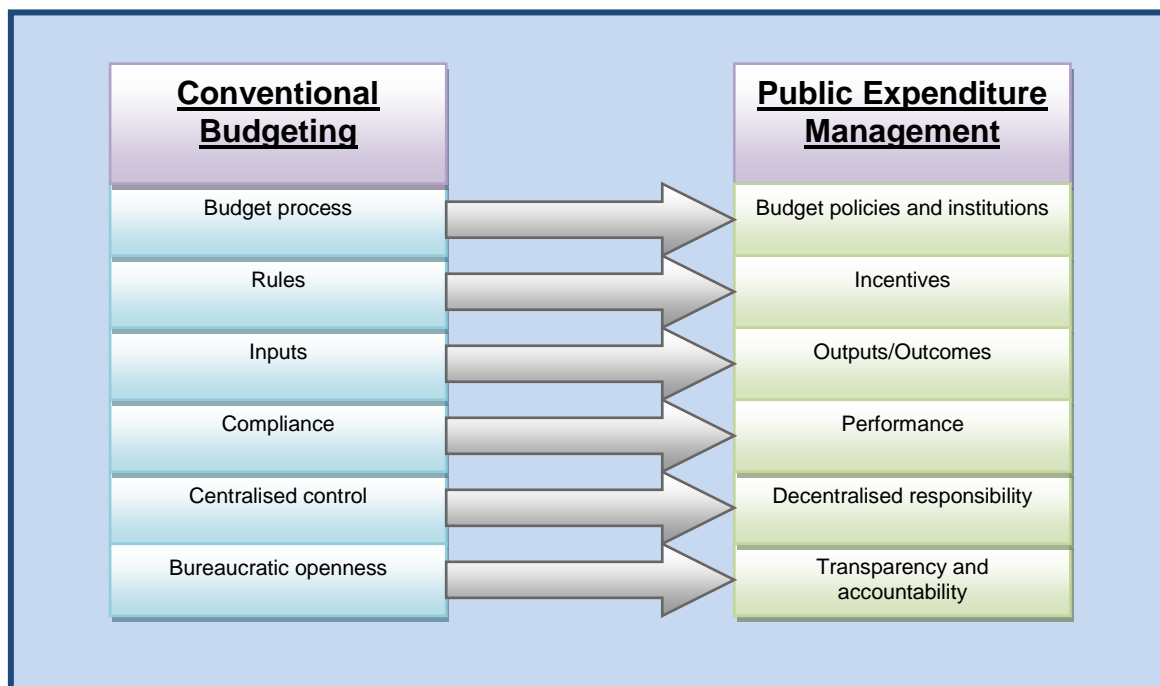
and where these allocations have been made through the machinery of budgeting. Governments generated the routines and procedures to decide the amounts spent, the balance between revenue and expenditure, and the allocation of funds among public activities and entities. PEM evolved from an emphasis on investment efficiency to substantive outcomes and a wider recognition of institutions and governance building (Schick, 1998a:1).

According to Schick (1998b:124), a PEM approach is country-specific and planned interventions must be based on the economic, social, administrative and implementation capacity realities of the specific country. A PEM approach recognises that budget outcomes are not likely to be optimal if the public sector is poorly structured and managed. Substantive outcomes relate to three key objectives of good public expenditure management as follows:

- 1) aggregate fiscal discipline (expenditure control), budget totals should be the result of explicit, enforced decisions; they should not merely accommodate spending demands. These totals should be set before individual spending decisions are made, and should be sustainable over the medium term and beyond;
- 2) allocative efficiency (strategic allocation), expenditures should be based on government policy priorities and on effectiveness of public programmes. The budget system should spur reallocation from lower to higher priorities and from less to more effective programmes; and
- 3) operational efficiency, good operational management to ensure both efficiency (minimising cost per unit of output) and effectiveness (achieving the outcome for which the output is intended) (Schick, 1998a:2).

Figure 5.5 illustrates the shift in focus from a conventional budgeting approach to a broader platform, which highlights the importance of the complex network of actors and institutions involved in the total budget process, and of linking expenditure with measurable results in terms of outputs and outcomes. In particular, the PEM approach focuses on incentives and the informal practices and behaviour of budgeting. Advocates of the approach emphasise that improvements in public expenditure management require changes in budgetary institutions, the roles of spenders and controllers, the rules under which they claim, allocate and use resources and the information available to them (Pretorius & Pretorius, 2008:9).

Figure 5.5: The PEM paradigm shift.



Source: Adapted from Pretorius, C. & Pretorius, N. 2008. A review of PFM reform literature. London: DFID. page 9.

All accountability must be for performance, but performance, is a relative and culture-specific concept. Government employees could be considered well-performing:

- 1) if they always stick to the letter of the rules in a system where rule compliance is the dominant goal;
- 2) if they account precisely for every cent of public money, in a system where protection of resources is the dominant goal;
- 3) if they obey without question a superior's instructions, in a strictly hierarchical system;
- 4) if they compete vigorously for individual influence and resources, in a system where such competition is viewed positively; and
- 5) if they co-operate harmoniously for group influence, in a system where conflict is discouraged.

Whenever the word *performance* is heard, the immediate question should be: In terms of what? It is essential to understand that administrative cultures are not inherently superior or inferior, and that they evolve in response to concrete problems and incentive structures. Even when an administrative culture has become badly dysfunctional, it is still necessary to understand its roots if one wish to improve it in a durable way.

*Performance* is the achievement of agreed results within the funding provided, without diluting their quality and respecting the prevailing norms of due process. In a PEM approach, performance should be assessed by reference to three objectives namely, expenditure control, strategic allocation and good operational management. The PEM approach and related performance focus attempt to bridge the gap between the traditional performance as “probity and propriety” and a new paradigm of “policy and performance”. The policy and performance approach is the appropriate model, but must be accompanied by respect for due process in order to be sustainable. A results orientation is necessary in PEM, but results must be properly defined, and an exclusive focus on results without consideration of process will not only destroy the process but eventually produce bad results as well.

Transparency of fiscal and financial information is essential for an informed legislature, executive, and the public at large. It is essential not only that information be provided, but that it be relevant and in understandable form. Accountability is needed both for the use of public money and for the results of spending it. Effective accountability has two components: The first component deals with answerability (the original meaning of the word *responsibility*) where it is the requirement to respond periodically to questions concerning where the money went and what was achieved with it. The second component is where there is a need for predictable and meaningful consequences because without consequences, *accountability* is only an empty and time-consuming formality. External accountability is needed as well and strengthening external accountability is especially necessary in the context of initiatives for greater decentralisation or managerial autonomy, when new checks and balances are required to assure that access to and quality of public services are not compromised as a result.

#### **5.4.6 Strengthened approach to public financial management reform**

Responding to the need to improve public financial management systems as a critical element for economic growth and development, several institutions came together in 2001 to form the Public Expenditure and Financial Accountability (PEFA) initiative. PEFA is a multi donor effort composed of the European Commission, the UK Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the World Bank, the International Monetary Fund and the Strategic Partnership with Africa (Public Expenditure and Financial Framework, 2005).

PEFA (2005) identifies the critical dimensions of an open and orderly public financial management system. They are budget comprehensiveness and transparency; policy-based budgeting; predictability and control in budget execution; accounting and reporting and external scrutiny and audit. The introduction of sound systems and procedures in these areas should lead to another dimension, namely budget credibility.

#### 5.4.6.1 **Budget comprehensiveness and transparency**

The United Nations Classification of the Functions of Government (COFOG) and Government Finance Statistics (GFS) manual provides guidance on the classification of government revenues, expenditures and functions (IMF, 2001:1). Conformity with these classifications facilitates the preparation of statistical reports and the macroeconomic analysis of fiscal data. Programme classification as the basis for programme budgeting is also used in many OECD countries and developing countries. Here, in contrast to economic and functional classifications, there is no guidance on its construction. Consequently, there are numerous variations, although many now restrict the scope of a programme to a single administrative unit, e.g. 'Health' rather than a programme, which is multi-institutional and for which there is therefore no clear line of responsibility (Diamond, 2003:12).

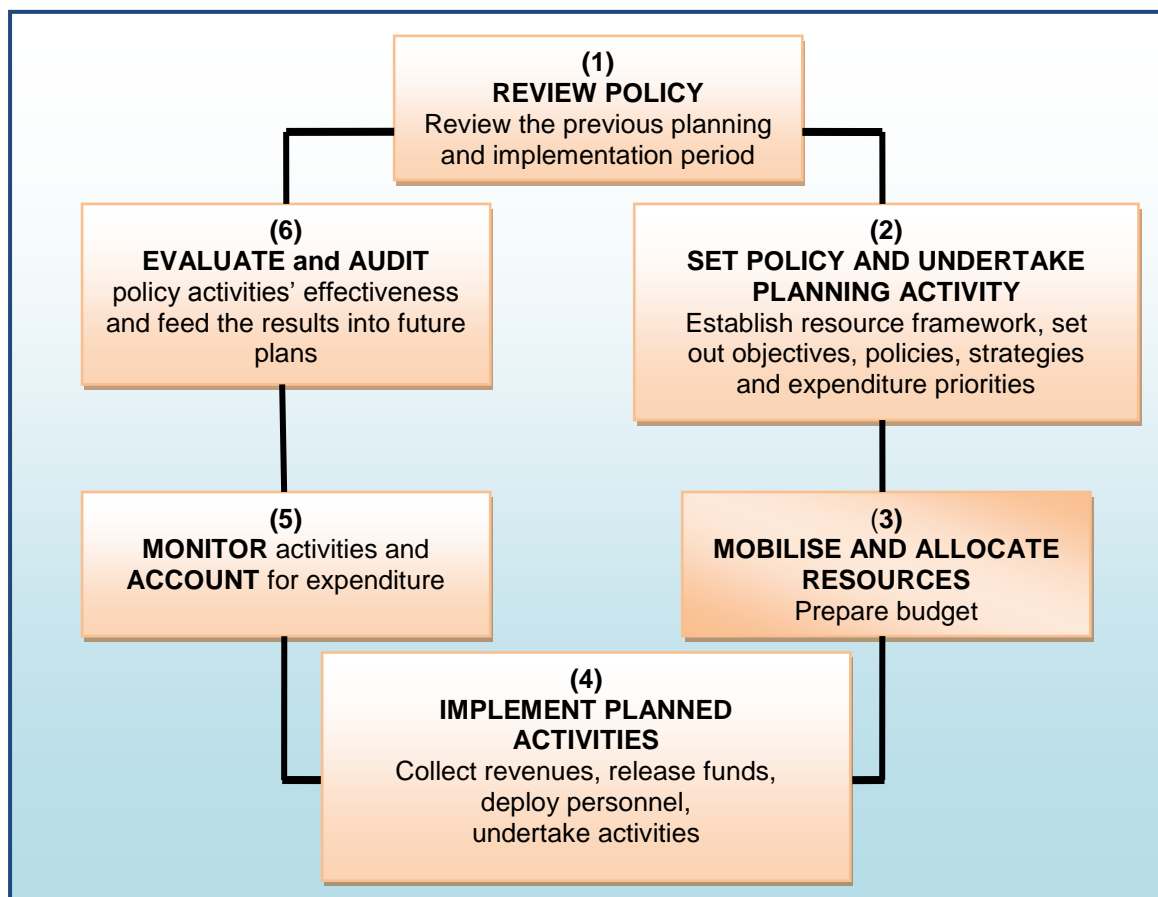
Improving the information base for budget reporting and budget management purposes has been a core part of the South African Public Financial Management Reform Programme (PFMRP). Success is attributed to a number of factors, namely phased implementation approach; comprehensive communication strategy and close monitoring of implementation and compliance. However, the main reason given for the successful implementation of the new budget classification system (Economic Reporting Format and SCOA) is that it is part of a strategy to make public finances more accountable, transparent and better targeted (CABRI, 2005:63).

There seems to be no evidence that improvements in budget classification, to meet international standards have also led to improvements in budget reporting for either management or public use. Indeed, results from the International Budget Project (IBP) open budget questionnaire show that the weakest scores in terms of public accessibility to budget information relate to the fact that most governments fail to provide user-friendly information to the legislature (Gomez, Friedman & Shapiro, 2004:35).

#### 5.4.6.2 Policy-based budgeting

A government budget (budget vote) should reflect what it says it will do (government policies). A medium-term perspective (see Figure 5.6) is crucial for improving links between policy, planning and budgeting (World Bank, 1998:32). According to Holmes and Evans (2003:5), the appeal of MTEFs lies in their potential to link the often competing short-term imperatives of macroeconomic stabilisation with the medium- and longer-term demands on the budget to contribute to improved policy-making and planning, and to the efficiency and effectiveness of service delivery. As an integral part of the annual budget process, the World Bank (1998: 48) describes an MTEF as consisting of a top-down resource envelope, a bottom-up estimation of the current and medium-term costs of existing policy and ultimately, the matching of these costs with available resources.

Figure 5.6: Linking policy, planning and budgeting in the planning and resource management cycle



Source: Adapted from World Bank. 1998. *Public expenditure management handbook*. Washington: World Bank. page 32.

Figure 5.6 highlights the institutional mechanisms that facilitate the allocation of resources to achieve strategic objectives. Affordability must influence policy-making and planning at the point when the decision is made. Where adjustment is required to deal with changing macroeconomic conditions and even more particularly, changing priorities, that adjustment needs to take place through policy change to be sustainable. A medium-term approach that encompasses all expenditure provides a linking framework and facilitates the management of policies and budget realities to reduce pressure throughout the whole budget cycle. The result is better monitoring and control of activities and account for expenditure towards efficiency and effectiveness in implementing policies, programmes and projects (World Bank, 1998:32).

A key reform in budgeting is the move from an emphasis on inputs to a focus on performance, outcomes or results. The OECD (2008c:2) defines *performance budgeting* as budgeting that links the funds allocated to measurable results. The concept of performance budgeting has a long history. During the fifties and sixties, the terms *performance budgeting*, *programme budgeting* and *planning, programming*, and *budgeting systems* were first used, and to a certain degree practised, in the United States. It is an integral element of NPFM, but there is no single model and many countries have introduced performance budgeting for different reasons and in different ways. The main objectives of improving the allocation and use of funds, enhancing public-sector performance and improving accountability are common across all countries. Currently, there is a need to customise the approach to the country context, design reforms with the end-user in mind, involve key stakeholders in the design process and develop appropriate incentive systems for civil servants and politicians. For implementation, it is important to select an approach appropriate to the wider governance and institutional structures, gain the support of political and administrative leaders, have information systems that communicate with each other, consider how changes to budget rules influence behaviour, positively or negatively and recognise the limitations of performance information (OECD, 2008c:5-6).

Although there are exceptions, most OECD governments are finding it difficult to provide decision-makers with good quality, credible and relevant information in a timely manner, let alone incentives to use this information in budgetary decisions. (OECD 2008c:7). Diamond (2003:11) highlights four major features as prerequisites for performance budgeting: setting the programme structure in a wider strategic

planning and medium-term budget framework; redesigning the existing programme structures to ensure accountability; improving the budget-costing systems and associated skills; and introducing a new system of accountability and budget incentives.

#### **5.4.6.3 Predictability and control in budget execution**

Effective internal controls are essential for the integrity of the overall public financial management system. The International Organisation of Supreme Audit Institutions (INTOSAI) prepared technical guidelines on internal controls standards in 1992 and these were revised in 2004. These guidelines set out a framework for internal controls including the objectives and five main components of internal control, which are the control environment, risk assessment, control activities, information and communication and monitoring. Importantly, the guidelines stress that all personnel in an organisation play an important role in making internal control work (INTOSAI, 2004:2).

Reforms in developing countries have tended to concentrate on control activities, particularly the introduction of automated expenditure commitment controls. The overall control environment (elements of the control environment include personal and professional integrity, commitment to competence, management style, organisational structure and human resource policies and practices) has also received only limited attention (Dorotinsky & Pradhan, 2007:267).

Internal audit (IA) receives significantly more attention, both in the literature and in reform efforts. In the UK and northern Europe, reforms have mirrored the changes in managerial accountability. Over the last 30 years, IA has been reorganised from a 'turn and tick' to a system-based approach, providing management with advice and assurance (Diamond, 2002b:11). For developing countries, there is considerable debate as to the most appropriate structure and functions; some argue that there is still a need for a centralised function with a continuing role in compliance and regularity (Diamond 2002b:18; Hepworth, 2004:2). Others, although recognising the time and indeed the change in culture required, still argue that a more independent system-based audit is the way forward (Rameesh, 2003:6; Van Gansberghe 2005:14).

Although internal audit is recognised as an important function in the ‘fight’ against corruption, there appears to be comparatively limited research on how effective follow-up of recommendations can be achieved. However, experience in South Africa and Kenya suggests that internal audit achieves better results when working together with management rather than in a more confrontational or policing role (Van Gansberghe, 2005:8).

#### 5.4.6.4 Accounting and reporting

The importance of timely, consistent and comprehensive reports is emphasised in public financial management reform literature, and efforts to improve consistency and comparability have been made through the introduction of the International Public Sector Accounting Standards (IPSAS). The academic debate on the advantages and disadvantages of accrual accounting (and budgeting) continues. OECD experience shows that the move from cash to accrual accounting needs careful planning and should be part of wider public-sector reforms: “Consolidated year-end financial statements ... are critical for transparency in the PFM system” (Public Expenditure and Financial Framework, 2005:45). Statements need to be understandable and provide information in a consistent manner. In the last 12 years, the Public Sector Committee of the International Federation of Accountants (IFAC) has established a set of public-sector accounting standards for general purpose financial statements (GPFs), prepared on either a cash or accrual basis.

In the context of NPM reforms, with their emphasis on performance, a need was identified to introduce the accrual basis in order to “encompass accounting and reporting on the allocation and use of total economic resources (both cash and non-cash) at the disposal of managers” (OECD, 1993:3). However, Diamond (2002a:27) is of the opinion that accounting serves rather than leads budget systems reform and he rejects any assumption that performance budgeting requires accrual accounting. The OECD (2002a:1) argues that accrual accounting cannot be introduced successfully without accrual budgeting. “*More recently, led primarily by the international agencies, such as the OECD, the IMF, and the World Bank, and by some international accounting bodies, such as the IFAC, countries have been strongly encouraged to adopt the accounting system generally used by the private sector: accrual accounting*” (Boothe, 2007:181). However, even after almost two decades, the question remains whether the accounting needs of the public sector, which revolve around democratic accountability, are well served by private sector-



based accounting that revolves around financial performance and profitability, according to Boothe (2007:183).

What appears to be lost in some of these arguments is that cash accounting and accrual accounting is not mutually exclusive concepts, but rather opposite ends of a spectrum. Accrual accounting is a means not an end in itself. Moving along the spectrum can be done gradually (Allen & Tomassi, 2001:26). Currently, only one third of OECD countries have adopted full accrual accounting, either for the whole of government accounts or at ministry or agency level. Important lessons from the introduction of accrual accounting in OECD countries are that the transition is not just a technical exercise, it requires a culture change and needs to link with wider public-sector management reforms. The phasing of implementation needs to be carefully planned and there is a need for enhanced accountancy skills and appropriate IT systems. Finally, the importance of communication, particularly with users such as parliamentarians, media and the public should not be overlooked (OECD, 2002:9).

The essential purpose of a financial reporting system is to demonstrate how the government has managed its financial resources in terms of revenues, expenditures and assets and liabilities. An effective budget reporting system will report on budget integrity, operating performance, stewardship and systems and control. Reports are an important instrument for planning and policy formulation and are based on principles such as completeness, legitimacy, user-friendliness, reliability, relevance, consistency, timeliness, comparability and usefulness (Allen & Tommasi, 2001:318).

#### **5.4.6.5 External audit and legislative scrutiny**

Supreme audit institutions (SAI) have a vital role in holding government to account and ensuring transparency in government operations. Although there are differing models for external audit (Westminster model – UK and most commonwealth countries; judicial model – Latin countries in Europe and francophone countries; board or collegiate model – Germany, the Netherlands, Indonesia, Japan and Korea), all models are guided by the fundamental objectives set out in the Lima Declaration, and the international standards of auditing developed by INTOSAI. In response to the growing performance orientation of the public sector, performance (or value for money) auditing is widespread in Europe, Australia, New Zealand and North America and developing elsewhere. There is also a growing emphasis on the central position

of SAIs in their countries' national integrity systems and their role in detecting and reporting on corruption and fraudulent practices (Dye & Stapenhurst, 1998:10).

According to the DFID (2005:2), recent research shows that reform techniques such as peer reviews, twinning arrangements, development of technical training capacity and contact committees appear to be succeeding in both accession and developing countries. EU accession countries frequently request peer reviews. Twinning arrangements are also proving to be effective.

With regard to legislative scrutiny, even as far back as the 14th century, the English Parliament had some power over the purse, when it was ruled that no taxes could be raised from citizens without parliamentary consent, and commissioners were appointed to audit tax collectors. In most countries, the budgetary role of the legislature is both *ex ante* (approval of the budget and/or change) and *ex post* (oversight). The particular emphasis varies. Some research suggests that parliaments in a Westminster-type system focus on a strong *ex post* review, primarily done through the public accounts committee (PAC). On the other hand, legislatures in presidential systems, such as those of the US and France, focus on strong *ex ante* review of budgetary control and resource allocation. The role of legislatures in semi-presidential systems varies within this spectrum (Stapenhurst, 2004:1-6).

## 5.5 CROSS-CUTTING ISSUES

Legislation, automated systems, gender issues, training and change management cut across all the public financial management components discussed above. The legal basis for national budget systems varies considerably among OECD countries. In developing countries, automated systems, particularly integrated financial management information systems (IFMIS) have become synonymous with public financial management reform, even seen by some as drivers of reform. They are often considered as the answer to the problems of a lack of reliable and timely data and poor financial controls. Gender-responsive budgets (GRB) involve analysing and reordering budgetary priorities from a gender perspective. GRB is not about having separate budgets for women or men or about budgets being divided equally (DFID, 2005:2).

## 5.6 PUBLIC FINANCIAL MANAGEMENT REFORM – PUTTING THE THEORY INTO PRACTICE

Polidano (2001:10) argues that most reforms fail not because of the contents or technical aspects of the reform programmes, but because of the way they were implemented. Public financial management reform programmes need to be country-specific as they cannot be divorced from their historical, political and social heritage (Schick, 1998b:124). Schiavo-Campo & Tommasi (1999:22) support this notion and they are sceptical about the rigid application of 'best practices' without consideration of local and country-specific realities. Colonial history has often established the foundations of the PFM system. According to Bouley, Fournel & Leruth, (2002:12) traditional approaches have failed to produce sound, efficient and effective systems of resource mobilisation, budgeting and financial management. Prior to 1994, South African government financial processes were controlled by centrally prescribed bureaucratic rules, which allowed little scope for managerial discretion, and even mundane issues had to be referred for central approval. This was, in fact, financial administration, regulating how money was used to 'buy' inputs, and diverting attention from the delivery of the outputs that the inputs were intended to achieve. This approach did not clearly define responsibilities, and resulted in poor accountability and value for money.

In 1999, the Public Finance Management Act (1/1999) was enabled in the South African Government to introduce the approach of management for results instead of managing for compliance and to enhance accountability. Some characteristics of this approach are the following:

- 1) accounting officers (departmental heads) are to account for resources allocated and to improve economy, efficiency and effectiveness in public service organisations based on performance standards;
- 2) effective alignment of strategic and operational planning and budgeting processes;
- 3) central instructions are reduced to the minimum and replaced with guidelines and regulations;
- 4) accounting officers are allowed flexibility in the utilisation of resources focusing on outputs and outcomes;
- 5) appropriate internal control and risk management principles are followed; and

- 6) accounting practices similar to that employed in the private sector are being followed (i.e. accrual accounting, capitalisation of fixed assets and depreciation) (National Treasury, Guide for Accounting Officers, 2000:1-5).

In practice and as illustrated in Figure 5.1, an effective PFM system is critically important in achieving the strategic goals and objectives of government and requires a series of realistic platforms to accommodate multiple role players and to manage relationships. At the core of the PFM system is the budget process, which starts with the preparation of a comprehensive medium-term strategic framework (MTSF), which reflects the political priorities. Figure 5.3 emphasises the relations that exist between the public financial management system and the budget process and highlights the fact that for successful budgeting and specifically, the budget outcome and financial performance, various role players in different relationships are in constant interaction. Interaction is to be based on the concept of getting the basics right as illustrated in Figure 5.4 and is also aligned with the public financial management system as a series of realistic platforms to accommodate the multiple role players. The result is a financial system that provides the opportunity for financial performance management.

PEM application requires a country-specific approach based on the economic, social, administrative and implementation capacity realities of the specific country. Effective and optimal budget outcomes are the result of proper structured and well-managed administrations. The key objectives of expenditure control, strategic allocation and operational efficiency provide for substantive outcomes (Schick, 1998a:2).

Figure 5.6 highlights the planning and resource management cycle with the emphasis on financial performance management opportunities in the various institutional mechanisms. The result is better monitoring and control of activities and accounts for expenditure towards efficiency and effectiveness in implementing policies, programmes and projects (World Bank, 1998:32).

## 5.7 CAPACITY DEVELOPMENT

The United Nations Development Programme (UNDP) defines capacity as “the ability of people, institutions and societies to perform functions, solve problems, and set and achieve objectives” (UNDP, 2002:2). The strengthened approach to public financial management reform emphasises the importance of moving from diagnosis to implementation and in particular developing a public financial management capacity.

There is general agreement that capacity development should take place at individual, organisational and institutional level. Olander (2007:76) describes four interrelated elements that need to be considered when assessing and developing public financial management capacity (see Table 5.7).

Table 5.7: Public financial management capacity assessment

<b>PFM Assessment Issues</b>			
Management	Resources	Institutional Framework	Support Structures
<ul style="list-style-type: none"> <li>• Leadership - political will and strategic direction</li> <li>• Operations management – improving service delivery outputs</li> <li>• Change management – management PFM reform</li> </ul>	<ul style="list-style-type: none"> <li>• Staff – quantity and quality</li> <li>• Finances – timely and adequate resources</li> <li>• Equipment and facilities – IT, telecom and infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>• Culture – values and norms</li> <li>• Procedures – administrative rules</li> <li>• Legislation – mandate, role and responsibilities</li> </ul>	<ul style="list-style-type: none"> <li>• Education – supply of PFM professionals</li> <li>• Training – skills development</li> <li>• Consulting – role of consultants</li> </ul>

Source: Adapted from Olander, S. (ed.) 2007. *Public finance management in development co-operation*. Stockholm: Sida. page 102.

The first element, management, consists of leadership and political will, operational management and change management of the public financial management reform programme. The second element deals with resources and includes the quantity and quality of staff, adequate and timely financial resources, equipment and facilities. The third element, institutional framework, takes account of legislation, procedures and organisational culture. The final element relates to support structures such as the role of tertiary education institutions and professional bodies, the upgrading of skills through training and the role of consultants (Olander, 2007:79).

### 5.7.1 Management

In terms of management and leadership capacity, AusAID (2004:6) stresses the importance of clear partner leadership and ownership in the successful implementation of financial reform projects in Samoa. An evaluation of several public financial management programmes in the South Pacific also highlights the link between the programmes' success, and the existence of a clear organisational vision, tied to an overall national reform plan. Some evaluations identify a lack of technical capacity as a constraint on public financial management reform, but the

influence of general management capacity on public financial management reform does not appear to have been studied. Similarly, little evidence was found of governments or donors using explicit managerial coaching. According to Skiffington & Zeus (2003), coaching involves a structured mentor-based process, which includes examining values and motivation, setting measurable goals, defining action plans and using behavioural change management tools and techniques to assist the development of individual or group competencies.

### 5.7.2 Resources

The key constraint in this area is the quantity and quality of the staff. Many assessments identify a lack of economic and accountancy skills in most institutions, as a major problem in public financial management reforms. Clearly, the personnel issue of recruitment and retention of staff highlights the link between financial management and personnel management reforms. In external audit reforms, the need for operational independence, in both financial and personnel management, is also frequently raised (Olander, 2007:77).

Although limitations in resources for the funding of reforms are central themes for discussion, sustainability of the reforms is the more critical issue. As Diamond & Khemani (2005:24) note, “it should be recognized that there are recurrent costs associated with the maintenance and operation of major financial management information systems that must be covered in budgets and that often are not considered”. Other authors cite technological constraints, e.g. reliability of internet provision, as constraints on the adoption of some types of reforms such as e-procurement (Soreide, 2002:39). Regardless of the level of funding, commitment or technical expertise of the donor agency, investments in capacity development have rarely proved significant or sustainable without national champions for reform (OECD, 2006). Hunja (2001:22) also notes that money alone does not buy real reform.

### 5.7.3 Institutional framework

The World Bank (2005) refer to the impact of an organisation’s culture, the degree of competition, co-operation and information sharing on public financial management reform and the need to improve ethical norms at institutional and organisational level. Lack of compliance with the formal rules of the game is sometimes attributed to

vested interests and informal practices which undermine the system; however, Haller and Shore (2005:22) point out that people may not always attach the same meaning to a particular concept, e.g. gift giving in Kazakhstan. Similarly, in an accountability study in Tanzania, Lawson & Rakner (2005:28) found that “members of parliament are largely judged by voters according to their ability to bring the goods home. As a result, members of parliament see themselves as accountable for providing tangible benefits to their constituencies”.

The importance of understanding different cultural perspectives in implementing reforms, and how cultural values help shape people’s behaviour, is well documented in general management literature. In public financial management reform literature, Andersson & Isaksen (2003:44) ask whether culture is ignored in practice, because it is not regarded as important or whether it is too difficult or threatening to study.

#### 5.7.4 Support structures

Support for public financial management reform in developing countries is provided at a number of levels. Support for national, regional and sub-regional organisations, e.g. the Eastern and Southern African Association of Accountant Generals (ESAAAG), has proved effective in improving capacity and sharing knowledge (Andersson & Isaksen, 2003:43). In South Africa, the Institute of Public Finance and Auditing (IPFA) has established professional training schemes for public-sector accountants. The OECD (2008b:22) notes: “South-South knowledge sharing is increasingly proving useful in addressing the similar problems faced by countries at similar stages of development.” Communities of practice such as the Public Expenditure Management Peer Assisted Learning (PEMPAL) group in Eastern Europe and the Collaborative Africa Budget Reform Initiative (CABRI) have been established to share experience on reform programmes.

The comparative effectiveness of various forms of training (e.g. workshop, on-the-job training, mentoring) on the success of public financial management reforms does not appear to have been studied. Although it is worth noting that, as part of their evaluation of their assistance in the South Pacific, the AusAID (2004:6) evaluation did find that on-the-job training was the most effective in all three countries visited, and well regarded by senior managers and project teams for the results achieved. More generally, a lack of proper training strategies in the civil service is cited as a constraint on public financial management reforms (World Bank, 2005:4).

Capacity is important and goes hand in hand with accountability and responsiveness. Too often citizens have little or no influence over the way services are delivered, and this needs to change if service providers are to become more accountable. To be responsive to the rights of poor people, a state needs the capacity and political motivation to assess citizens' demands and prioritise actions (DFID, 2007:29).

## 5.8 Service delivery and public financial management reform

Recent literature has highlighted the link between effective public financial management systems and poverty reduction. Weaknesses in public financial management affect efficient service delivery, as illustrated in several public expenditure tracking surveys (PETS), and many sector public expenditure reviews (PERs) show that funds do not always flow as intended.

A sound public financial management system is crucial for the sustainable and successful implementation of a poverty reduction strategy, and indeed the general provision of public services. In developing countries, changes in sector policies and management, especially in the social sectors (health and education) and infrastructure, are regarded as core contributions to poverty reduction and reaching the Millennium Development Goals (MDG). However, the perspective and focus on public financial management of the central ministries, particularly the ministries of finance and planning are different from those of the line ministries. In public financial management reform programmes, led by the minister of finance the needs of the line ministries to achieve quality and efficiency in spending within and across programmes and to combine financial and non-financial information, seem to receive less attention than the need to control overall government spending and to improve allocative efficiency (Witt & Müller 2006:30).

From an overall sector perspective, the situation is complicated by the actual provision of services at various levels of government. Sector-wide approaches (SWAs) are becoming commonplace in many developing countries, particularly those that are heavily aid dependent. From an allocative efficiency perspective, the development of sector expenditure frameworks (SEF) and sector working groups (SWG) is seen as an important component of MTEF implementation (DFID, 2007:30) Yet there appears to be little evaluation of whether sector (e.g. education reform programmes) and public financial management reform programmes are mutually reinforcing or the reverse. In designing an IFMIS, for example, "it is important that it



cater to management needs not just those of the central agencies, but also line agencies...[and] also to support those needs that are likely to arise as parallel budget reforms are implemented” (Diamond & Khemani, 2005:4). The fact that PETS are required because of limited information on resources received at service delivery level, might suggest that this is not always the case. Similarly, the inclusion of a national auditing function in sector groups could be contrary to their legal independence from the national budgeting system.

## 5.9 CONCLUSION

There is no universally agreed definition of public financial management. Definitions range from the narrow focus on the downstream activities of the budget process to a system of complex relationships, numerous role players and multiple dynamic processes. There is a realisation that PFM sub-systems are interconnected, so that changing one affects another.

In terms of PFM, financial performance management is an integrated strategy with the goal of improving the performance of public service organisations. An effective PFM system is critically important in achieving the strategic goals and objectives of government in the most economic, efficient and effective way. Therefore, international reform initiatives to enhance public financial performance management emphasise the establishment of a series of performance platforms to accommodate multiple role players and to manage relationships. For optimal financial performance, the performance platform must be used more effectively or the performance platform must be modified.

Due to the unique country-specific and changing nature of the public financial management environment, future financial performance will rely on concepts that exceed the conventional boundaries of public administration. The concepts of the future role of government as it has evolved over time illustrate (Figure 3.2) the role of governance as the ideal platform to deal with the current environmental realities and the need for financial performance management. The concept of *stewardship* centrally placed on the firm basis of governance provides the opportunity for the application of public financial performance improvement in the four areas of resource input requirements, process efficiency, output requirements and outcome requirements.

The performance platform allows for an interactive relationship between the public financial management system and the budget process to be facilitated by various role players in different relationships. Interaction is based on the concept of getting the basics right and is also aligned with the public financial management system as a series of realistic platforms to accommodate the multiple role players. The result is a financial system that provides the opportunity for financial performance management and effective and optimal budget outcomes.

The importance of sound PFM systems to enhance service delivery, poverty reduction and the achievement of the development goals is highlighted. In developing capacity, the new guidance is to build on existing capacity and not to impose external solutions. A lack of professional and managerial skills, as a serious constraint on PFM reform, is evident. Peer groups and regional affiliations are becoming increasingly popular. The next chapter analyses the public-sector financial performance management situation in the South African Government environment.