



A Strengthened Approach to moving Public Financial Management reforms forward

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INTRODUCTION

Effective Public Financial Management (PFM) systems are crucial to countries making progress in reducing poverty. This connection - between PFM systems and poverty reduction - was given added attention with the introduction several years ago of the HIPC¹ debt relief initiative.

Most reform programs of developing countries recognize that sound PFM supports aggregate control, prioritization, accountability, transparency and efficiency in the management of public resources and delivery of services. These resources and services are critical to the achievement of public policy objectives, including achievement of the Millennium Development Goals (MDGs)². In addition, sound PFM systems are fundamental to the effective and appropriate use of donor assistance, since aid is increasingly provided through channels that rely on well-functioning systems for budget development, execution and control.

A decade of intensive diagnostic and analytic work undertaken by donor agencies and individual countries has generated a vast body of information and knowledge on the operation of PFM systems throughout the world. The diagnostic work has been undertaken to support the development of current PFM reform programs worldwide and also to meet the need of donors for information with which to assess fiduciary risks, take informed decisions about aid modalities, and to design appropriate safeguard measures.

Despite the diagnostic work done and the existence of PFM reform programs, actual progress in improving PFM performance has been limited. The reasons for this include the following:

- Duplication of effort by donors, and lack of coordination between donors has led to a heavy burden being placed on partner governments;
- More focus has been placed on diagnostics, and less on supporting the implementation of PFM reforms;
- With the exception of the HIPC benchmarks, it has been difficult to determine the extent of improvement in a country's PFM performance over time;
- Unhelpful donor practices: diagnostic instruments have often been deployed in response to donor timelines and schedules, not those of the recipient governments;
- Sequencing of reforms has been inadequate due to donor pressure or to the governments' difficulties in determining

the path of reforms;

- Fragmented approach to reforms, capacity constraints and limited leadership within government;
- Technical reform has been at variance with systemic/institutional change;
- The increasing use of budget support that has given rise to an entirely new set of ad hoc fiduciary evaluations and analyses that have in turn burdened country officials and have threatened to create another source of conflicting policy recommendations, conditionalities and advice.

As a result, problems now exist not in the absence of reform programs but in their proliferation. Each plan is supported by a web of preconditions unique to the demands of its donors, and carries its own related technical support, amidst a tangle of conflicting claims to legitimacy and country ownership. In many countries it has not been unusual to find five or more different action plans in various stages of implementation, all designed to enhance the same PFM system.

While countries have increasingly spoken about achieving results, until recently there has not been a consistent framework within which the recipient countries and their donors could evaluate the workings of their systems, or to measure the improved performance. In short, there was a need for a common platform to encourage dialogue between government and donors, and amongst donors, that would assist in managing the developmental and fiduciary dimensions of PFM reform.

NATURE AND FEATURES OF THE STRENGTHENED APPROACH

Over time a number of principles have emerged that embody good practice in PFM work and guide international support for development. These principles have been incorporated in the so-called *Strengthened Approach*, which has been developed by the World Bank and the IMF together with the Public Expenditure and Financial Accountability (PEFA)³ program, and in consultation with the OECD-DAC Joint Venture on PFM. It proposes a flexible approach to building constructive partnerships among countries and donors, and is focused on delivering effective results at grass roots level. Building upon lessons learned from and good practices derived from recent and current projects, the Strengthened Approach has three components:

A country-led agenda comprising a country-led PFM reform strategy and an action plan.

The starting point for PFM reform is a home-grown, country-owned program of reform, and a country-owned structure for managing the reform process. The Monterey Summit of 2002 emphasized the principle that each country has the primary responsibility for its own economic and social development. Country ownership and leadership are critical to successful reform - donors can support these efforts but they are not a sub-

stitute for government leadership, and should not undermine domestic accountability arrangements. This principle is also emphasized and supported by the indicators of success as agreed upon by the Paris Declaration⁴. In developing a country-led PFM reform program, the most important consideration for all stakeholders is that the program builds from the country's current circumstances and capacities.

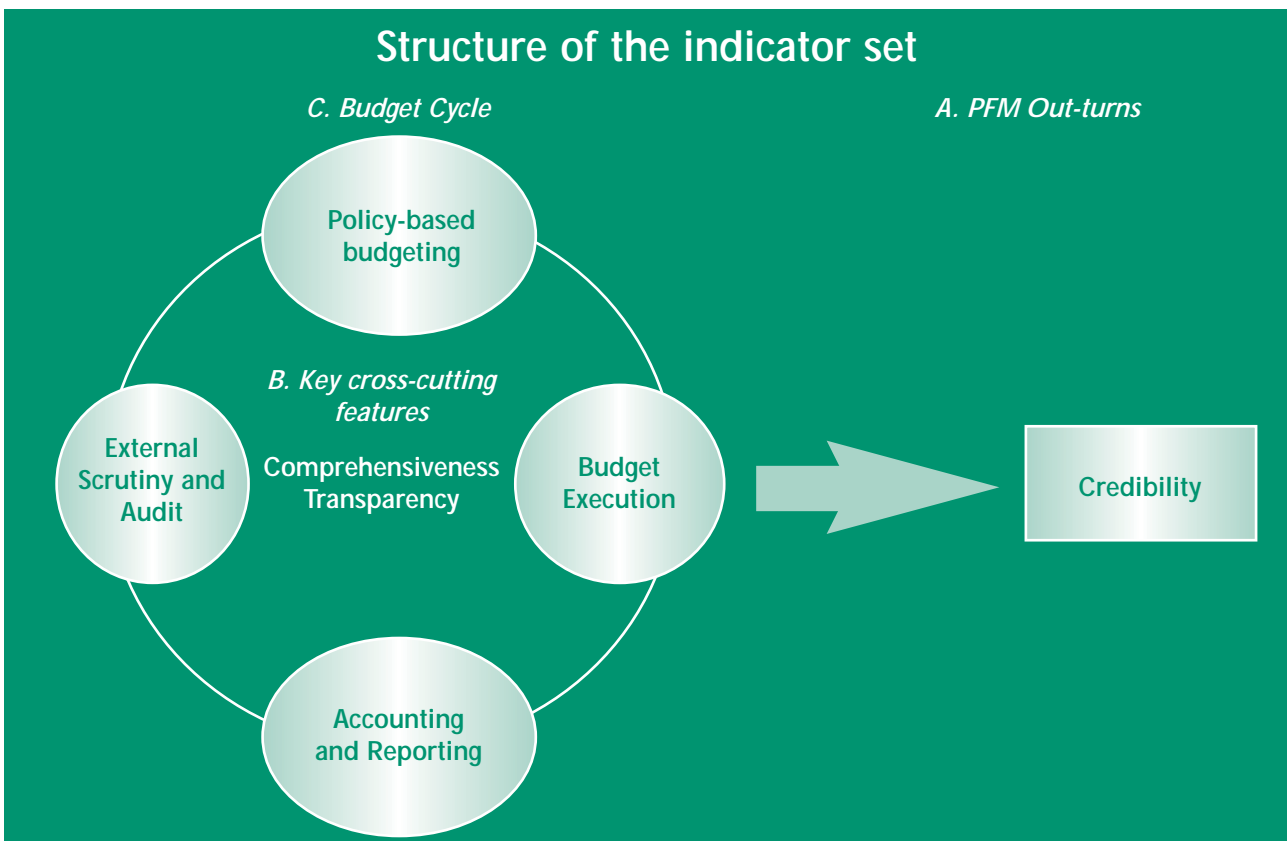
A coordinated program of support, comprising a coordinated, integrated, multi-year donor program of PFM work that provides support for, and is aligned with the government's PFM strategy.

Regardless of the number of donors involved in PFM reforms in a country, donor coordination remains important. Donor support will include assistance for diagnosis, development of feasible, sequenced action plans, and support for the plans' implementation with a clear focus throughout on the goal of capacity development. The program of support should be integrated across the entire PFM arena, and activities should be aligned with government budget and reform cycles. Ideally, a yearly program of support would be defined based upon a dialogue between the government and donors. Coordinated policy dialogue between government and donors would facilitate sequencing and prioritization of reforms. Collaboration among donors would recognize the distinct competencies of different donor agencies, and seek to integrate work into a coherent program delivered by a broad-based team, thereby eliminating the possibility of government's limited capacities being burdened by the competition between the multiple and often duplicated requirements of many donors. Finally, commitment to a coordinated program of PFM work in support of a country's strategy is

complemented by making use of a country's financial systems to the greatest extent feasible for all forms of aid delivery.

A shared information pool comprising a framework for measuring results that provide objective and consistent information on a country's PFM performance, including progress over time.

Until recently, neither countries nor donors have had a framework within which to determine the degree to which PFM reforms have been yielding improved performance. The absence of reliable information derived from a consistent set of indicators has created problems for the management of reform, and has inhibited the ability to identify and to learn from reform successes. Moreover, the lack of readily available objective information has led to a variety of invasive and costly diagnostic efforts being undertaken by donors in order to satisfy their own fiduciary requirements. In order to overcome this lack of objective information, donors jointly developed an integrated PFM performance measurement framework, which was issued by the PEFA Secretariate⁵ in June 2005, and which covers all aspects of the budget cycle, including budget formulation and execution, procurement, accounting, auditing and internal and external controls. The framework⁵ includes (i) a set of high level indicators, which measures and monitors performance of PFM systems, processes and institutions and (ii) a PFM Performance Report that provides a framework in which the PFM performance indicators are measured, analyzed and reviewed. The structure and the content of the indicators are summarized in the diagram below, followed by a table that provides an overview of the indicators:



Overview of the PFM High-Level Performance Indicator Set

A.	PFM-OUT-TURNS: Credibility of the budget
PI-1	Aggregate expenditure out-turn compared to original approved budget
PI-2	Composition of expenditure out-turn compared to original approved budget
PI-3	Aggregate revenue out-turn compared to original approved budget
PI-4	Stock and monitoring of expenditure payment arrears
B.	KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency
PI-5	Classification of the budget
PI-6	Comprehensiveness of information included in budget documentation
PI-7	Extent of unreported government operations
PI-8	Transparency of inter-governmental fiscal relations
PI-9	Oversight of aggregate fiscal risk from other public sector entities.
PI-10	Public access to key fiscal information
C.	BUDGET CYCLE
C(i)	Policy-Based Budgeting
PI-11	Orderliness and participation in the annual budget process
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting
C(ii)	Predictability and Control in Budget Execution
PI-13	Transparency of taxpayer obligations and liabilities
PI-14	Effectiveness of measures for taxpayer registration and tax assessment
PI-15	Effectiveness in collection of tax payments
PI-16	Predictability in the availability of funds for commitment of expenditures
PI-17	Recording and management of cash balances, debt and guarantees
PI-18	Effectiveness of payroll controls
PI-19	Competition, value for money and controls in procurement
PI-20	Effectiveness of internal controls for non-salary expenditure
PI-21	Effectiveness of internal audit
C(iii)	Accounting, Recording and Reporting
PI-22	Timeliness and regularity of accounts reconciliation
PI-23	Availability of information on resources received by service delivery units
PI-24	Quality and timeliness of in-year budget reports
PI-25	Quality and timeliness of annual financial statements
C(iv)	External Scrutiny and Audit
PI-26	Scope, nature and follow-up of external audit
PI-27	Legislative scrutiny of the annual budget law
PI-28	Legislative scrutiny of external audit reports
D.	DONOR PRACTICES
D-1	Predictability of Direct Budget Support
D-2	Financial information provided by donors for budgeting and reporting on project and program aid
D-3	Proportion of aid that is managed by use of national procedures

THE WAY FORWARD

The Strengthened Approach represents a significant evolution of support to PFM systems and can be characterized as moving its emphasis from diagnostics to implementation. Implementation on the ground is vital, and this involves:

- tailoring the donor approach and analytical work to the country's circumstances and needs in order to support country-led reform;
- making internal changes within donor organizations to support improved donor practices on the ground, an issue that entails reducing and streamlining analytical work to eliminate duplication, and to promote standardization;
- aligning donor support to the country's priorities, and
- ensuring a credible assessment of PFM performance over time as an information pool for donors to draw upon for their fiduciary assessments.

Successful implementation of this approach requires a concerted effort that will require PFM work to be undertaken, as far as possible, through donor teams that continue to coordinate and share diagnostic and technical assistance. This will reduce duplication, help harmonize assistance, and reduce the burden on client countries. This would probably require a painful adjustment of donor styles, approaches and methods, but as Mr Nelson Mandela once observed: *"There is no limit to what you can achieve as long as you don't give a damn that gets the credit."*⁶

REFERENCES

OECD. Harmonising Donor Practices for Effective Aid Delivery - Volume 2: Budget Support, Sector Wide Approaches and Capacity Development in Public Financial Management. OECD Publishing. 2005. [Available at: <http://www.oecd.org/dac/harmonisingpractices>] SIDA. Public Finance Management in Development Co-operation - A Handbook for SIDA staff. Department for Policy and Methodology. April 2007.

ENDNOTES

- ¹ HIPC = Heavily Indebted Poor Countries.
- ² Refer to the web page: <http://ddp-ext.worldbank.org/ext/MDG/home.do>
- ³ PEFA is a partnership between the World Bank, European Commission, UK Department for International Development, Swiss State Secretariat for Economic Affairs, French Ministry of Foreign Affairs, Norwegian Ministry of Foreign Affairs, the International Monetary Fund, and the Strategic Partnership with Africa.
- ⁴ Refer to the web page: <http://www.oecd.org/dataoecd/57/60/36080258.pdf>
- ⁵ Refer to the web page: http://www.pefa.org/about_test.htm#framework
- ⁶ Quotation from a speech by Mr. Paul Wolfowitz, former World Bank president, marking the official opening of the World Bank and International Monetary Fund Annual Meetings, 24 September 2005. Refer to the web page: <http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/ORGANIZATION/EXTPRESIDENT2007/EXTPRESIDENTS/EXTOFFICEPRESIDENT/0,,content-MDK:20659658~menuPK:51175739~pagePK:51174171~piPK:64258873~theSitePK:1014541,00.html>