



Public Financial Management (PFM) reform virtual training

Day 3 – Developing a reform strategy – 2

MENTIMETER

How do you feel today ?

Wrap up of day 2

- Icebreaker (mentimeter)
- What do you remember from yesterday? (open discussion)
 - Main conditions for successful PFM reform (Gleicher)?
 - What are the main features of PEFA?
 - What diagnostic tools to assess PFM systems are you familiar with?

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- **Module 3.1** **Sequencing of reforms (part 2)**
- Module 3.2 PEFA platform exercise – Ethiopia
- Module 3.3 Basics and beyond

MENTIMETER

Quick Wins

Getting the basics right

Individual Exercise – Quick Wins (mentimeter)

- Where can I find a quick win?

Group Exercise – Quick Wins (mentimeter)

According to the Gleicher, one of the pre-requisites for successful change management are some successful first steps.

- From the list of PFM reforms shown on the next slide which ones would you identify as good candidates for successful first steps?
- List the main reason why your selection reforms would be good candidates for quick wins?

Group Exercise – Quick Wins (mentimeter)

1. Civil service reform project covering the implementation of a new integrated personnel database and payroll management system
2. Reform of the constitution to address the independence of the auditor general and to clarify the role of parliament in the approval of the appropriations law
3. Implementation of the pilot phase of the IFMIS project
4. Reform of debt management
5. Reform of the mechanism for transfers of tax revenue to the consolidated revenue fund and the implementation of daily reconciliations between the revenue agencies and the ministry of finance.
6. Implementation of a Medium-Term Expenditure Framework (MTEF)
7. Implementation of new procurement procedures that include the institution of an independent procurement review board and a public procurement oversight authority
8. Implement programme-based budgeting
9. Introduce a Treasury Single Account (TSA)

Why establish a sequence of reforms? (1)

- In developed countries, experience demonstrates that budgetary reform takes a long time
 - Over 18 years for accruals accounting reform in UK to be completed. Announced 1993 first whole of Government accounts 2011/12 (published 20 months late)
 - In France: Accruals accounting reforms – prepared in 1999; voted in 2001; Implemented in 2006 Budget

Why establish a sequence of reforms? (2)

- Experience shows that premature introduction of complex instruments in developing/transition countries is counterproductive

What are the objectives?



Be accountable towards citizens, be receptive

Aggregate fiscal discipline

Role of Parliament in democratic societies

Resource allocation & fiscal policy consistent with objectives

Efficient public service provision and tax administration

Proper procedures (integrity, regularity)



The Platform approach (Peter Brooke, 2003)

- It aims at implementing a package of measures or activities designed to achieve increasing levels ('platforms') of PFM competence over a manageable timeframe
- Each platform establishes a clear basis for **consolidation and launching to the next step**, based on the premise that a certain level of **PFM competence** is required to enable further progress to take place

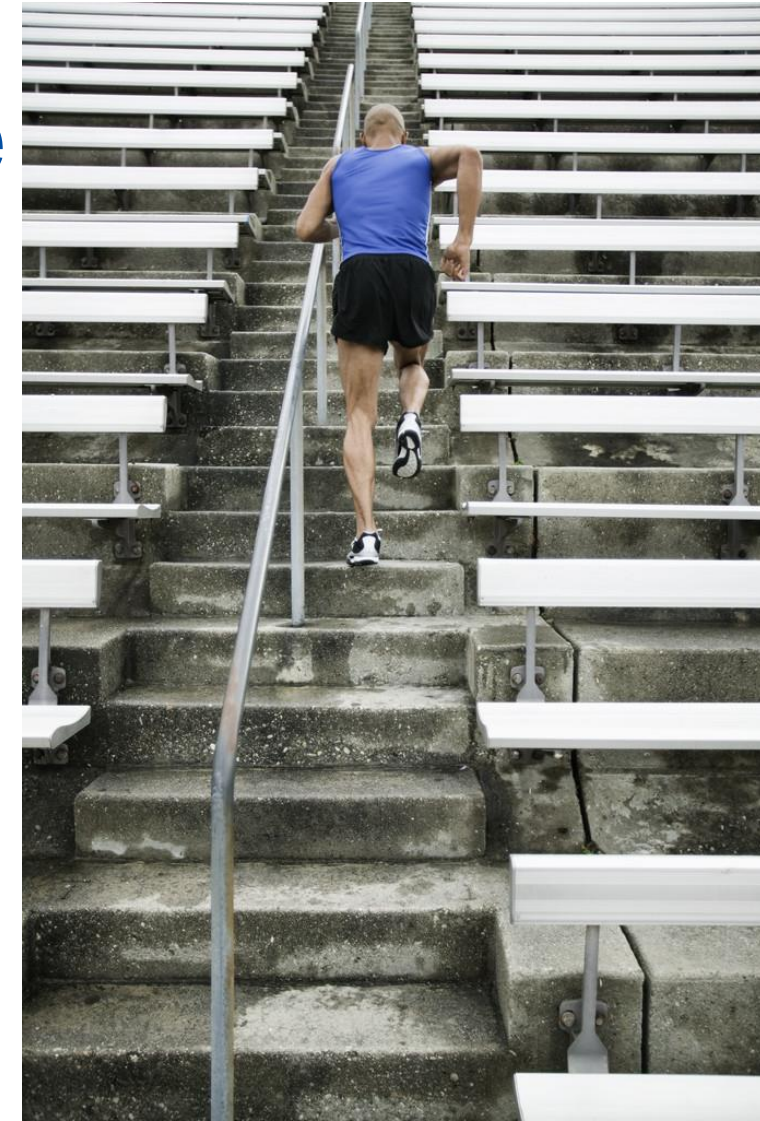


The Platform approach

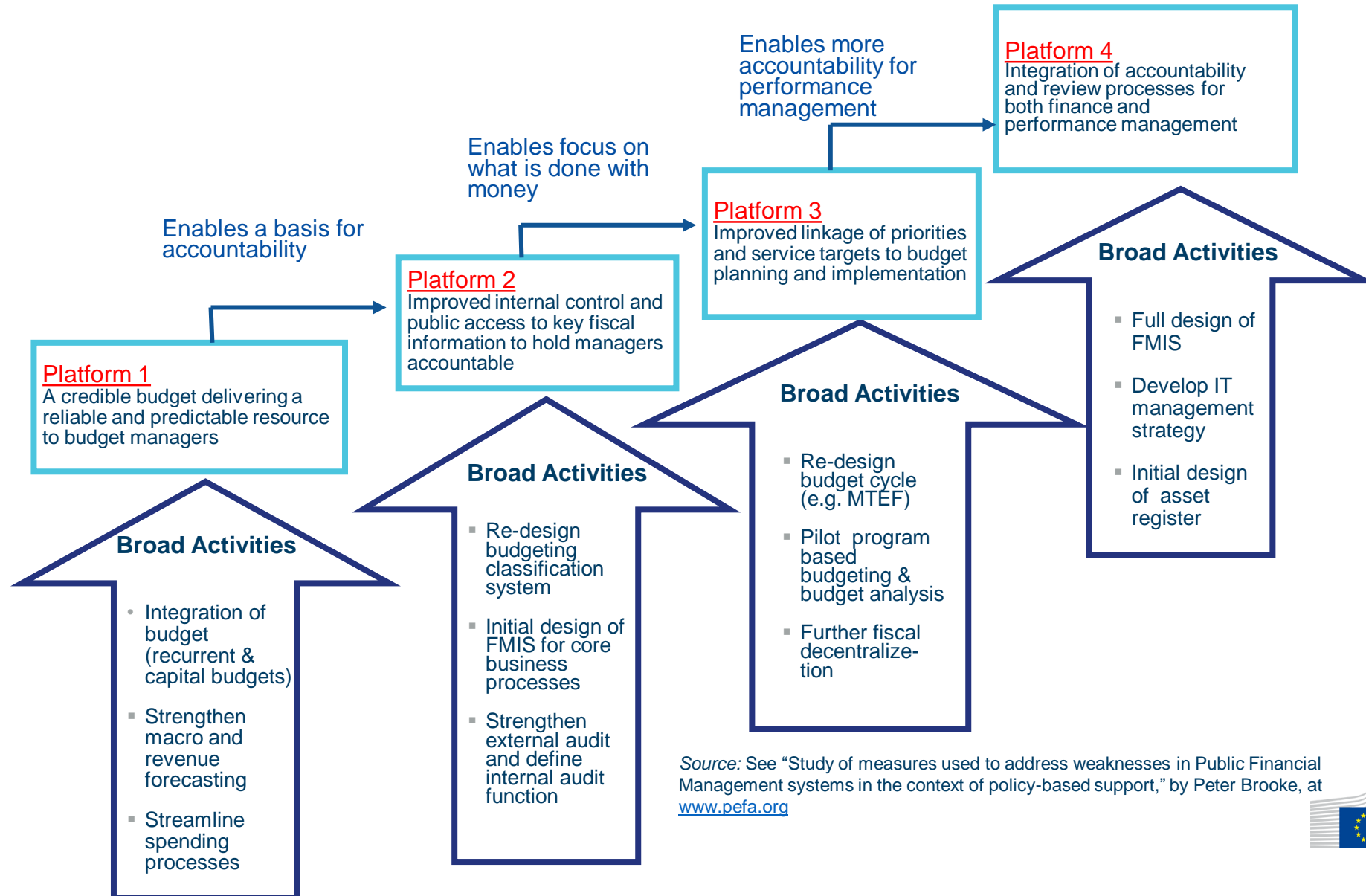
- It facilitates broad reform focus for the individual components and serves as a basis for aligning and coordinating activities
- There are no standard platform specifications, but they seem to conform broadly to a sequence of:
 - Fiscal Discipline (first steps)
 - Efficiency (performance) in Service Delivery (second steps) and finally
 - Strategic Allocation of Resources (final steps)

The Platform approach -example

- **Platform 1:** A credible budget delivering a reliable resource to budget managers
- **Platform 2:** Improved internal control to hold managers accountable
- **Platform 3:** Improved links of priorities to budget planning
- **Platform 4:** Integration of accountability and review processes



Example: Sequence of Platforms



Source: See "Study of measures used to address weaknesses in Public Financial Management systems in the context of policy-based support," by Peter Brooke, at www.pefa.org

Cluster approach (Jack Diamond)

The subset of Platform approach

Three main stages:

- Ensure core PFM functions are operating (reach core level functionality by **3 top-level priorities**)
- **Consolidation**: establish an adequate IT basis, an accounting system, and regulatory framework, to anchor subsequent reforms
- Subsequent PFM reforms, sequenced along **three clusters**:
 - further improving compliance
 - medium term planning
 - programme and performance budgeting

Cluster approach (Jack Diamond)

Cluster approach – stage 1: 3 top-level priorities

STAGE ONE: ESTABLISH CORE PFM FUNCTIONS FOCUSED ON COMPLIANCE:

PFM Deliverable 1:
Financial
Compliance

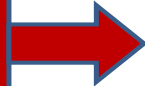


1. In-year control of spending
2. In-year control of taxes
3. Timely accounting & reporting
4. Central control over cash/borrowing
5. Adequate internal controls
6. Adequate external control



SUPPORTS a credible budget, and vice versa

PFM Deliverable 2:
Macroeconomic
Stability



1. Realistic revenue forecasts
2. Realistic costing of expenditure
3. Budget outturn avoids revenue shortfalls & arrears
4. Deficit delivered as planned



SUPPORTS a minimum level of service delivery focused on economy

PFM Deliverable 3:
Efficiency and
Effectiveness



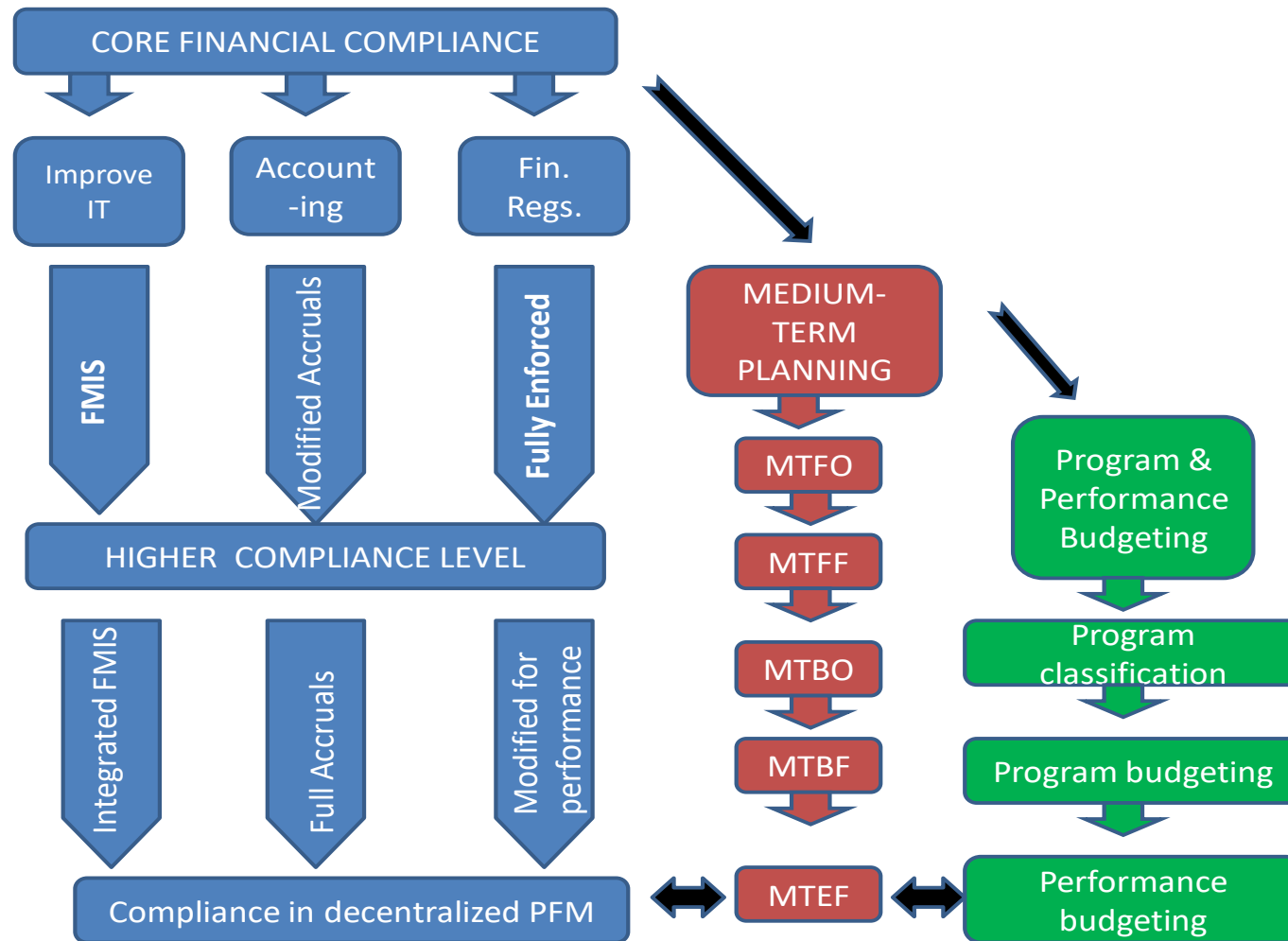
1. Actual spending matches budget allocations
2. Resources available for service delivery as planned
3. Service delivery costs as planned
4. Costs are minimized



STAGE TWO: MOVE BEYOND THE CORE ON THREE TRACKS:

Cluster approach (Jack Diamond)

Cluster approach – stage 2 and 3



Cluster approach (Jack Diamond)

Cluster approach – stage 1

- Sequencing decisions should focus on the three top-level PFM priorities
- These priorities, determining the overall sequencing strategy, should be the same for all countries
- Attempting to leapfrog this hierarchy in the top PFM priorities will likely lead to unsuccessful reforms
- The first top-level priority in PFM reform is **to establish a core (or basic operational) level for the core PFM functions**

This core level can be defined by using the ratings of **PEFA indicators**

Cluster approach

Cluster approach – stage 2

- Before advancing to reforms aimed beyond core PFM functions, it is important to establish:
 - A financial management information system
 - Accounting system that can meet International Public Sector Accounting Standards (IPSAS) cash reporting standards for central government operations
 - Budget legislation that meets critical control standards and is adequately enforced

Cluster approach

Cluster approach – stage 3

- Reforms aimed beyond core PFM functions
- Focus on policy and performance
- Sequenced along three clusters:
 - Further improving compliance
 - Progressive move from annual to medium term budget planning
 - A staged move from traditional line-item budgeting to programme (and eventually performance) budgeting

The Dilemma

- Sometimes need to go against logical sequence, it may be driven by:
 - Pressure from donors
 - Internal determination to show that country is on the path of modernisation & capable to carry out complex reforms, etc.

How to handle such situations?

Strengthening foundations must be priority: however, if not possible to avoid complex reforms, is necessary to:

- Ensure that basic measures & necessary pre-conditions for the complex reform are included in reform programme
- Reshape complex reform measures & limit their ambition
 - E.g., a programme budget may initially be limited to an information document

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- Module 3.1 Sequencing of reforms (part 2)
- **Module 3.2 PEFA platform exercise - Ethiopia**
- Module 3.3 Basics and beyond

MURAL

Group exercise - PEFA Ethiopia

Group exercise - PEFA Ethiopia

Break out groups

- Review the PEFA Summary Assessment for the Federal Republic of Ethiopia, 2018
- Make a judgment on the likelihood for PFM reform in Ethiopia linked to the platform approach

Group exercise - PEFA Ethiopia

Review the Summary Assessment of the PEFA for the Republic of Ethiopia, 2019, discuss it in your group and do the following:

1. Make a shared judgment on the likelihood of successful PFM reform in Ethiopia
2. Detail the sequence of PFM reform activities you would recommend in the first platform

e.g. would you regard the following as basics (link to Diamond's hierarchy)?

- a) The adoption of MTEF
- b) The adoption of Accrual Accounting

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- **Module 3.3 Basics and beyond**

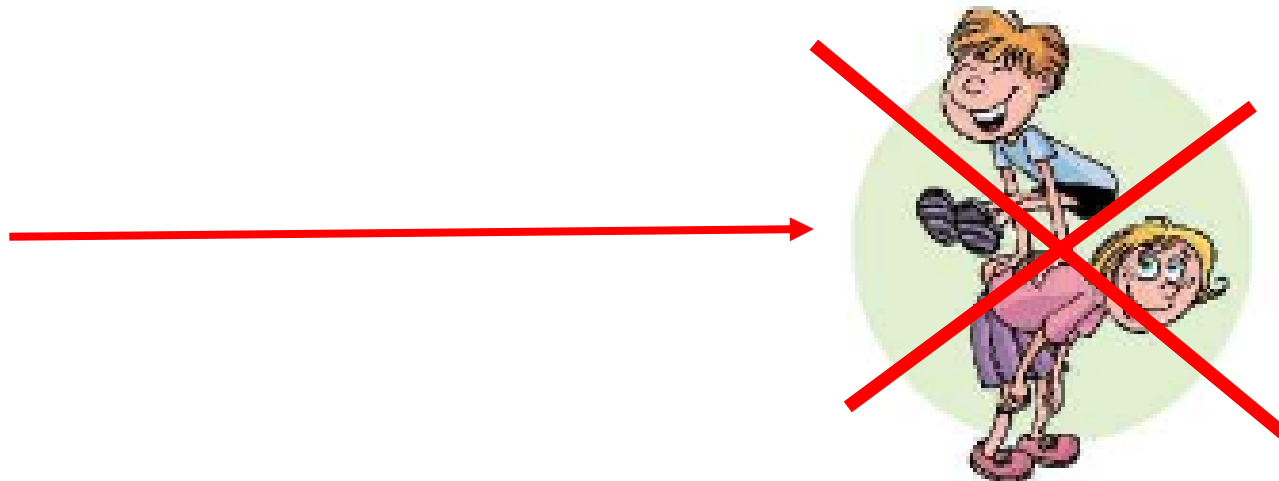
Objectives of the module

- To examine the key sub-systems of PFM
- For each sub-system, we look at:
 - The level of development regarding ‘foundations’
 - Developments **beyond** the foundations

Allen Schick: the foundations first!

- In 1998, Schick reacted against the attempts to export and apply the New Zealand model to developing countries
- He recommends to first **consolidate 'foundations'**, rather than “leapfrogging”: often referred to as “core functions” (basics) first

Schick, Allen, 1998. “Why Most Developing Countries Should Not Try New Zealand Reforms.” The World Bank Research Observer



Examples of basic functions

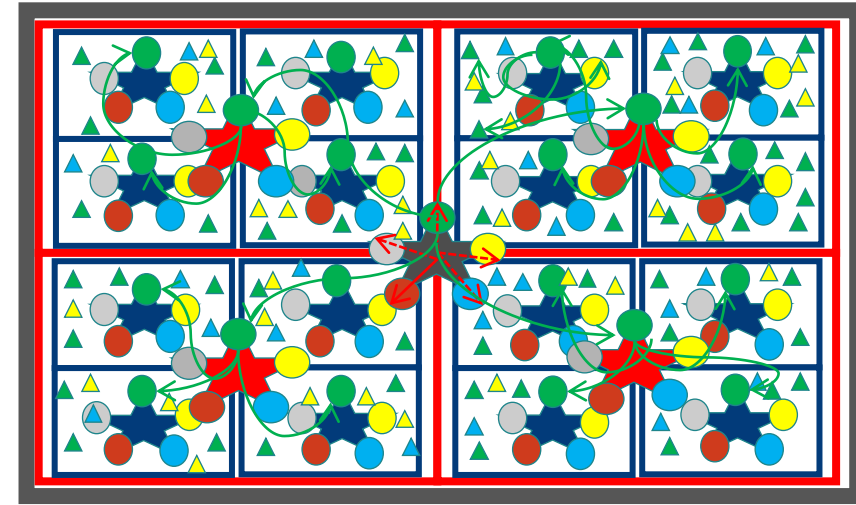
- Administrative as well as economic classification of expenses (consistent with GFS)
- Satisfactory level of comprehensiveness of budget
- Taxpayer registration
- Regular monitoring of financial budget – cash & commitments
- Registry of physical assets for “risky” assets (e.g. vehicles, computers)
- Suspense Accounts
- End-of-year accounts
- External Audit

Get the Basics Right



Getting the Basics Right (Allen Schick)

How to define 'foundations'?



Suggested definitions:

- Set of functions necessary to ensure that other functions are sustainably applicable and cost effective
- This set of functions aimed at:
 1. Ensuring “budget credibility” (in budget preparation)
 2. Ensuring budgetary discipline (integrity, regularity – financial compliance in budget execution)

The PFM Foundations:

1. ensuring credibility of the budget

PEFA pillar 1 (budget reliability)

PEFA pillar 2 (transparency) and

PEFA pillar 4 (budget preparation):

- Budgetary and macroeconomic framing (PI-14)
- A budget formulation process that (PI-18):
 - eases strategic decision-making and
 - leaves enough time for line ministries to carry out internal decisions: “two stage” budget process
- Budget calendar that is clear and enforced (PI-17)

The PFM Foundations:

2. ensuring budgetary discipline

PEFA Pillar 5: Predictability and control of budget execution

Schick identifies **3 stages** to the development of **control systems**:

1. **Basics**: supervision by third party, external to spending ministries (i.e. MoF)
2. Internal supervision **within** spending ministries
3. Strengthen managerial accountability

The foundations: economic and administrative classification (PI-4)

<div> <div>Economic classification (1)</div> <div>Public administration functions classification (2)</div> </div>	Employee compensation	Goods and services utilisation	Interests	Subsidies	Grants	Social benefirs	Other charges	Non-financial assets acquisition	Buildings and civil engineering projects	Machines and equipemnt	Miscellenious
General services of public administrations											
Defence											
Public order and safety											
Economic affairs											
Environmental policy											
Housing and communal equipments											
Health											
Leisure, culture and religion											
Education											
Social protection											
TOTAL											

(1) Principales catégories de SFP/GFS, amortissement des actifs physiques exclus

(2) Premier niveau de la CFAP/COFOG

- Going beyond:

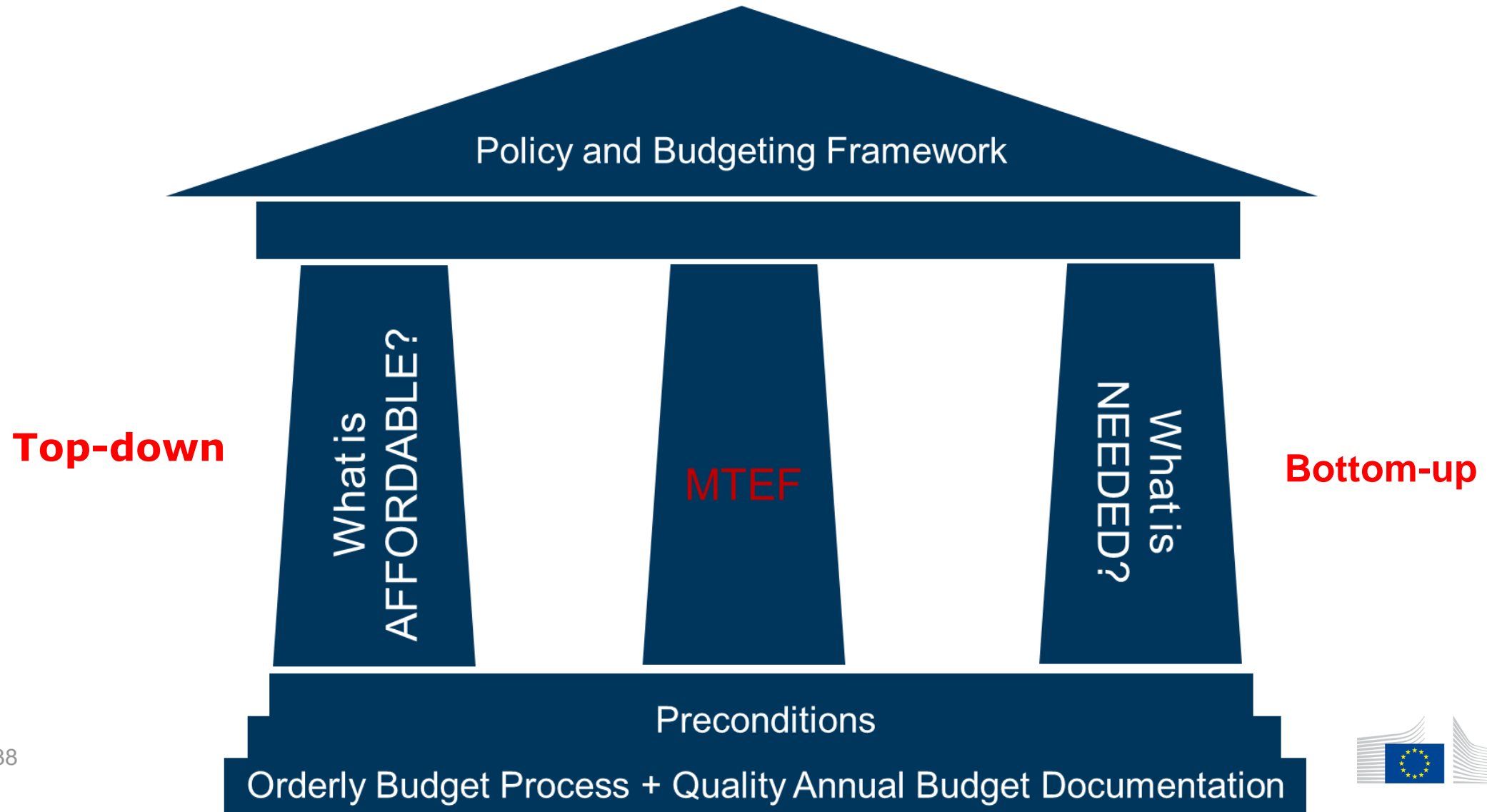
- more advanced classification for analysis of public policy and performance: **functional and programme classification**

Going beyond the basics: the MTEF

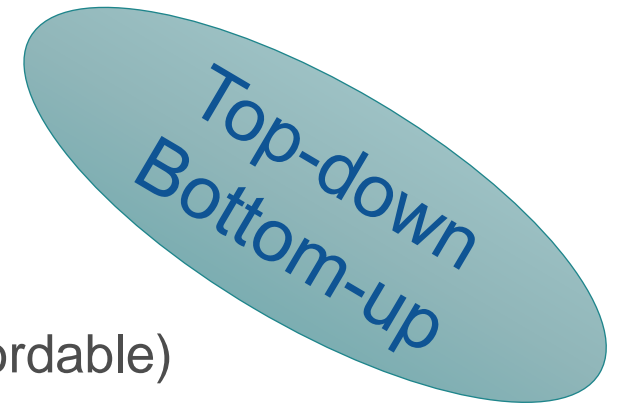
A Medium-Term Expenditure Framework (MTEF) is defined as:

- An additional budget document showing the multi-year expenditure forecasts
- A change of approach to budgeting
- A tool to embed the annual budget process in a **medium term** budget and policy framework with:
 - A rolling multi-annual expenditure programme
 - Established on a yearly basis
 - The first year is the next year budget

Main features of MTEF



Main features of MTEF



Top-down budget preparation

Multi-year projections of resource envelope targets (what is affordable)

Bottom-up budget preparation

Multi-year cost estimates of sector programmes (what has to be financed, with a focus on programme performance)

Integrating these two pillars

Institutional (political-administrative) decision-making process to make the necessary trade-offs

Main features of MTEF

Top-down ceiling

Costing

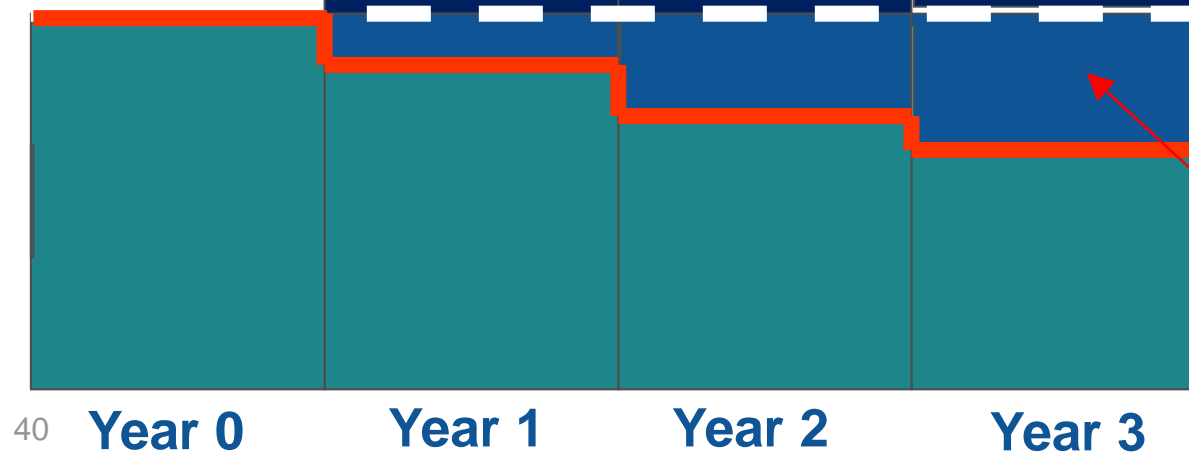
MTEF expenditure projections

Expenditure ceiling

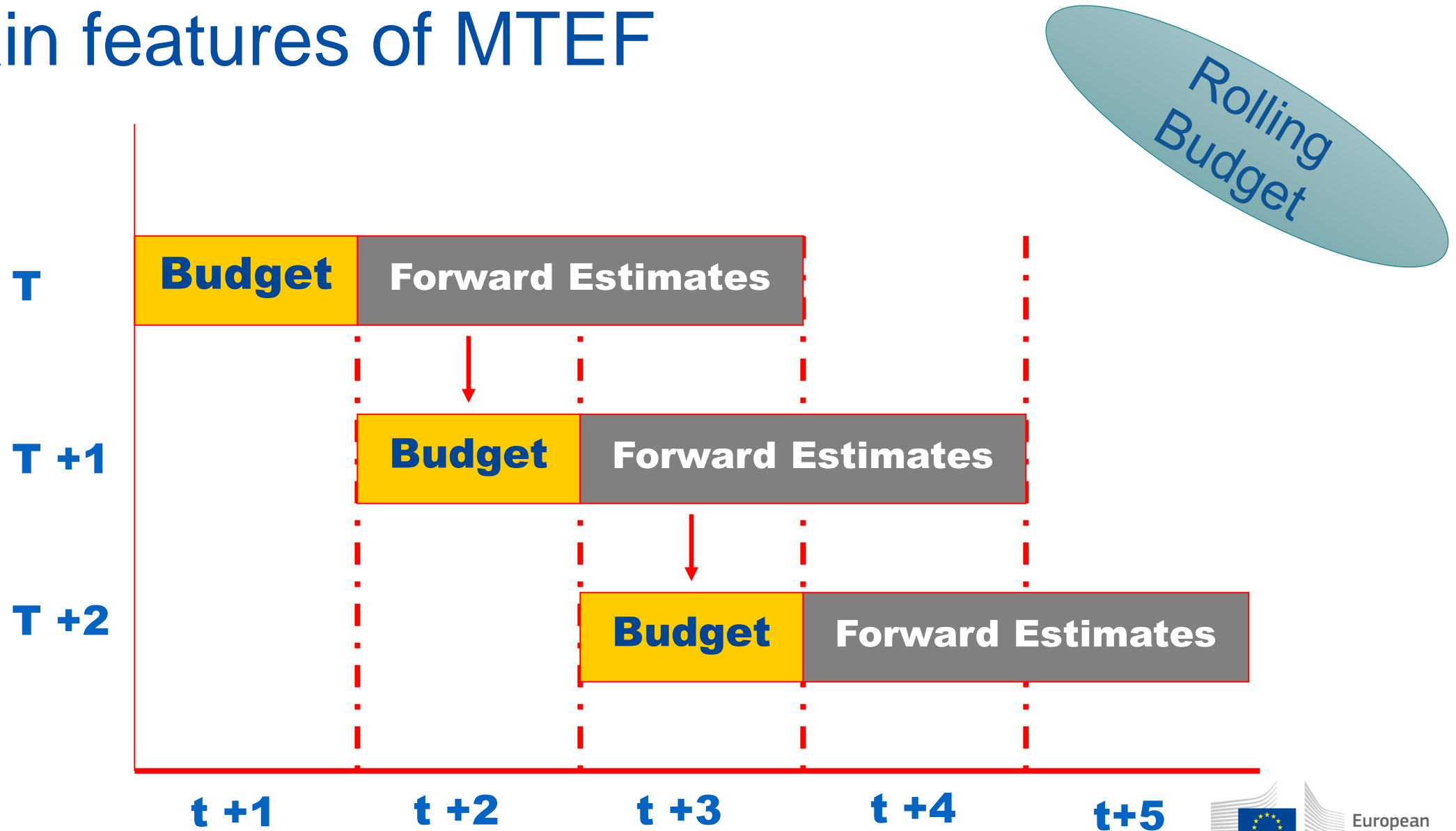
Fiscal space for new programmes and policy change

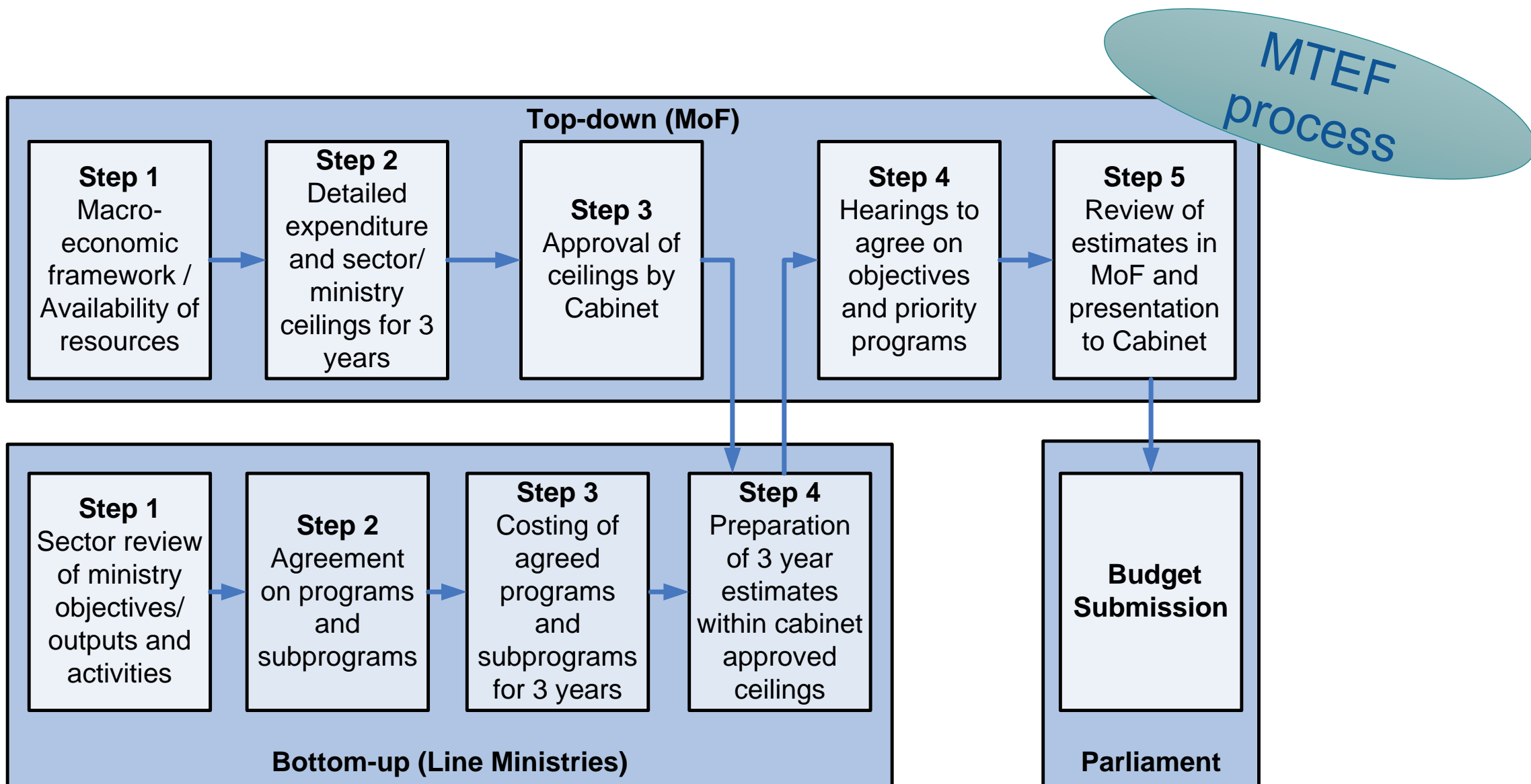
Baseline

Savings on existing programmes



Main features of MTEF





Risks of 'leapfrogging' the basics - MTEF

IMF – World Bank:

*"developing comprehensive MTEFs can be effective **when circumstances and capacities permit.***

Otherwise, it can be a great consumer of time and resources and might distract attention from the immediate needs for improving the annual budget and budget execution processes.

...in a number of African countries, the MTEF was introduced prematurely, and is turning out to be merely a paper exercise".

IMF — World Bank "Global Monitoring Report 2006" page 146.

Budget execution

- This section examines key points about the budget execution cycle
 - Management procedures of the expenditure cycle
 - Personnel, procurement
 - Financial monitoring and accountancy
 - Internal audit
- Aims at identifying the “basics”
- Brief examination of a few issues that go beyond the basics, including accrual accounting

Guaranteeing foundations

- Take measures to make budget execution effective
- Make sure funds are available, improve predictability
- Rationalise controls within the executive by accounting for specific aspects of budgetary system
 - Francophone countries: rationalise control within the MoF, ensure transparency of Treasury
 - Anglophone countries: follow commitments, audit internal controls, strengthen Treasury
 - Post-conflict countries: put in place a centralised payment monitoring and management system

Payment systems: points to consider

- Single Treasury Account (STA):
cash centralisation - desirable for sound treasury management

Accounting methods

Cash-based accounting

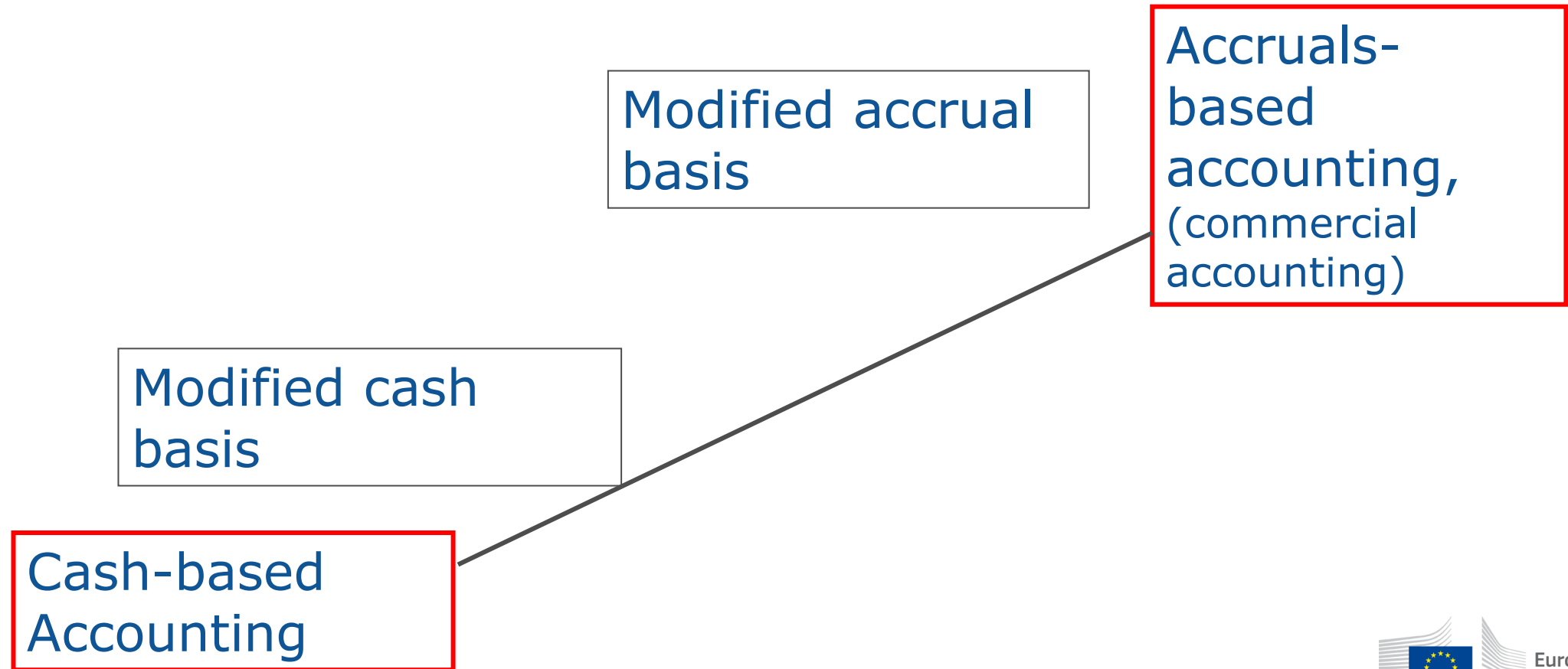
- Keeps track of expenses when paid for, implementation of revenue when registered (i.e. when cash moves)

Accruals-based accounting

- Used in commercial world
- Keeps track of events when they occur: assets, liabilities, net assets/net position, outputs & expenses (including depreciation, inventory stocks, etc.)

Accounting methods

- Depends on the country: variants between the extremes



The basics

The accounting system must enable the basics in terms of budget preparation, control, reporting, & publication as per country regulations: this requires:

- Adequate budgetary classification
- Registration of expenditure at both commitment & payment stages
- Reports on arrears & other liabilities
- Reports on financial assets
- Asset register at least for those physical assets liable to misappropriation or waste

External Audit

- Undertaken by Supreme Audit Institution (SAI: Court of Audit, Court of Finances, National Audit Office, etc.)
- Key point is the independence of the SAI should (must!) be guaranteed by the **constitution** according to International Organization of Supreme Audit Institutions (INTOSAI)

Different types of Audit

- **Compliance audit:** assessing extent to which legal & administrative requirements are followed; integrity & suitability of administrative, financial & management control systems
- **Financial audit:** review of financial statements & accounting systems which underlie them
- **Performance audits:** assesses management & operation performance of government programs & MDAs to evaluate effectiveness & efficiency with which program or organization uses resources

End-of-year Accounts

- End-of-year accounts are first submitted to the SAI, then to parliament (often with significant delays)
- Major weaknesses
 - Long delays
 - Administrative & management accounts are often incomplete & difficult to compare

Legislative and Regulatory framework

- Constitution
- [Organic] Budget Act (or Public Finance Management Act, Budget Framework Law, etc.)
- Other laws and regulations
 - Audit Act
 - Fiscal responsibility law
 - Public Accounting Law
 - Financial regulations

Key points of the legislative framework

- Provide a framework for parliamentary authority
- Establish responsibilities (*Countries in transition: strengthen the powers of the Minister of Finance*)
- Define principles of sound fiscal management
- Define reporting obligations

Management Information Systems

- Management information is necessary
 - For scheduling, implementation and surveillance
 - For the MoF & sectoral ministries
- Not a mere collection of statistical data
 - Financial & Physical Information
 - Dashboard
 - Must be available quickly in order to enable to take decisions
- It is not only IT, but may be useful to classify, sort & publish data in various formats

Integrated Financial Management System

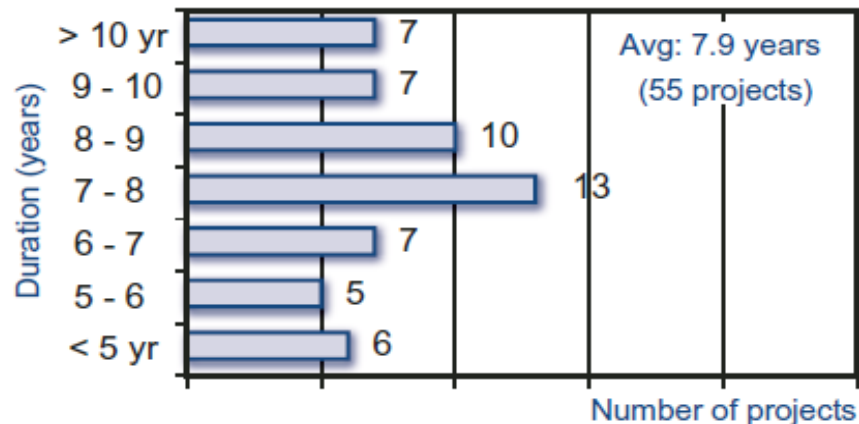
- “Heart” of the accounting system (General Accounting)
 - Setting standard exchanges between systems
 - Covers all financial transactions
- Other Systems:
 - Budgetary module: Accounting & budgetary control
 - Preparation of budget
 - Treasury management
 - Debt management
 - Revenue
 - Management modules for managers

In practice



- A large majority of the integrated systems are only partially implemented
- Yet, the implementation process is time consuming

Figure 2.1. Total Duration of Completed Projects



**Dener:
WB 2011**

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[EU Spotify](https://open.spotify.com/playlist/37i9ZQAEWUpe1a2Pn0727t)

Thank you



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