

# PEFA

Public Expenditure and Financial Accountability

Dépenses publiques et responsabilité financière

## Public Financial Management Performance Measurement Framework

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## Foreword

There is wide agreement that effective institutions and systems of public financial management (PFM) have a critical role to play in supporting implementation of policies of national development and poverty reduction. This PEFA PFM Performance Measurement Framework has been developed as a contribution to the collective efforts of many stakeholders to assess and develop essential PFM systems, by providing a common pool of information for measurement and monitoring of PFM performance progress, and a common platform for dialogue. The development of the Framework has been undertaken by the Public Expenditure Working Group, which involves World Bank, IMF and PEFA staff, with direction provided by the PEFA Steering Committee.

The PEFA PFM Performance Measurement Framework incorporates a PFM performance report, and a set of high level indicators which draw on the HIPC expenditure tracking benchmarks, the IMF Fiscal Transparency Code and other international standards. It forms part of the Strengthened Approach to supporting PFM reform, which emphasizes country-led reform, donor harmonization and alignment around the country strategy, and a focus on monitoring and results. This approach seeks to mainstream the better practices that are already being applied in some countries.

The Framework has been developed through a concerted international effort, rather than by a single agency, and has undergone a process of wide consultation and country-level testing. A draft of the Framework, dated February 12, 2004, was applied in 24 country cases, largely through desk exercises. Numerous consultations took place, including with the DAC Joint Venture on PFM, a group of African PFM experts, and government representatives from Eastern Europe and Central Asia. Comments were also received from practitioners within the World Bank, IMF, other PEFA partners, government agencies and professional organizations. From this feedback, improvements and clarifications have been made, and the Framework finalized. The improvements include extended coverage in the areas of revenue collection systems and inter-governmental fiscal relations. The related indicators therefore have not been tested to the same extent as the rest of the set. Early lessons from application of the Framework will be drawn through a review to be undertaken in 2006.

The PEFA program is pleased to now issue the PEFA PFM Performance Measurement Framework. Further information on the Framework and the Strengthened Approach can be found at the PEFA website – [www.pefa.org](http://www.pefa.org).



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## List of Abbreviations

AGA	Autonomous Government Agencies
CGAF	Compte Général de l'Administration des Finances
COFOG	Classifications of Functions of Government
DAC	Development Assistance Committee of OECD
GFS	Government Financial Statistics
IAASB	International Auditing and Assurance Standards Board
IFAC	International Federation of Accountants
IGF	Inspection Générale des Finance
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards (of IFAC)
ISPPIA	International Standards for the Professional Practice of Internal Auditors
MDA	Ministries, Departments and Agencies
MOF	Ministry of Finance
OECD	Organisation for Economic Co-operation and Development
PFM	Public Financial Management
PFM-PR	PFM Performance Report
PI	Performance Indicator
PE	Public Enterprise
RA	Revenue Administration
SAI	Supreme Audit Institution
SN	Sub-National (government)
USD	United States Dollars

# The PFM Performance Measurement Framework

## 1. Introduction and background

The PFM Performance Measurement Framework is an integrated monitoring framework that allows measurement of country PFM performance over time. It has been developed by the PEFA partners, in collaboration with the OECD/DAC Joint Venture on PFM as a tool that would provide reliable information on the performance of PFM systems, processes and institutions over time. The information provided by the framework would also contribute to the government reform process by determining the extent to which reforms are yielding improved performance and by increasing the ability to identify and learn from reform success. It would also facilitate harmonization of the dialogue between government and donors around a common framework measuring PFM performance and therefore contribute to reduce transaction costs for partner governments.

The PFM Performance Measurement Framework is one of the elements of a strengthened approach to supporting PFM reforms<sup>1</sup>. It is designed to measure PFM performance of countries across a wide range of development over time. The Performance Measurement Framework includes **a set of high level indicators**, which measures and monitors performance of PFM systems, processes and institutions and **a PFM Performance Report (PFM-PR)** that provides a framework to report on PFM performance as measured by the indicators.

## 2. Scope and coverage of the framework

A good PFM system is essential for the implementation of policies and the achievement of developmental objectives by supporting aggregate fiscal discipline, strategic allocation of resources and efficient service delivery. An open and orderly PFM system is one of the enabling elements for those three levels of budgetary outcomes:

- Effective controls of the budget totals and management of fiscal risks contribute to maintain aggregate fiscal discipline.
- Planning and executing the budget in line with government priorities contributes to implementation of government's objectives.
- Managing the use of budgeted resources contributes to efficient service delivery and value for money.

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<sup>1</sup> The Strengthened Approach has three components (i) a country led PFM reform strategy and action plan, (ii) a coordinated IFI-donor integrated, multi-year program of PFM work that supports and is aligned with the government's PFM reform strategy and, (iii) a shared information pool. The Performance Measurement Framework is a tool for achieving the third objective.

The Performance Measurement Framework identifies **the critical dimensions of performance of an open and orderly PFM system** as follows<sup>2</sup>:

1. **Credibility of the budget** - The budget is realistic and is implemented as intended
2. **Comprehensiveness and transparency** - The budget and the fiscal risk oversight are comprehensive, and fiscal and budget information is accessible to the public.
3. **Policy-based budgeting** - The budget is prepared with due regard to government policy.
4. **Predictability and control in budget execution** - The budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds.
5. **Accounting, recording and reporting** – Adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes.
6. **External scrutiny and audit** - Arrangements for scrutiny of public finances and follow up by executive are operating.

Against the six core dimensions of PFM performance, the set of high-level indicators measures **the operational performance of the key elements of the PFM systems, processes and institutions** of a country central government, legislature and external audit. In addition, the PFM-PR uses the indicator-based analysis to develop an integrated assessment of the PFM system against the six critical dimensions of PFM performance and evaluate the likely impact of PFM weaknesses on the three levels of budgetary outcomes.

The set of high-level indicators captures **the key PFM elements** that are recognized as being critical for all countries to achieve sound public financial management. In some countries, the PFM-PR may also include an assessment of additional, country specific issues in order to provide a comprehensive picture of PFM performance.

It is expected that the repeated application of the indicator tool will provide information on the extent to which **country PFM performance is improving or not**. In addition, the PFM-PR recognizes the efforts made by government to reform its PFM system by describing recent and on-going reform measures, which may not have yet impacted PFM performance. The report does not, however, include any recommendations for reforms or assumptions as to the potential impact of ongoing reforms on PFM performance.

**The focus of the PFM performance indicator set is the public financial management at central government level, including the related institutions of oversight.** Central government comprises a central group of ministries and departments (and in some cases deconcentrated units such as provincial administrations), that make up a single institutional unit. In many countries, other units are operating under the authority of the central government with a separate legal entity and substantial autonomy in its operations (in this

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<sup>2</sup> These core dimensions have been determined on the basis of what is both desirable and feasible to measure and define the nature and quality of the key elements of a PFM system captured by the set of high-level indicators.

document referred to as autonomous government agencies) and also constitute a part of central government operations. Such units would be used for the purpose of implementing central government policy and may include non-profit institutions, which are controlled and mainly financed by central government.

**Operations of other levels of general government and of public enterprises are considered in the PFM performance indicator set only to the extent they impact the performance of the national PFM system and its linkages to national fiscal policy, formulated and monitored by central government (refer to PI-8, PI-9 and PI-23).** Other parts of general government include lower levels with separate accountability mechanisms and their own PFM systems (e.g. budgets and accounting systems). Such sub-national governments may include state, provincial, and regional government at a higher level and local government (including e.g. districts and municipalities) at a lower level. In addition to general government, the public sector includes public corporations or enterprises, created for the purpose of providing goods and services for a market, and controlled by and accountable to government units. Public corporations can be non-financial or financial, the latter including monetary corporations such as the central bank<sup>3</sup>. Additional information on other levels of government and public enterprises may be included in the section on country specific issues of the PFM-PR.

**The focus of the indicator set is on revenues and expenditures undertaken through the central government budget.** However, activities of central government implemented outside the budget are covered in part by the indicators PI-7, PI-9, PI-26 and D-2. Typically, this includes expenditure executed by central government units and financed from earmarked revenue sources (whether domestic or external, the latter often being only nominally on-budget), and by autonomous government agencies.

The Performance Measurement Framework does not measure **the factors impacting performance**, such as the legal framework or existing capacities in the government. In particular, the set of high-level indicators focuses on the operational performance of the key elements of the PFM system rather than on the inputs that enable the PFM system to reach a certain level of performance.

The Performance Measurement Framework does not involve **fiscal or expenditure policy analysis**, which would determine whether fiscal policy is sustainable, whether expenditures incurred through the budget have their desired effect on reducing poverty or achieving other policy objectives, or whether there is value for money achieved in service delivery. This would require detailed data analysis or utilization of country-specific indicators. The framework rather focuses on assessing the extent to which **the PFM system is an enabling factor** for achieving such outcomes.

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<sup>3</sup> For further details of definition of the public sector and its sub-divisions, refer to the GFS Manual paragraphs 2.9-2.62 (Government Finance Statistics Manual, IMF 2001)

### 3. The set of high level performance indicators

The selected 28 indicators for the country's PFM system are structured into three categories:

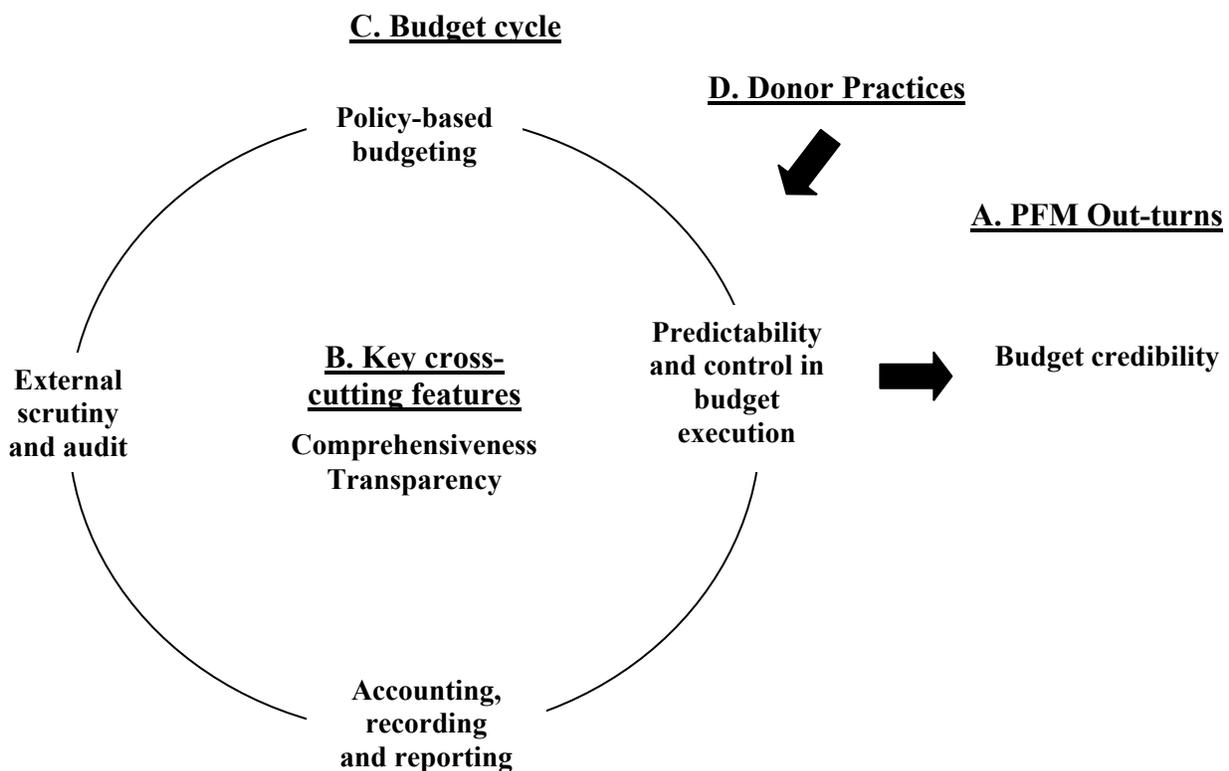
- A. **PFM system out-turns:** these capture the immediate results of the PFM system in terms of actual expenditures and revenues by comparing them to the original approved budget, as well as level of and changes in expenditure arrears.
- B. **Cross-cutting features of the PFM system:** these capture the comprehensiveness and transparency of the PFM system across the whole of the budget cycle.
- C. **Budget cycle:** these capture the performance of the key systems, processes and institutions within the budget cycle of the central government.

In addition to the indicators of country PFM performance, this framework also includes

- D. **Donor practices:** these capture elements of donor practices which impact the performance of country PFM system.

A complete listing of the individual indicators is found at the beginning of Annex 1.

The following diagram illustrates the structure and coverage of the PFM system measured by the set of high level indicators and the links with the six core dimensions of a PFM system:



Each indicator seeks to measure performance of a key PFM element against a four point ordinal scale from A to D. Guidance has been developed on what performance would meet each score, for each of the indicators. The highest score is warranted for an individual indicator if the core PFM element meets the relevant objective in a complete, orderly, accurate, timely and coordinated way. The set of high-level indicators is therefore focusing on the basic qualities of a PFM system, based on existing good international practices, rather than setting a standard based on the latest innovation in PFM.

**Annex 1 includes further information on the calibration and the scoring methodology as well as detailed guidance for each of the indicators.**

#### **4. The PFM Performance Report**

The objective of the PFM Performance report (PFM-PR) is to provide an assessment of PFM performance based on the indicator-led analysis in a concise and standardized manner. Information provided by the PFM-PR would feed into the government and donor dialogue.

The PFM-PR is a concise document (30-35 pages), which has the following structure and content:

- **A summary assessment** (to be at the beginning of the report) uses the indicator-led analysis to provide an integrated assessment of the country's PFM system against the six core dimensions of PFM performance and a statement of the likely impact of those weaknesses on the three levels of budgetary outcomes, aggregate fiscal discipline, strategic allocation of resources and efficient service delivery.
- **An introductory section** presents the context and the process of preparing the report and specifies the share of public expenditures captured by the report.
- **A section presents country-related information** which is necessary to understand the indicator-led and overall assessment of PFM performance. It includes a brief review of the country economic situation, a description of the budgetary outcomes as measured by achievement of aggregate fiscal discipline and strategic allocation of funds<sup>4</sup> and, a statement on the legal and institutional PFM framework.
- **The main body of the report assesses the current performance of PFM systems, processes and institutions based on the indicators**, and describes the recent and on-going reform measures implemented by government.
- **A section on government reform process** briefly summarizes recent and ongoing reform measures implemented by government and assesses the institutional factors that are likely to impact reform planning and implementation in the future.

As mentioned above, the report is a statement of current PFM performance and does not include recommendations for reforms or action plans. In case of different views between the donors and the government over the findings of the report, the government's opinion could be reflected in an annex of the report.

**Annex 2 provides additional information and guidance on the PFM-PR.**

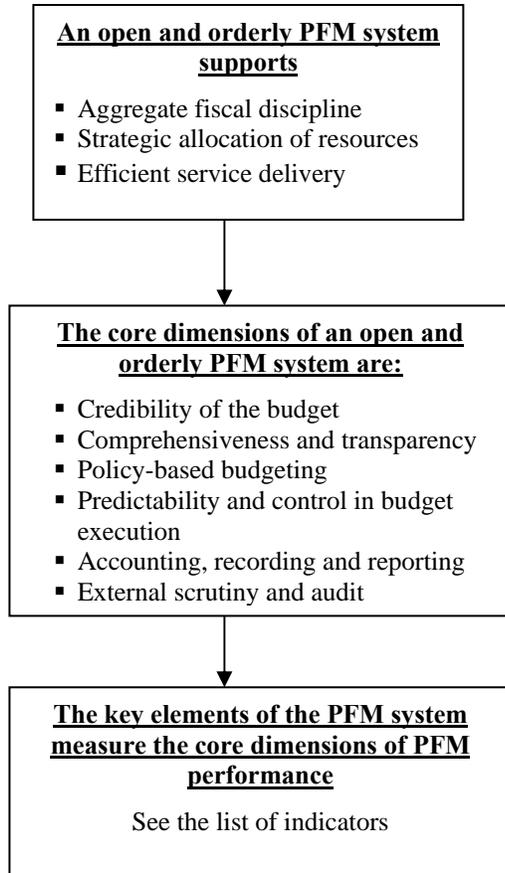
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<sup>4</sup> As drawn from other analytical work.

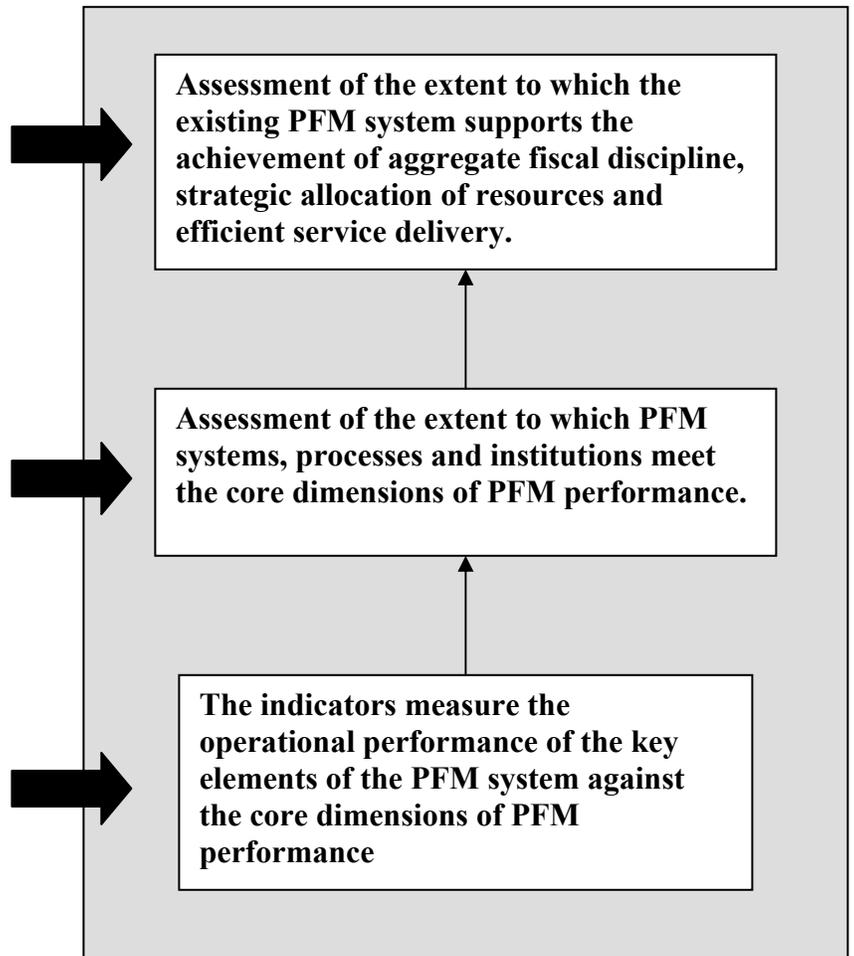
## 5. Overall structure of the Performance Measurement Framework

The structure of the Performance Measurement Framework is summarized below:

### *Analytical Framework underpinning the Performance Measurement Framework*



### *The assessment provided by the Performance Measurement Framework*



# Annex 1

## The PFM High-Level Performance Indicator Set



# Annex 1

## The PFM High-Level Performance Indicator Set

### Overview of the indicator set

	<b>A. PFM-OUT-TURNS: Credibility of the budget</b>
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>B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency</b>
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
	<b>C. BUDGET CYCLE</b>
	<b>C(i) Policy-Based Budgeting</b>
PI-11	Orderliness and participation in the annual budget process
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting
	<b>C(ii) Predictability and Control in Budget Execution</b>
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
	<b>C(iii) Accounting, Recording and Reporting</b>
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
	<b>C(iv) External Scrutiny and Audit</b>
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
	<b>D. DONOR PRACTICES</b>
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

## Scoring Methodology

Most of the indicators have a number of dimensions linked to the subject of the indicator. Each of these dimensions must be assessed separately. The overall score for an indicator is then based on the assessments for the individual dimensions of the indicator. Combining the scores for dimensions into the overall score for the indicator is done by Scoring Method 1 (M1) for some indicators and Scoring Method 2 (M2) for other indicators. It is specified in the indicator guidance for each indicator what methodology should be used.

Method 1 (M1) is used for all single dimensional indicators and for multi-dimensional indicators where poor performance on one dimension of the indicator is likely to undermine the impact of good performance on other dimensions of the same indicator (in other words, by the weakest link in the connected dimensions of the indicator). For indicators with 2 or more dimensions, the steps in determining the overall or aggregate indicator score are as follows:

- Each dimension is initially assessed separately and given a score.
- Combine the scores for the individual dimensions by choosing the lowest score given for any dimension.
- A '+' should be added, where any of the other dimensions are scoring higher (Note: It is NOT possible to choose the score for one of the higher scoring dimensions and add a '-' for any lower scoring dimensions. And it is NOT possible to add a '+' to the score of an indicator with only one listed dimension).

Method 2 (M2) is based on averaging the scores for individual dimensions of an indicator. It is prescribed for selected multi-dimensional indicators, where a low score on one dimension of the indicator does not necessarily undermine the impact of a high score on another dimension of the same indicator. Though the dimensions all fall within the same area of the PFM system, progress on individual dimensions can be made independent of the others and without logically having to follow any particular sequence. The steps in determining the overall or aggregate indicator score are as follows:

- For each dimension, assess what standard has been reached on the 4-point calibration scale (as for M1).
- Go to the Conversion Table for Scoring Method M2 (below) and find the appropriate section of the table (2, 3 or 4 dimensional indicators),
- Identify the line in the table that matches the combination of scores that has been given to the dimensions of the indicator (the order of the dimensional scores is immaterial),
- Pick the corresponding overall score for the indicator.

The Conversion Table applies to all indicators using M2 scoring methodology only and cannot be used for indicators using M1, as that would result in an incorrect score. The Conversion Table should NOT be used to aggregate scores across all or sub-sets of indicators, since the table was not designed for that purpose. In general, the performance indicator set has not been designed for aggregation, and therefore, no aggregation methodology has been developed

**Conversion Table for Scoring Method M2**

Scores for individual dim.		Overall score M2	
2-dimensional indicators			
D	D	D	
D	C	D+	
D	B	C	
D	A	C+	
C	C	C	
C	B	C+	
C	A	B	
B	B	B	
B	A	B+	
A	A	A	
3-dimensional indicators			
D	D	D	D
D	D	C	D+
D	D	B	D+
D	D	A	C
D	C	C	D+
D	C	B	C
D	C	A	C+
D	B	B	C+
D	B	A	B
D	A	A	B
C	C	C	C
C	C	B	C+
C	C	A	B
C	B	B	B
C	B	A	B
C	A	A	B+
B	B	B	B
B	B	A	B+
B	A	A	A
A	A	A	A

Scores for individual dim.				Overall score M2
4-dimensional indicators				
D	D	D	D	D
D	D	D	C	D
D	D	D	B	D+
D	D	D	A	D+
D	D	C	C	D+
D	D	C	B	D+
D	D	C	A	C
D	D	B	B	C
D	D	B	A	C+
D	D	A	A	C+
D	C	C	C	D+
D	C	C	B	C
D	C	C	A	C+
D	C	B	B	C+
D	C	B	A	C+
D	C	A	A	B
D	B	B	B	C+
D	B	B	A	B
D	B	A	A	B
D	A	A	A	B+
C	C	C	C	C
C	C	C	B	C+
C	C	C	A	C+
C	C	B	B	C+
C	C	B	A	B
C	C	A	A	B
C	B	B	B	B
C	B	B	A	B
C	B	A	A	B+
C	A	A	A	B+
B	B	B	B	B
B	B	B	A	B+
B	B	A	A	B+
B	A	A	A	A
A	A	A	A	A

Note: It is of no importance in which order the dimensions in an indicator are assigned the individual scores

**The table CANNOT be applied to indicators using scoring method M1.**

## General Guidance on Scoring

In order to justify a particular score for a dimension of an indicator, all the requirements specified for that score in the scoring table must be fulfilled. However, there are cases where a score can be justified by alternative requirements, in which case the alternatives are separated by the word ‘OR’.

The ‘D’ score is considered the residual score, to be applied if the requirements for any higher score are not met. While the calibration of each dimension of an indicator (i.e. the minimum requirements for a particular score) includes a description also of the ‘D’ score requirements, there may be cases where the actual situation does not fit reasonably well into this description, even if the requirements for any higher score are not met. In that case a ‘D’ score should be allocated and the difference between the score requirements and the actual situation be commented in the narrative.

The requirements for a score can be assessed on the basis of different time horizons. The relevant period on which a dimension should be assessed, and therefore for which evidence should be sought, is specified in the guidance or calibration for many indicators/dimensions. Where it is not specified, it should be assessed on the basis of the current situation, or in the case of periodic events, on the basis of the events during the most recent budget cycle.

Indicators PI-1, PI-2, PI-3 and D-1 require data for three years as a basis for the assessment. The data should cover the most recent completed fiscal year for which data is available and the two immediately preceding years. The assessment is based on the performance in two out of those three years<sup>5</sup> i.e. allowance is made for one year to be abnormal (and not contributing to the score) due to unusual circumstances such as external shocks (e.g. natural disasters, price fluctuations in important export or import commodities) or domestic problems (e.g. of a political nature). As such anomalies have generally been catered for in the calibration, no fiscal year should be skipped in the basic data set.

Further guidance on scoring will be made available on the website [www.pefa.org](http://www.pefa.org), including answers to frequently asked questions.

## Specific Guidance on Each Indicator

The remainder of this Annex 1 provides detailed guidance on the scoring of each of the indicators including the scoring tables for each indicator.

Guidance on the narrative reporting on each indicator is provided in the Box inserted in Section 3 of Annex 2.

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<sup>5</sup> With the exception of the requirements for a score of ‘A’ under PI-2.

**PI-1. Aggregate expenditure out-turn compared to original approved budget**

The ability to implement the budgeted expenditure is an important factor in supporting the government’s ability to deliver the public services for the year as expressed in policy statements, output commitments and work plans. The indicator reflects this by measuring the actual total expenditure compared to the originally budgeted total expenditure (as defined in government budget documentation and fiscal reports), but excludes two expenditure categories over which the government will have little control. Those categories are (a) debt service payments, which in principle the government cannot alter during the year while they may change due to interest and exchange rates movements, and (b) donor funded project expenditure, the management and reporting of which are typically under the donor agencies’ control to a high degree.

In order to understand the reasons behind a deviation from the budgeted expenditure, it is important that the narrative describes the external factors that may have led to the deviation and particularly makes reference to the impact of deviations from budgeted revenue, assessed by indicators PI-3 (domestic revenue) and D-1 (external revenue). It is also important to understand the impact of a total expenditure deviation on the ability to implement the expenditure composition as budgeted, ref. also PI-2 and PI-16.

**Dimensions to be assessed (Scoring Method M1):**

(i) The difference between actual primary expenditure and the originally budgeted primary expenditure (i.e. excluding debt service charges, but also excluding externally financed project expenditure).

Score	Minimum Requirements (Scoring Method M1)
A	(i) In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 5% of budgeted expenditure.
B	(i) In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 10 % of budgeted expenditure.
C	(i) In no more than one of the last three years has the actual expenditure deviated from budgeted expenditure by more than an amount equivalent to 15% of budgeted expenditure.
D	(i) In two or all of the last three years did the actual expenditure deviate from budgeted expenditure by an amount equivalent to more than 15% of budgeted expenditure.

## PI-2. Composition of expenditure out-turn compared to original approved budget

Where the composition of expenditure varies considerably from the original budget, the budget will not be a useful statement of policy intent. Measurement against this indicator requires an empirical assessment of expenditure out-turns against the original budget at a sub-aggregate level. As budgets are usually adopted and managed on an administrative (ministry/agency) basis, the administrative basis is preferred for assessment, but a functional basis is an acceptable alternative. At administrative level, variance shall be calculated for the main budgetary heads (votes) of ministries, independent departments and agencies, which are included in the approved budget<sup>6</sup>. If functional classification is used, it should be based on the GFS/COFOG ten main functions.

Changes in overall level of expenditure (assessed in PI-1) will translate into changes in spending for administrative (and functional) budget lines. This indicator (PI-2) measures the extent to which reallocations between budget lines have contributed to variance in expenditure composition beyond the variance resulting from changes in the overall level of expenditure. To make that assessment requires that the total variance in the expenditure composition is calculated and compared to the overall deviation in primary expenditure for each of the last three years.

Variance is calculated as the weighted average deviation between actual and originally budgeted expenditure calculated as a percent of budgeted expenditure on the basis of administrative or functional classification, using the absolute value of deviation<sup>7</sup>. In order to be compatible with the assessment in PI-1, the calculation should exclude debt service and donor funded project expenditure.

### Dimensions to be assessed (Scoring Method M1):

(i) Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years.

Score	Minimum Requirements (Scoring Method M1)
<b>A</b>	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by no more than 5 percentage points in any of the last three years.
<b>B</b>	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 5 percentage points in no more than one of the last three years.
<b>C</b>	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in no more than one of the last three years.
<b>D</b>	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in at least two out of the last three years.

<sup>6</sup> In case the number of main budgetary heads exceed 20, the deviation should be calculated for the 20 largest heads (by amount) or for the largest heads that represent 75% of budgeted expenditure if the latter number of heads is larger than 20. The deviation for the remaining headlines should be done on an aggregated basis i.e. as if they constituted one budget head only.

<sup>7</sup> The steps in calculation for each year are as follows (an Excel spreadsheet for easy calculation can be downloaded from the website [www.pefa.org](http://www.pefa.org), also including an example):

- For each budget head that contributed to primary expenditure, calculate the deviation between actual expenditure and the original budget.
- Add up the absolute value of the deviations for all budget heads (absolute value = the positive difference between the actual and the budget figures). Do not use percentage deviations.
- Calculate this sum as a percentage of the total budgeted primary expenditure.
- Deduct the percentage of overall primary expenditure deviation for each year (calculated for PI-1) to arrive at the number of percentage points by which expenditure composition variance exceeded overall expenditure deviation.
- Go to the scoring table above and establish in how many years the percentage points exceeded 5 or 10.

**PI-3. Aggregate revenue out-turn compared to original approved budget**

Accurate forecasting of domestic revenue is a critical factor in determining budget performance, since budgeted expenditure allocations are based upon that forecast. A comparison of budgeted and actual revenue provides an overall indication of the quality of revenue forecasting.

External shocks may however occur, that could not have been forecast and do not reflect inadequacies in administration, they should be explained in the narrative. The calibration allows for a top score even if during one year in the last three the outturn is substantially different from the forecast e.g. as a result of a major external shock occurring during budget execution.

For this indicator, information from budget execution reports or final government accounts should be used to the extent available (rather than data from other sources such as a revenue authority or the central bank). The narrative should explain the sources of data and any concerns regarding consistency or reliability, which may also be highlighted by assessment of revenue data reconciliation in PI-14.

**Dimensions to be assessed (Scoring Method M1):**

(i) Actual domestic revenue collection compared to domestic revenue estimates in the original, approved budget.

Score	Minimum Requirements (Scoring Method M1)
A	(i) Actual domestic revenue collection was below 97% of budgeted domestic revenue estimates in no more than one of the last three years.
B	(i) Actual domestic revenue collection was below 94% of budgeted domestic revenue estimates in no more than one of the last three years.
C	(i) Actual domestic revenue collection was below 92% of budgeted domestic revenue estimates in no more than one of the last three years.
D	(i) Actual domestic revenue collection was below 92% of budgeted domestic revenue estimates in two or all of the last three years.

**PI-4. Stock and monitoring of expenditure payment arrears**

Expenditure payment arrears are expenditure obligations that have been incurred by government, for which payment to the employee, supplier, contractor or loan creditor is overdue, and constitutes a form of non-transparent financing. A high level of arrears can indicate a number of different problems such as inadequate commitment controls, cash rationing, inadequate budgeting for contracts, under-budgeting of specific items and lack of information. Expenditure arrears assume that the outstanding payment is due under a specific legal obligation or contractual commitment, which the government has entered, and may include due but unpaid claims for salaries, pensions, supplies, services, rents, interest on domestic and external debt. Delays or reductions in transfers of subsidies and grants to autonomous government agencies and other levels of government would not constitute arrears unless they are part of a legal obligation (specifying amount and timing of each payment) or contractual agreement. A provision for a transfer in the annual budget law or appropriations act would not in itself constitute a legal obligation. Unpaid amortization of loan principal is not considered an arrear for this indicator, since amortization is not expenditure, but a financing transaction.

Local regulations or widely accepted practices may specify when an unpaid claim becomes in arrears. If such a local practice is applied in measuring the stock of arrears, then its content and basis should be described in the narrative. The default for the assessment, however, would be internationally accepted business practices according to which a claim will be considered in arrears if payment has not been made within 30 days from government’s receipt of supplier’s invoice/claim (for supplies, services or works delivered), whereas the failure to make staff payroll payment or meet a deadline for payment of interest on debt immediately results in the payment being in arrears.

This indicator is concerned with measuring the extent to which there is a stock of arrears, and the extent to which the systemic problem is being brought under control and addressed. While special exercises to identify and pay off old arrears may be necessary, this will not be effective if new arrears continue to be created (payments due during the last year but not made). Most fundamentally, however, is the assessment of the existence and completeness of data on arrears, without which no assessment can be made.

**Dimensions to be assessed (Scoring Method M1):**

- (i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock.
- (ii) Availability of data for monitoring the stock of expenditure payment arrears.

<b>Score</b>	<b>Minimum Requirements (Scoring Method M1)</b>
<b>A</b>	(i) The stock of arrears is low (i.e. is below 2% of total expenditure) (ii) Reliable and complete data on the stock of arrears is generated through routine procedures at least at the end of each fiscal year (and includes an age profile).
<b>B</b>	(i) The stock of arrears constitutes 2-10% of total expenditure; and there is evidence that it has been reduced significantly (i.e. more than 25%) in the last two years. (ii) Data on the stock of arrears is generated annually, but may not be complete for a few identified expenditure categories or specified budget institutions.
<b>C</b>	(i) The stock of arrears constitutes 2-10% of total expenditure; and there is no evidence that it has been reduced significantly in the last two years. (ii) Data on the stock of arrears has been generated by at least one comprehensive ad hoc exercise within the last two years.
<b>D</b>	(i) The stock of arrears exceeds 10% of total expenditure. (ii) There is no reliable data on the stock of arrears from the last two years.

## PI-5. Classification of the budget

A robust classification system allows the tracking of spending on the following dimensions: administrative unit, economic, functional and program. Where standard international classification practices are applied, governments can report expenditure in GFS format and track poverty-reducing and other selected groups of expenditure. The budget will be presented in a format that reflects the most important classifications (usually administrative combined with economic, functional and/or programmatic) and the classification will be embedded in the chart of accounts to ensure that all transactions can be reported in accordance with any of the classifications used.

In countries where a poverty reduction strategy is a core element in the government's overall policy framework, the definition of poverty reducing expenditure is normally linked directly to the classification of the budget.

The international standard for classification systems is the Government Finance Statistics (GFS) which provides the framework for economic and functional classification of transactions. Under the UN-supported Classification of Functions of Government (COFOG), which is the functional classification applied in GFS, there are ten main functions at the highest level and 69 functions at the second (sub-functional) level.

No international standard for programmatic classification exists, and this type of classification is used in widely deviating ways across countries. However, program classification can be an important tool in budget formulation, management and reporting (ref. indicator PI-12), and the way in which it is applied should be explained in the narrative if the highest score is assigned on this basis.

### Dimensions to be assessed (Scoring Method M1):

(i) The classification system used for formulation, execution and reporting of the central government's budget.

Score	Minimum Requirements (Scoring Method M1)
<b>A</b>	(i) The budget formulation and execution is based on administrative, economic and sub-functional classification, using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards. (Program classification may substitute for sub-functional classification, if it is applied with a level of detail at least corresponding to sub-functional.)
<b>B</b>	(i) The budget formulation and execution is based on administrative, economic and functional classification (using at least the 10 main COFOG functions), using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards.
<b>C</b>	(i) The budget formulation and execution is based on administrative and economic classification using GFS standards or a standard that can produce consistent documentation according to those standards.
<b>D</b>	(i) The budget formulation and execution is based on a different classification (e.g. not GFS compatible or with administrative break-down only).

**PI-6. Comprehensiveness of information included in budget documentation**

Annual budget documentation (the annual budget and budget supporting documents), as submitted to the legislature for scrutiny and approval, should allow a complete picture of central government fiscal forecasts, budget proposals and out-turn of previous years. In addition to the detailed information on revenues and expenditures, and in order to be considered complete, the annual budget documentation should include information on the following elements:

1. Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate.
2. Fiscal deficit, defined according to GFS or other internationally recognized standard.
3. Deficit financing, describing anticipated composition.
4. Debt stock, including details at least for the beginning of the current year.
5. Financial Assets, including details at least for the beginning of the current year.
6. Prior year’s budget outturn, presented in the same format as the budget proposal.
7. Current year’s budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal.
8. Summarized budget data for both revenue and expenditure according to the main heads of the classifications used (ref. PI-5), including data for the current and previous year.
9. Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs.

**Dimensions to be assessed (Scoring Method M1):**

(i) Share of the above listed information in the budget documentation most recently issued by the central government (in order to count in the assessment, the full specification of the information benchmark must be met).

Score	Minimum Requirements (Scoring Method M1)
<b>A</b>	(i) recent budget documentation fulfils 7-9 of the 9 information benchmarks
<b>B</b>	(i) recent budget documentation fulfils 5-6 of the 9 information benchmarks
<b>C</b>	(i) recent budget documentation fulfils 3-4 of the 9 information benchmarks
<b>D</b>	(i) recent budget documentation fulfils 2 or less of the 9 information benchmarks

**PI-7. Extent of unreported government operations**

Annual budget estimates, in-year execution reports, year-end financial statements and other fiscal reports for the public, should cover all budgetary and extra-budgetary activities of central government to allow a complete picture of central government revenue, expenditures across all categories, and financing. This will be the case if (i) extra-budgetary operations (central government activities which are not included in the annual budget law, such as those funded through extra-budgetary funds), are insignificant or if any significant expenditures on extra-budgetary activities are included in fiscal reports, and if (ii) activities included in the budget but managed outside the government’s budget management and accounting system (mainly donor funded projects) are insignificant or included in government fiscal reporting.

While donor project funding is partially outside government control (particularly for inputs provided in-kind i.e. supplied and paid under contracts to which the government is not a party) , MDAs in charge of implementing donor funded projects should at least be able to provide adequate financial reports on the receipt and use of donor funding received in cash. Donors’ assistance to the government in providing full financial information on project support (including inputs in-kind) is assessed in indicator D-2.

**Dimensions to be assessed (Scoring Method M1):**

- (i) The level of extra-budgetary expenditure (other than donor funded projects) which is unreported i.e. not included in fiscal reports.
- (ii) Income/expenditure information on donor-funded projects which is included in fiscal reports.

Dimension	Minimum requirements (Scoring Method M1).
<b>A</b>	(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) is insignificant (below 1% of total expenditure). (ii) Complete income/expenditure information for 90% (value) of donor-funded projects is included in fiscal reports, except inputs provided in-kind OR donor funded project expenditure is insignificant (below 1% of total expenditure).
<b>B</b>	(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes 1-5% of total expenditure. (ii) Complete income/expenditure information is included in fiscal reports for all loan financed projects and at least 50% (by value) of grant financed projects.
<b>C</b>	(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes 5-10% of total expenditure. (ii) Complete income/expenditure information for all loan financed projects is included in fiscal reports.
<b>D</b>	(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes more than 10% of total expenditure. (ii) Information on donor financed projects included in fiscal reports is seriously deficient and does not even cover all loan financed operations.

## **PI-8. Transparency of Inter-Governmental Fiscal Relations**

While the performance indicator set is focused on PFM by central government, Sub-National (SN) Governments<sup>8</sup> in many countries have wide-ranging expenditure responsibilities. In federal states, the fiscal relationship between the central (federal or union) government and the individual states is typically established in the Constitution of the Union or Federation. In other cases, specific laws determine the layers of SN government, the expenditure responsibilities and revenue sharing arrangements. Transfers falling in these categories are usually unconditional grants, the use of which will be determined by SN governments through their budgets. In addition, central government may provide conditional (earmarked) grants to SN governments to implement selected service delivery and expenditure responsibilities e.g. by function or program, on a case by case basis. The overall level of grants (i.e. the vertical allocation) will usually be budget policy decisions at the central government's discretion or as part of constitutional negotiation processes and is not assessed by this indicator. However, clear criteria, such as formulas, for the distribution of grants among SN government entities (i.e. horizontal allocation of funds) are needed to ensure allocative transparency and medium-term predictability of funds available for planning and budgeting of expenditure programs by SN governments. It is also crucial for SN governments that they receive firm and reliable information on annual allocations from central government well in advance of the completion (preferably before commencement) of their own budget preparation processes.

Given the increasing tendency for primary service delivery to be managed at sub-national government levels, correct interpretation of sectoral resource allocation and actual spending effort require tracking of expenditure information at all levels of government according to sectoral categories (which may or may not correspond to the GFS functional classification), even when this is not the legal form in which the budget is executed. Generation of a full overview of expenditure allocations by general government requires that SN government can generate fiscal data with a classification that is comparable to central government and that such information is collected at least annually and consolidated with central government fiscal reports. SN governments may not have obligations to report directly to central government. Collection and consolidation of fiscal data for general government, therefore, may not necessarily be undertaken by central government, but rather by a national statistical office. For the coverage to be meaningful, the consolidated reporting of fiscal information should be of a reasonable quality, include all tiers of general government, and be presented on both an ex-ante (budgeted) and an ex-post (actual) basis. Ex-post information should be sourced from routine accounting systems.

### **Dimensions to be assessed (Scoring method M2):**

- (i) Transparent and rules based systems in the horizontal allocation among SN governments of unconditional and conditional transfers from central government (both budgeted and actual allocations);
- (ii) Timeliness of reliable information to SN governments on their allocations from central government for the coming year;
- (iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories.

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<sup>8</sup> Funding provided to deconcentrated units of central government (which do not have local accountability mechanisms) is not covered by the scope of this indicator.

<b>Dimension</b>	<b>Minimum requirements for dimension score. Scoring Methodology M2</b>
(i) Transparency and objectivity in the horizontal allocation among SN governments	<p><b>Score = A:</b> The horizontal allocation of almost all transfers (at least 90% by value) from central government is determined by transparent and rules based systems</p> <p><b>Score = B:</b> The horizontal allocation of most transfers from central government (at least 50% of transfers) is determined by transparent and rules based systems.</p> <p><b>Score = C:</b> The horizontal allocation of only a small part of transfers from central government (10-50%) is determined by transparent and rules based systems.</p> <p><b>Score = D:</b> No or hardly any part of the horizontal allocation of transfers from central government is determined by transparent and rules based systems.</p>
(ii) Timeliness of reliable information to SN governments on their allocations	<p><b>Score = A:</b> SN governments are provided reliable information on the allocations to be transferred to them before the start of their detailed budgeting processes.</p> <p><b>Score = B:</b> SN governments are provided reliable information on the allocations to be transferred to them ahead of completing their budget proposals, so that significant changes to the proposals are still possible.</p> <p><b>Score = C:</b> Reliable information to SN governments is issued before the start of the SN fiscal year, but too late for significant budget changes to be made.</p> <p><b>Score = D:</b> Reliable estimates on transfers are issued after SN government budgets have been finalized, or earlier issued estimates are not reliable.</p>
(iii) Extent of consolidation of fiscal data for general government according to sectoral categories	<p><b>Score = A:</b> Fiscal information (ex-ante and ex-post) that is consistent with central government fiscal reporting is collected for 90% (by value) of SN government expenditure and consolidated into annual reports within 10 months of the end of the fiscal year.</p> <p><b>Score = B:</b> Fiscal information (ex-ante and ex-post) that is consistent with central government fiscal reporting is collected for at least 75% (by value) of SN government expenditure and consolidated into annual reports within 18 months of the end of the fiscal year.</p> <p><b>Score = C:</b> Fiscal information (at least ex-post) that is consistent with central government fiscal reporting is collected for at least 60% (by value) of SN government expenditure and consolidated into annual reports within 24 months of the end of the fiscal year.</p> <p><b>Score = D:</b> Fiscal information that is consistent with central government fiscal reporting is collected and consolidated for less than 60% (by value) of SN government expenditure OR if a higher proportion is covered, consolidation into annual reports takes place with more than 24 months delay, if at all.</p>

**PI-9. Oversight of aggregate fiscal risk from other public sector entities**

Central government will usually have a formal oversight role in relation to other public sector entities and should monitor and manage fiscal risks with national implications arising from activities of sub-national (SN) levels of government, autonomous government agencies (AGA) and public enterprises (PE), including state-owned banks, but may also for political reasons be obliged to assume responsibility for financial default of other public sector entities, where no formal oversight role exists. Fiscal risks can be created by SN government, AGAs and PEs and *inter alia* take the form of debt service defaulting (with or without guarantees issued by central government), operational losses caused by unfunded quasi-fiscal operations, expenditure payment arrears and unfunded pension obligations.

Central government should require and receive quarterly financial statements and audited year-end statements from AGAs and PEs, and monitor performance against financial targets. AGAs and PEs often report to parent line ministries, but consolidation of information is important for overview and reporting of the total fiscal risk for central government. Where SN governments can generate fiscal liabilities for central government, their fiscal position should be monitored, at least on an annual basis, again with consolidation of essential fiscal information.

Central government’s monitoring of these fiscal risks should enable it to take corrective measures arising from actions of AGAs, PEs and SN governments, in a manner consistent with transparency, governance and accountability arrangements, and the relative responsibilities of central government for the rest of the public sector.

**Dimensions to be assessed (Scoring Method M1):**

- (i) Extent of central government monitoring of AGAs and PEs.
- (ii) Extent of central government monitoring of SN governments’ fiscal position.

Score	Minimum requirements (Scoring methodology: M1)
<b>A</b>	(i) All major AGAs/PEs submit fiscal reports to central government at least six-monthly, as well as annual audited accounts, and central government consolidates fiscal risk issues into a report at least annually. (ii) SN government cannot generate fiscal liabilities for central government OR the net fiscal position is monitored at least annually for all levels of SN government and central government consolidates overall fiscal risk into annual (or more frequent) reports.
<b>B</b>	(i) All major AGAs/PEs submit fiscal reports including audited accounts to central governments at least annually, and central government consolidates overall fiscal risk issues into a report. (ii) The net fiscal position is monitored at least annually for the most important level of SN government, and central government consolidates overall fiscal risk into a report.
<b>C</b>	(i) Most major AGAs/PEs submit fiscal reports to central governments at least annually, but a consolidated overview is missing or significantly incomplete. (ii) The net fiscal position is monitored at least annually for the most important level of SN government, but a consolidated overview is missing or significantly incomplete.
<b>D</b>	(i) No annual monitoring of AGAs and PEs takes place, or it is significantly incomplete. (ii) No annual monitoring of SN governments’ fiscal position takes place or it is significantly incomplete.

**PI-10. Public Access to key fiscal information**

Transparency will depend on whether information on fiscal plans, positions and performance of the government is easily accessible to the general public or at least the relevant interest groups.

The narrative of the assessment should comment on the quality of information made available (e.g. understandable language and structure, appropriate layout, summarized for large documents) and the means used to facilitate public access (such as the press, websites, sale of major documents at no more than printing cost and notice boards for mainly locally relevant information). The extent to which the means are appropriate depends on the nature of the documentation and the characteristics of the relevant interest or user groups, such as access to different media.

Elements of information to which public access is essential include:

- (i) Annual budget documentation: A complete<sup>9</sup> set of documents can be obtained by the public through appropriate means when it is submitted to the legislature.
- (ii) In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion.
- (iii) Year-end financial statements: The statements are made available to the public through appropriate means within six months of completed audit.
- (iv) External audit reports: All reports on central government consolidated operations are made available to the public through appropriate means within six months of completed audit.
- (v) Contract awards: Award of all contracts with value above approx. USD 100,000 equiv. are published at least quarterly through appropriate means.
- (vi) Resources available to primary service units: Information is publicized through appropriate means at least annually, or available upon request, for primary service units with national coverage in at least two sectors (such as elementary schools or primary health clinics).

**Dimensions to be assessed (Scoring Method M1):**

- (i) Number of the above listed elements of public access to information that is fulfilled (in order to count in the assessment, the full specification of the information benchmark must be met).

Score	Minimum Requirements (Scoring Method M1)
<b>A</b>	(i) the government makes available to the public 5-6 of the 6 listed types of information
<b>B</b>	(i) the government makes available to the public 3-4 of the 6 listed types of information
<b>C</b>	(i) the government makes available to the public 1-2 of the 6 listed types of information
<b>D</b>	(i) the government makes available to the public none of the 6 listed types of information

<sup>9</sup> ‘Complete’ means that the documents made publicly available contains the all of information listed under indicator PI-6, to the extent this information exists.

## **PI-11. Orderliness and participation in the annual budget process**

While the Ministry of Finance (MOF) is usually the driver of the annual budget formulation process, effective participation in the budget formulation process by other ministries, departments and agencies (MDAs) as well as the political leadership<sup>10</sup>, impacts the extent to which the budget will reflect macro-economic, fiscal and sector policies. Full participation requires an integrated top-down and bottom-up budgeting process, involving all parties in an orderly and timely manner, in accordance with a pre-determined budget formulation calendar.

The calendar should allow for passing of the budget law before the start of the fiscal year as well as for sufficient time for the other MDAs to meaningfully prepare their detailed budget proposals as per the guidance. Delays in passing the budget may create uncertainty about the level of approved expenditures and delays in some government activities, including major contracts. Clear guidance on the budget process should be provided in the budget circular and budget formulation manual, including indicative budgetary ceilings for administrative units or functional areas.

In order to avoid last minute changes to budget proposals, it is important that the political leadership is actively involved in the setting of aggregate allocations (particularly for sectors or functions) from an early stage of the budget preparation process. This should be initiated through review and approval of the allocation ceilings in the budget circular, either by approving the budget circular or by approving a preceding proposal for aggregate allocations (e.g. in a budget outlook paper).

### **Dimensions to be assessed (Scoring method M2):**

- (i) Existence of and adherence to a fixed budget calendar;
- (ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent);
- (iii) Timely budget approval by the legislature or similarly mandated body (within the last three years);

NOTE: The MDAs concerned for the purpose of this indicator are those which are directly charged with responsibility for implementing the budget in line with sector policies and which directly receive funds or authorization to spend from the MOF. Department and agencies that report and receive budgetary funds through a parent ministry should not be considered in the assessment.

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<sup>10</sup> By 'political leadership' is meant the leadership of the executive, such as the Cabinet or equivalent body. Involvement of the legislative in review of budget proposals is covered by indicator PI-27.

<b>Dimension</b>	<b>Minimum requirements for dimension score. Scoring Methodology M2</b>
(i) Existence of and adherence to a fixed budget calendar	<p><b>Score = A:</b> A clear annual budget calendar exists, is generally adhered to and allows MDAs enough time (and at least six weeks from receipt of the budget circular) to meaningfully complete their detailed estimates on time.</p> <p><b>Score = B:</b> A clear annual budget calendar exists, but some delays are often experienced in its implementation. The calendar allows MDAs reasonable time (at least four weeks from receipt of the budget circular) so that most of them are able to meaningfully complete their detailed estimates on time,</p> <p><b>Score = C:</b> An annual budget calendar exists, but is rudimentary and substantial delays may often be experienced in its implementation, and allows MDAs so little time to complete detailed estimates, that many fail to complete them timely.</p> <p><b>Score = D:</b> A budget calendar is not prepared OR it is generally not adhered to OR the time allowed for MDAs' budget preparation is clearly insufficient to make meaningful submissions.</p>
(ii) Guidance on the preparation of budget submissions	<p><b>Score = A:</b> A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by Cabinet (or equivalent) prior to the circular's distribution to MDAs.</p> <p><b>Score = B:</b> A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by Cabinet (or equivalent). This approval takes place after the circular distribution to MDAs, but before MDAs have completed their submission.</p> <p><b>Score = C:</b> A budget circular is issued to MDAs, including ceilings for individual administrative units or functional areas. The budget estimates are reviewed and approved by Cabinet only after they have been completed in all details by MDAs, thus seriously constraining Cabinet's ability to make adjustments.</p> <p><b>Score = D:</b> A budget circular is not issued to MDAs OR the quality of the circular is very poor OR Cabinet is involved in approving the allocations only immediately before submission of detailed estimates to the legislature, thus having no opportunities for adjustment.</p>
(iii) Timely budget approval by the legislature	<p><b>Score = A:</b> The legislature has, during the last three years, approved the budget before the start of the fiscal year.</p> <p><b>Score = B:</b> The legislature approves the budget before the start of the fiscal year, but a delay of up to two months has happened in one of the last three years.</p> <p><b>Score = C:</b> The legislature has, in two of the last three years, approved the budget within two months of the start of the fiscal year.</p> <p><b>Score = D:</b> The budget has been approved with more than two months delay in two of the last three years.</p>

**PI-12. Multi-year perspective in fiscal planning, expenditure policy and budgeting**

Expenditure policy decisions have multi-year implications, and must be aligned with the availability of resources in the medium-term perspective. Therefore, multi-year fiscal forecasts of revenue, medium term expenditure aggregates for mandatory expenditure and potential deficit financing (including reviews of debt sustainability involving both external and domestic debt) must be the foundation for policy changes.

Expenditure policy decisions or options should be described in sector strategy documents, which are fully costed in terms of estimates of forward expenditures (including expenditures both of a recurring nature as well as those involving investment commitments and their recurrent cost implications) to determine whether current and new policies are affordable within aggregate fiscal targets. On this basis, policy choices should be made and indicative, medium-term sector allocations be established. The extent to which forward estimates include explicit costing of the implication of new policy initiatives, involve clear, strategy-linked selection criteria for investments and are integrated into the annual budget formulation process will then complete the policy-budget link.

Countries that have effectively introduced multi-annual program budgeting are likely to show good performance on most aspects of this indicator. In this regard, assessors could substitute ‘programs’ for ‘functions’ in dimension (i) and for ‘sector strategies’ in dimensions (iii) and (iv) of the indicator.

**Dimensions to be assessed (Scoring method M2):**

- (i) Preparation of multi -year fiscal forecasts and functional allocations;
- (ii) Scope and frequency of debt sustainability analysis
- (iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure;
- (iv) Linkages between investment budgets and forward expenditure estimates.

<b>Dimension</b>	<b>Minimum requirements for dimension score. Scoring Methodology M2</b>
(i) Multi-year fiscal forecasts and functional allocations	<p><b>Score = A:</b> Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least three years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences explained</p> <p><b>Score = B:</b> Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least two years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences are explained.</p> <p><b>Score = C:</b> Forecasts of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least two years on a rolling annual basis.</p> <p><b>Score = D:</b> No forward estimates of fiscal aggregates are undertaken</p>

<p>(ii) Scope and frequency of debt sustainability analysis</p>	<p><b>Score = A:</b> DSA for external and domestic debt is undertaken annually.</p> <p><b>Score = B:</b> DSA for external and domestic debt is undertaken at least once during the last three years.</p> <p><b>Score = C:</b> A DSA for at least for external debt undertaken once during last three years.</p> <p><b>Score = D:</b> No DSA has been undertaken in the last three years</p>
<p>(iii) Existence of costed sector strategies</p>	<p><b>Score = A:</b> Strategies for sectors representing at least 75% of primary expenditure exist with full costing of recurrent and investment expenditure, broadly consistent with fiscal forecasts.</p> <p><b>Score = B:</b> Statements of sector strategies exist and are fully costed, broadly consistent with fiscal forecasts, for sectors representing 25-75% of primary expenditure.</p> <p><b>Score = C:</b> Statements of sector strategies exist for several major sectors but are only substantially costed for sectors representing up to 25% of primary expenditure OR costed strategies cover more sectors but are inconsistent with aggregate fiscal forecasts.</p> <p><b>Score = D:</b> Sector strategies may have been prepared for some sectors, but none of them have substantially complete costing of investments and recurrent expenditure.</p>
<p>(iv) Linkages between investment budgets and forward expenditure estimates</p>	<p><b>Score = A:</b> Investments are consistently selected on the basis of relevant sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector.</p> <p><b>Score = B:</b> The majority of important investments are selected on the basis of relevant sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector.</p> <p><b>Score = C:</b> Many investment decisions have weak links to sector strategies and their recurrent cost implications are included in forward budget estimates only in a few (but major) cases.</p> <p><b>Score = D:</b> Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared.</p>

### **PI-13. Transparency of Taxpayer Obligations and Liabilities**

Effective assessment of tax liability is subject to the overall control environment that exists in the revenue administration system (ref. PI-14) but is also very dependent on the direct involvement and co-operation of the taxpayers from the individual and corporate private sector. Their contribution to ensuring overall compliance with tax policy is encouraged and facilitated by a high degree transparency of tax liabilities, including clarity of legislation and administrative procedures, access to information in this regard, and the ability to contest administrative rulings on tax liability.

A good tax collection system encourages compliance and limits individual negotiation of tax liability by ensuring that tax legislation is clear and comprehensive and that it limits discretionary powers (especially in decisions on tax assessments and exemptions) of the government entities involved, such as e.g. the revenue administration (RA), the ministry of finance and investment promotion agencies.

It should be noted that a country's RA may comprise several entities, each of which has revenue collection as its principal function (e.g. an Inland Revenue Agency and a Customs Authority). All of those entities should be included in the assessment of the revenue related indicators PI-13, PI-14 and PI-15, where it is relevant.

Taxpayer education is an important part of facilitating taxpayer compliance with registration, declaration and payment procedures. Actual and potential taxpayers need easy access to user friendly, comprehensive and up-to-date information on the laws, regulations and procedures (e.g. posted on government websites, made available through taxpayer seminars, widely distributed guidelines/pamphlets and other taxpayer education measures). Potential taxpayers also need to be made aware of their liabilities through taxpayer education campaigns.

Taxpayers' ability to contest decisions and assessment made by the revenue administration requires the existence of an effective complaints/appeals mechanism, that guarantees the taxpayer a fair treatment. The assessment of the tax appeals mechanism should reflect the *existence* in practice of such a system, *its independence* in terms of organizational structure, appointments and finance, *its powers* in terms of having its decisions acted upon as well as its *functionality* in terms of access (number and size of cases), efficiency (case processing periods), and fairness (balance in verdicts).

#### **Dimensions to be assessed (Scoring method M2):**

- (i) Clarity and comprehensiveness of tax liabilities
- (ii) Taxpayer access to information on tax liabilities and administrative procedures.
- (iii) Existence and functioning of a tax appeals mechanism.

<b>Dimension</b>	<b>Minimum requirements for dimension score. Scoring Methodology M2</b>
(i) Clarity and comprehensiveness of tax liabilities	<p><b>Score = A:</b> Legislation and procedures for all major taxes are comprehensive and clear, with strictly limited discretionary powers of the government entities involved.</p> <p><b>Score = B:</b> Legislation and procedures for most, but not necessarily all, major taxes are comprehensive and clear, with fairly limited discretionary powers of the government entities involved.</p> <p><b>Score = C:</b> Legislation and procedures for some major taxes are comprehensive and clear, but the fairness of the system is questioned due to substantial discretionary powers of the government entities involved.</p> <p><b>Score = D:</b> Legislation and procedures are not comprehensive and clear for large areas of taxation and/or involve important elements of administrative discretion in assessing tax liabilities.</p>
(ii) Taxpayers' access to information on tax liabilities and administrative procedures	<p><b>Score A:</b> Taxpayers have easy access to comprehensive, user friendly and up-to-date information tax liabilities and administrative procedures for all major taxes, and the RA supplements this with active taxpayer education campaigns.</p> <p><b>Score = B:</b> Taxpayers have easy access to comprehensive, user friendly and up-to-date information on tax liabilities and administrative procedures for some of the major taxes, while for other taxes the information is limited.</p> <p><b>Score = C:</b> Taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of the information is limited due coverage of selected taxes only, lack of comprehensiveness and/or not being up-to-date.</p> <p><b>Score = D:</b> Taxpayer access to up-to-date legislation and procedural guidelines is seriously deficient.</p>
(iii) Existence and functioning of a tax appeals mechanism.	<p><b>Score A:</b> A tax appeals system of transparent administrative procedures with appropriate checks and balances, and implemented through independent institutional structures, is completely set up and effectively operating with satisfactory access and fairness, and its decisions are promptly acted upon.</p> <p><b>Score = B:</b> A tax appeals system of transparent administrative procedures is completely set up and functional, but it is either too early to assess its effectiveness or some issues relating to access, efficiency, fairness or effective follow up on its decisions need to be addressed..</p> <p><b>Score = C:</b> A tax appeals system of administrative procedures has been established, but needs substantial redesign to be fair, transparent and effective.</p> <p><b>Score = D:</b> No functioning tax appeals system has been established</p>

## **PI-14. Effectiveness of measures for taxpayer registration and tax assessment**

Effectiveness in tax assessment is ascertained by an interaction between registration of liable taxpayers and correct assessment of tax liability for those taxpayers.

Taxpayer registration is facilitated by control mechanisms introduced by the revenue administration (RA). Maintenance of a taxpayer database based on a unique taxpayer identification number is an important element of such a control system, but is most effective if combined with other government registration systems that involve elements of taxable turnover and assets (such as e.g. issue of business licenses, opening of bank accounts and pension fund accounts). In addition, RAs should ensure compliance with registration requirements through occasional surveys of potential taxpayers e.g. by selective, physical inspection of business premises and residences.

Ensuring that taxpayers comply with their procedural obligations of taxpayer registration and tax declaration is usually encouraged by penalties that may vary with the seriousness of the fault. Effectiveness of such penalties is determined by the extent to which penalties are sufficiently high to have the desired impact, and are consistently and fairly administered.

Modern RAs rely increasingly on self-assessment and use risk targeted auditing of taxpayers as a key activity to improve compliance and deter tax evasion. Inevitable resource constraints mean that audit selection processes must be refined to identify taxpayers and taxable activities that involve the largest potential risk of non-compliance. Indicators of risk are the frequency of amendments to returns and additional tax assessed from tax audit work. Collection and analysis of information on non-compliance and other risks is necessary for focusing tax audit activities and resources towards specific sectors, and types of taxpayers have the highest risk of revenue leakage. More serious issues of non-compliance involve deliberate attempts of tax evasion and fraud, which may involve collusion with representatives of the RA. The ability of the RA to identify, investigate and successfully prosecute major evasion and fraud cases on a regular basis is essential for ensuring that taxpayers comply with their obligations.

### **Dimensions to be assessed (Scoring method M2):**

- (i) Controls in the taxpayer registration system.
- (ii) Effectiveness of penalties for non-compliance with registration and declaration obligations
- (iii) Planning and monitoring of tax audit and fraud investigation programs.

<b>Dimension</b>	<b>Minimum requirements for dimension score. Scoring Methodology M2</b>
(i) Controls in the taxpayer registration system.	<p><b>Score = A:</b> Taxpayers are registered in a complete database system with comprehensive direct linkages to other relevant government registration systems and financial sector regulations.</p> <p><b>Score = B:</b> Taxpayers are registered in a complete database system with some linkages to other relevant government registration systems and financial sector regulations.</p> <p><b>Score = C:</b> Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers.</p> <p><b>Score = D:</b> Taxpayer registration is not subject to any effective controls or enforcement systems</p>
(ii) Effectiveness of penalties for non-compliance with registration and tax declaration	<p><b>Score = A:</b> Penalties for all areas of non-compliance are set sufficiently high to act as deterrence and are consistently administered.</p> <p><b>Score = B:</b> Penalties for non-compliance exist for most relevant areas, but are not always effective due to insufficient scale and/or inconsistent administration.</p> <p><b>Score = C:</b> Penalties for non-compliance generally exist, but substantial changes to their structure, levels or administration are needed to give them a real impact on compliance.</p> <p><b>Score = D:</b> Penalties for non-compliance are generally non-existent or ineffective (i.e. set far too low to have an impact or rarely imposed).</p>
(iii) Planning and monitoring of tax audit programs.	<p><b>Score A:</b> Tax audits and fraud investigations are managed and reported on according to a comprehensive and documented audit plan, with clear risk assessment criteria for all major taxes that apply self-assessment.</p> <p><b>Score = B:</b> Tax audits and fraud investigations are managed and reported on according to a documented audit plan, with clear risk assessment criteria for audits in at least one major tax area that applies self-assessment.</p> <p><b>Score = C:</b> There is a continuous program of tax audits and fraud investigations, but audit programs are not based on clear risk assessment criteria.</p> <p><b>Score = D:</b> Tax audits and fraud investigations are undertaken on an ad hoc basis if at all.</p>

**PI-15. Effectiveness in collection of tax payments**

Accumulation of tax arrears can be a critical factor undermining high budgetary outturns, while the ability to collect tax debt lends credibility to the tax assessment process and reflects equal treatment of all taxpayers, whether they pay voluntarily and need close follow up. The level of tax arrears itself does not necessarily correlate to the effectiveness of the tax collection system, since a major tax assessment drive may substantially increase tax arrears. However, the RA’s ability to collect the taxes assessed is critical, unless the overall level of arrears is insignificant. Part of the arrears collection effort relates to resolution of tax debt in dispute. In some countries, tax arrears in dispute constitute a significant part of the total tax arrears, for which reason there may be a major difference between gross and net arrears (including and excluding disputes respectively).

Prompt transfer of the collections to the Treasury is essential for ensuring that the collected revenue is available to the Treasury for spending. This may take place either by having a system that obliges taxpayers to pay directly into accounts controlled by the Treasury (possibly managed by a bank) or, where the RA maintains its own collection accounts, by frequent and full transfers from those accounts to Treasury controlled accounts (time periods mentioned do not include delays in the banking system).

Aggregate reporting on tax assessments, collections, arrears and transfers to (and receipts by) the Treasury must take place regularly and be reconciled, where appropriate, in order to ensure that the collection system functions as intended, that tax arrears are monitored and the revenue float is minimized.

**Dimensions to be assessed (Scoring Method M1):**

- (i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years).
- (ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration.
- (iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury.

<b>Score</b>	<b>Minimum requirements (Scoring methodology: M1)</b>
<b>A</b>	(i) The average debt collection ratio in the two most recent fiscal years was 90% or above OR the total amount of tax arrears is insignificant (i.e. less than 2% of total annual collections). (ii) All tax revenue is paid directly into accounts controlled by the Treasury or transfers to the Treasury are made daily. (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least monthly within one month of end of month.
<b>B</b>	(i) The average debt collection ratio in the two most recent fiscal years was 75-90% and the total amount of tax arrears is significant. (ii) Revenue collections are transferred to the Treasury at least weekly. (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least quarterly within six weeks of end of quarter.
<b>C</b>	(i) The average debt collection ratio in the two most recent fiscal years was 60-75% and the total amount of tax arrears is significant (ii) Revenue collections are transferred to the Treasury at least monthly. (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least annually within 3 months of end of the year.
<b>D</b>	(i) The debt collection ratio in the most recent year was below 60% and the total amount of tax arrears is significant (i.e. more than 2% of total annual collections). (ii) Revenue collections are transferred to the Treasury less regularly than monthly (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury does not take place annually or is done with more than 3 months’ delay.

## **PI-16. Predictability in the availability of funds for commitment of expenditures**

Effective execution of the budget, in accordance with the work plans, requires that the spending ministries, departments and agencies (MDAs) receive reliable information on availability of funds within which they can commit expenditure for recurrent and capital inputs. This indicator assesses the extent to which the central ministry of finance provides reliable information on the availability of funds to MDAs, that manage administrative (or program) budget heads (or votes) in the central government budget and therefore are the primary recipients of such information from the ministry of finance. The MDAs concerned in this indicator are the same as those concerned in indicator PI-11.

In some systems, funds (commitment ceilings, authority to spend or transfers of cash) are released by the ministry of finance in stages within the budget year (monthly, quarterly etc). In others, the passing of the annual budget law grants the full authority to spend at the beginning of the year, but the ministry of finance (or other central agency) may in practice impose delays on ministries in incurring new commitments (and making related payments), when cash flow problems arise. To be reliable, the amount of funds made available to an entity for a specific period should not be reduced during that period.

Predictability for MDAs in the availability of funds is facilitated by effective cash flow planning, monitoring and management by the Treasury, based on regular and reliable forecasts of cash inflows and of major, atypical outflows (such as the cost of holding an election and discrete capital investments) which are linked to the budget implementation and commitment plans for individual MDAs, and incorporates the planned in-year borrowing to ensure adequate liquidity at any time.

Governments may need to make in-year adjustments to allocations in the light of unanticipated events impacting revenues and/or expenditures. The impact on predictability and on the integrity of original budget allocations is minimized by specifying, in advance, an adjustment mechanism that relates adjustment to the budget priorities in a systematic and transparent manner (e.g. protection of particular votes or budget lines that are declared to be high priority, or say 'poverty related'). In contrast, adjustments can take place without clear rules/guidelines or can be undertaken informally (e.g. through imposing delays on new commitments). While many budget adjustments can take place administratively with little implication for the expenditure composition outturn at the more aggregate level of budget classifications, other more significant changes may change the actual composition at fairly aggregate administrative, functional and economic classification levels. Rules for when the legislature should be involved in such in-year budget amendments are assessed in PI-27 and not covered here.

The adherence of MDAs with the ceilings for expenditure commitment and payments is not assessed here, but is covered by indicator PI-20 on internal controls.

### **Dimensions to be assessed (Scoring Method M1):**

- (i) Extent to which cash flows are forecast and monitored.
- (ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment
- (iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs.

Score	Minimum requirements (Scoring methodology: M1)
A	(i) A cash flow forecast is prepared for the fiscal year, and are updated monthly on the basis of actual cash inflows and outflows. (ii) MDAs' are able to plan and commit expenditure for at least six month in advance in accordance with the budgeted appropriations. (iii) Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a transparent and predictable way.
B	(i) A cash flow forecast is prepared for the fiscal year and updated at least quarterly, on the basis of actual cash inflows and outflows. (ii) MDAs are provided reliable information on commitment ceilings at least quarterly in advance. (iii) Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a fairly transparent way.
C	(i) A cash flow forecast is prepared for the fiscal year, but is not (or only partially and infrequently) updated. (ii) MDAs are provided reliable information for one or two months in advance. (iii) Significant in-year budget adjustments are frequent, but undertaken with some transparency.
D	(i) Cash flow planning and monitoring are not undertaken or of very poor quality. (ii) MDAs are provided commitment ceilings for less than a month OR no reliable indication at all of actual resource availability for commitment. (iii) Significant in-year budget adjustments are frequent and not done in a transparent manner.

## **PI-17. Recording and management of cash balances, debt and guarantees**

Debt management, in terms of contracting, servicing and repayment, and the provision of government guarantees are often major elements of overall fiscal management. Poor management of debt and guarantees can create unnecessarily high debt service costs and can create significant fiscal risks. The maintenance of a debt data system and regular reporting on main features of the debt portfolio and its development are critical for ensuring data integrity and related benefits such as accurate debt service budgeting, timely service payments, and well planned debt roll-over.

An important requirement for avoiding unnecessary borrowing and interest costs is that cash balances in all government bank accounts are identified and consolidated (including those for extra-budgetary funds and government controlled project accounts). Calculation and consolidation of bank accounts are facilitated where a single Treasury account exists or where all accounts are centralized. In order to achieve regular consolidation of multiple bank accounts not held centrally, timely electronic clearing and payment arrangements with the government's bankers will generally be required.

Critical to debt management performance are also the proper recording and reporting of government issued guarantees, and the approval of all guarantees by a single government entity (e.g. the ministry of finance or a debt management commission) against adequate and transparent criteria.

Undertaking of debt sustainability analyses is covered under multi-year perspectives in PI-12, whereas monitoring of liabilities arising from guarantees issued is covered under fiscal risk oversight in PI-9.

### **Dimensions to be assessed (Scoring method M2):**

- (i) Quality of debt data recording and reporting
- (ii) Extent of consolidation of the government's cash balances
- (iii) Systems for contracting loans and issuance of guarantees..

Dimension	Minimum requirements for dimension score. Scoring Methodology M2
(i) Quality of debt data recording and reporting	<p><b>Score = A:</b> Domestic and foreign debt records are complete, updated and reconciled on a monthly basis with data considered of high integrity. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least quarterly</p> <p><b>Score = B:</b> Domestic and foreign debt records are complete, updated and reconciled quarterly. Data considered of fairly high standard, but minor reconciliation problems occur. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least annually.</p> <p><b>Score = C:</b> Domestic and foreign debt records are complete, updated and reconciled at least annually. Data quality is considered fair, but some gaps and reconciliation problems are recognized. Reports on debt stocks and service are produced only occasionally or with limited content.</p> <p><b>Score = D:</b> Debt data records are incomplete and inaccurate to a significant degree.</p>
(ii) Extent of consolidation of the government's cash balances	<p><b>Score = A:</b> All cash balances are calculated daily and consolidated.</p> <p><b>Score = B:</b> Most cash balances calculated and consolidated at least weekly, but some extra-budgetary funds remain outside the arrangement.</p> <p><b>Score = C:</b> Calculation and consolidation of most government cash balances take place at least monthly, but the system used does not allow consolidation of bank balances</p> <p><b>Score = D:</b> Calculation of balances takes place irregularly, if at all, and the system used does not allow consolidation of bank balances.</p>
(iii) Systems for contracting loans and issuance of guarantees.	<p><b>Score = A:</b> Central government's contracting of loans and issuance of guarantees are made against transparent criteria and fiscal targets, and always approved by a single responsible government entity.</p> <p><b>Score = B:</b> Central government's contracting of loans and issuance of guarantees are made within limits for total debt and total guarantees, and always approved by a single responsible government entity.</p> <p><b>Score = C:</b> Central government's contracting of loans and issuance of guarantees are always approved by a single responsible government entity, but are not decided on the basis of clear guidelines, criteria or overall ceilings.</p> <p><b>Score = D:</b> Central government's contracting of loans and issuance of guarantees are approved by different government entities, without a unified overview mechanism.</p>

**PI-18. Effectiveness of payroll controls**

The wage bill is usually one of the biggest items of government expenditure and susceptible to weak control and corruption. This indicator is concerned with the payroll for public servants only. Wages for casual labor and discretionary allowances that do not form part of the payroll system are included in the assessment of general internal controls (PI-20). However, different segments of the public service may be recorded in different payrolls. All of the more important of such payrolls should be assessed as the basis for scoring this indicator, and mentioned in the narrative.

The payroll is underpinned by a personnel database (in some cases called the “nominal roll” and not necessarily computerized), which provides a list of all staff, who should be paid every month and which can be verified against the approved establishment list and the individual personnel records (or staff files). The link between the personnel database and the payroll is a key control. Any amendments required to the personnel database should be processed in a timely manner through a change report, and should result in an audit trail. Payroll audits should be undertaken regularly to identify ghost workers, fill data gaps and identify control weaknesses.

**Dimensions to be assessed (Scoring Method M1):**

- (i) Degree of integration and reconciliation between personnel records and payroll data.
- (ii) Timeliness of changes to personnel records and the payroll
- (iii) Internal controls of changes to personnel records and the payroll.
- (iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.

Score	Minimum requirements (Scoring methodology: M1)
<b>A</b>	(i) Personnel database and payroll are directly linked to ensure data consistency and monthly reconciliation. (ii) Required changes to the personnel records and payroll are updated monthly, generally in time for the following month’s payments. Retroactive adjustments are rare (if reliable data exists, it shows corrections in max. 3% of salary payments). (iii) Authority to change records and payroll is restricted and results in an audit trail. (iv) A strong system of annual payroll audits exists to identify control weaknesses and/or ghost workers.
<b>B</b>	(i) Personnel data and payroll data are not directly linked but the payroll is supported by full documentation for all changes made to personnel records each month and checked against the previous month’s payroll data. (ii) Up to three months’ delay occurs in updating of changes to the personnel records and payroll, but affects only a minority of changes. Retroactive adjustments are made occasionally. (iii) Authority and basis for changes to personnel records and the payroll are clear. (iv) A payroll audit covering all central government entities has been conducted at least once in the last three years (whether in stages or as one single exercise).
<b>C</b>	(i) A personnel database may not be fully maintained but reconciliation of the payroll with personnel records takes place at least every six months. (ii) Up to three months delay occurs in processing changes to personnel records and payroll for a large part of changes, which leads to frequent retroactive adjustments. (iii) Controls exist, but are not adequate to ensure full integrity of data. (iv) Partial payroll audits or staff surveys have been undertaken within the last 3 years.
<b>D</b>	(i) Integrity of the payroll is significantly undermined by lack of complete personnel records and personnel database, or by lacking reconciliation between the three lists. (ii) Delays in processing changes to payroll and nominal roll are often significantly longer than three months and require widespread retroactive adjustments. (iii) Controls of changes to records are deficient and facilitate payment errors. (iv) No payroll audits have been undertaken within the last three years.

## **PI-19. Competition, value for money and controls in procurement**

Significant public spending takes place through the public procurement system. A well-functioning procurement system ensures that money is used effectively and efficiently. Open competition in the award of contracts has been shown to provide the best basis for achieving efficiency in acquiring inputs for and value for money in delivery of programs and services by the government. This indicator focuses on the quality and transparency of the procurement regulatory framework in terms of establishing the use of open and fair competition as the preferred procurement method and defines the alternatives to open competition that may be appropriate when justified in specific, defined situations.

The procurement system benefits from the overall control environment that exists in the PFM system, including internal controls operated by implementing agencies and external control undertaken by external audit, ref. PI-20, PI-21, PI-22 and PI-26.

Unique to the public procurement process, however, is the direct involvement of participants from the private sector who, along with citizens, are direct stakeholders in the outcome of the procurement process. A good procurement system uses the participation of these stakeholders as part of the control system by establishing a clear regulated process that enables the submission and timely resolution of complaints submitted by private sector participants. Access to the process and information on complaints allows interested stakeholders to participate in the control of the system.

### **Dimensions to be assessed (Scoring method M2):**

- (i) Evidence on the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold);
- (ii) Extent of justification for use of less competitive procurement methods.
- (iii) Existence and operation of a procurement complaints mechanism

<b>Dimension</b>	<b>Minimum requirements for dimension score. Scoring Methodology M2</b>
(i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases	<p><b>Score = A:</b> Accurate data on the method used to award public contracts exists and shows that more than 75% of contracts above the threshold are awarded on the basis of open competition.</p> <p><b>Score = B:</b> Available data on public contract awards shows that more than 50% but less than 75% of contracts above the threshold are awarded on basis of open competition, but the data may not be accurate.</p> <p><b>Score = C:</b> Available data shows that less than 50% of contracts above the threshold are awarded on an open competitive basis, but the data may not be accurate.</p> <p><b>Score = D:</b> Insufficient data exists to assess the method used to award public contracts OR the available data indicates that use of open competition is limited.</p>
(ii) Justification for use of less competitive procurement methods	<p><b>Score = A:</b> Other less competitive methods when used are justified in accordance with clear regulatory requirements.</p> <p><b>Score = B:</b> Other less competitive methods when used are justified in accordance with regulatory requirements.</p> <p><b>Score = C:</b> Justification for use of less competitive methods is weak or missing.</p> <p><b>Score = D:</b> Regulatory requirements do not clearly establish open competition as the preferred method of procurement.</p>
(iii) Existence and operation of a procurement complaints mechanism	<p><b>Score = A:</b> A process (defined by legislation) for submission and timely resolution of procurement process complaints is operative and subject to oversight of an external body with data on resolution of complaints accessible to public scrutiny.</p> <p><b>Score = B:</b> A process (defined by legislation) for submitting and addressing procurement process complaints is operative, but lacks ability to refer resolution of the complaint to an external higher authority.</p> <p><b>Score = C:</b> A process exists for submitting and addressing procurement complaints, but it is designed poorly and does not operate in a manner that provides for timely resolution of complaints.</p> <p><b>Score = D:</b> No process is defined to enable submitting and addressing complaints regarding the implementation of the procurement process.</p>

**PI-20. Effectiveness of internal controls for non-salary expenditure**

An effective internal control system is one that (a) is relevant (i.e. based on an assessment of risks and the controls required to manage the risks), (b) incorporates a comprehensive and cost effective set of controls (which address compliance with rules in procurement and other expenditure processes, prevention and detection of mistakes and fraud, safeguard of information and assets, and quality and timeliness of accounting and reporting), (c) is widely understood and complied with, and (d) is circumvented only for genuine emergency reasons. Evidence of the effectiveness of the internal control system should come from government financial controllers, regular internal and external audits or other surveys carried out by management. One type of information could be error or rejection rates in routine financial procedures.

Other indicators in this set cover controls in debt management, payroll management and management of advances. This indicator, therefore, covers only the control of expenditure commitments and payment for goods and services, casual labor wages and discretionary staff allowances. The effectiveness of expenditure commitment controls is singled out as a separate dimension of this indicator due the importance of such controls for ensuring that the government’s payment obligations remain within the limits of projected cash availability, thereby avoiding creation of expenditure arrears (ref. indicator PI-4).

**Dimensions to be assessed (Scoring Method M1):**

- (i) Effectiveness of expenditure commitment controls.
- (ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures.
- (iii) Degree of compliance with rules for processing and recording transactions.

Score	Minimum requirements (Scoring methodology: M1)
A	(i) Comprehensive expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations (as revised). (ii) Other internal control rules and procedures are relevant, and incorporate a comprehensive and generally cost effective set of controls, which are widely understood. (iii) Compliance with rules is very high and any misuse of simplified and emergency procedures is insignificant.
B	(i) Expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations for most types of expenditure, with minor areas of exception. (ii) Other internal control rules and procedures incorporate a comprehensive set of controls, which are widely understood, but may in some areas be excessive (e.g. through duplication in approvals) and lead to inefficiency in staff use and unnecessary delays. (iii) Compliance with rules is fairly high, but simplified/emergency procedures are used occasionally without adequate justification.
C	(i) Expenditure commitment control procedures exist and are partially effective, but they may not comprehensively cover all expenditures or they may occasionally be violated. (ii) Other internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are understood by those directly involved in their application. Some rules and procedures may be excessive, while controls may be deficient in areas of minor importance. (iii) Rules are complied with in a significant majority of transactions, but use of simplified/emergency procedures in unjustified situations is an important concern.
D	(i) Commitment control systems are generally lacking OR they are routinely violated. (ii) Clear, comprehensive control rules/procedures are lacking in other important areas. (iii) The core set of rules are not complied with on a routine and widespread basis due to direct breach of rules or unjustified routine use of simplified/emergency procedures.

**PI-21. Effectiveness of internal audit**

Regular and adequate feedback to management is required on the performance of the internal control systems, through an internal audit function (or equivalent systems monitoring function). Such a function should meet international standards such as the ISPPA<sup>11</sup>, in terms of (a) appropriate structure particularly with regard to professional independence, (b) sufficient breadth of mandate, access to information and power to report, (c) use of professional audit methods, including risk assessment techniques. The function should be focused on reporting on significant systemic issues in relation to: reliability and integrity of financial and operational information; effectiveness and efficiency of operations; safeguarding of assets; and compliance with laws, regulations, and contracts. Internal audit functions are in some countries concerned only with pre-audit of transactions, which is here considered part of the internal control system and therefore assessed as part of indicator PI-20.

Specific evidence of an effective internal audit (or systems monitoring) function would also include a focus on high risk areas, use by the SAI of the internal audit reports, and action by management on internal audit findings. The latter is of critical importance since lack of action on findings completely undermines the rationale for the internal audit function.

The internal audit function may be undertaken by an organization with a mandate across entities of the central government (such as government inspection general or IGF) or by separate internal audit functions for individual government entities. The combined effectiveness of all such audit organizations is the basis for this indicator.

**Dimensions to be assessed (Scoring Method M1):**

- (i) Coverage and quality of the internal audit function.
- (ii) Frequency and distribution of reports.
- (iii) Extent of management response to internal audit findings.

Score	Minimum requirements (Scoring methodology: M1)
<b>A</b>	(i) Internal audit is operational for all central government entities, and generally meet professional standards. It is focused on systemic issues (at least 50% of staff time). (ii) Reports adhere to a fixed schedule and are distributed to the audited entity, ministry of finance and the SAI. (iii) Action by management on internal audit findings is prompt and comprehensive across central government entities.
<b>B</b>	(i) Internal audit is operational for the majority of central government entities (measured by value of revenue/expenditure), and substantially meet professional standards. It is focused on systemic issues (at least 50% of staff time). (ii) Reports are issued regularly for most audited entities and distributed to the audited entity, the ministry of finance and the SAI. (iii) Prompt and comprehensive action is taken by many (but not all) managers.
<b>C</b>	(i) The function is operational for at least the most important central government entities and undertakes some systems review (at least 20% of staff time), but may not meet recognized professional standards. (ii) Reports are issued regularly for most government entities, but may not be submitted to the ministry of finance and the SAI. (iii) A fair degree of action taken by many managers on major issues but often with delay
<b>D</b>	(i) There is little or no internal audit focused on systems monitoring. (ii) Reports are either non-existent or very irregular. (iii) Internal audit recommendations are usually ignored (with few exceptions).

<sup>11</sup> International Standards for the Professional Practice in Internal Audit, issued by the Institute of Internal Auditors.

**PI-22. Timeliness and regularity of accounts reconciliation**

Reliable reporting of financial information requires constant checking and verification of the recording practices of accountants – this is an important part of internal control and a foundation for good quality information for management and for external reports. Timely and frequent reconciliation of data from different sources is fundamental for data reliability. Two critical types of reconciliation are (i) reconciliation of accounting data, held in the government’s books, with government bank account data held by central and commercial banks, in such a way that no material differences are left unexplained; and (ii) clearing and reconciliation of suspense accounts and advances i.e. of cash payments made, from which no expenditures have yet been recorded. Advances would include travel advances and operational imprests, but not budgeted transfers to autonomous agencies and SN governments which are classified as expenditures when they are effected, even if reporting on any earmarked portion of the transfers is expected periodically.

**Dimensions to be assessed (Scoring method M2):**

- (i) Regularity of bank reconciliations
- (ii) Regularity of reconciliation and clearance of suspense accounts and advances.

<b>Dimension</b>	<b>Minimum requirements for dimension score. Scoring Methodology M2</b>
(i) Regularity of bank reconciliations	<p><b>Score = A:</b> Bank reconciliation for all central government bank accounts take place at least monthly at aggregate and detailed levels, usually within 4 weeks of end of period.</p> <p><b>Score = B:</b> Bank reconciliation for all Treasury managed bank accounts take place at least monthly, usually within 4 weeks from end of month.</p> <p><b>Score = C:</b> Bank reconciliation for all Treasury managed bank accounts take place quarterly, usually within 8 weeks of end of quarter.</p> <p><b>Score = D:</b> Bank reconciliation for all Treasury managed bank accounts take place less frequently than quarterly OR with backlogs of several months.</p>
(ii) Regularity of reconciliation and clearance of suspense accounts and advances	<p><b>Score = A:</b> Reconciliation and clearance of suspense accounts and advances take place at least quarterly, within a month from end of period and with few balances brought forward.</p> <p><b>Score = B:</b> Reconciliation and clearance of suspense accounts and advances take place at least annually within two months of end of period. Some accounts have uncleared balances brought forward.</p> <p><b>Score = C:</b> Reconciliation and clearance of suspense accounts and advances take place annually in general, within two months of end of year, but a significant number of accounts have uncleared balances brought forward.</p> <p><b>Score = D:</b> Reconciliation and clearance of suspense accounts and advances take place either annually with more than two months’ delay, OR less frequently.</p>

### PI-23. Availability of information on resources received by service delivery units

Problems frequently arise in front-line service delivery units providing services at the community level (such as schools and health clinics) in obtaining resources that were intended for their use, whether in terms of cash transfers, distribution of materials in kind (e.g. drugs and school books) or provision of centrally recruited and paid personnel. The intended resource provision may not be explicit in budget documentation, but is likely to form part of line ministries internal budget estimates preparation. Front line service delivery units, being furthest in the resource allocation chain, may be the ones to suffer most when overall resources fall short of budget estimates, or when higher level organizational units decide to re-direct resources to other (e.g. administrative) purposes. There may be significant delays in transfers of resources to the unit whether in cash or in kind. Tracking of such information is crucial in order to determine, if the PFM systems effectively support front-line service delivery.

Information about the receipt of resources by service units is often lacking. The accounting system, if sufficiently extensive, reliable and timely, should provide this information, but frequently information on expenditures in the field is incomplete and unreliable and the flow of information disrupted by different and unconnected systems being used at different levels of government (most primary service delivery units typically being the responsibility of sub-national governments). Routine data collection systems, other than accounting systems (i.e. statistical systems), may exist and be able to capture the relevant information along with other service delivery information. Public Expenditure Tracking Surveys, inspections, audits (whether by internal or external auditors) or other ad hoc assessments may constitute alternative information sources.

#### Dimensions to be assessed (Scoring Method M1):

(i) Collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units (focus on primary schools and primary health clinics) in relation to the overall resources made available to the sector(s), irrespective of which level of government is responsible for the operation and funding of those units.

Score	Minimum requirements (Scoring methodology: M1)
A	(i) Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by both primary schools and primary health clinics across the country. The information is compiled into reports at least annually.
B	(i) Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by either primary schools or primary health clinics across most of the country with information compiled into reports at least annually; OR special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by both primary schools and primary health clinics across most of the country (including by representative sampling).
C	(i) Special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by either primary schools or primary health clinics covering a significant part of the country OR by primary service delivery units at local community level in several other sectors.
D	(i) No comprehensive data collection on resources to service delivery units in any major sector has been collected and processed within the last 3 years.

**PI-24. Quality and timeliness of in-year budget reports**

The ability to “bring in” the budget requires timely and regular information on actual budget performance to be available both to the ministry of finance (and Cabinet), to monitor performance and if necessary to identify new actions to get the budget back on track, and to the MDAs for managing the affairs for which they are accountable. The indicator focuses on the ability to produce comprehensive reports from the accounting system on all aspects of the budget (i.e. flash reports on release of funds to MDAs are not sufficient). Coverage of expenditure at both the commitment and the payment stage is important for monitoring of budget implementation and utilization of funds released. Accounting for expenditure made from transfers to deconcentrated units within central government (such as provincial administrations) should be included.

The division of responsibility between the ministry of finance and line ministries in the preparation of the reports will depend on the type of accounting and payment system in operation. The role of the ministry of finance may be simply to consolidate reports provided by line ministries (and where applicable, from deconcentrated units) from their accounting records; in other cases the ministry of finance may undertake the data entry and accounting for transactions in which case the role of the line ministry is reduced, perhaps to reconciling ministry of finance data with their own records; in yet other cases ministry of finance can generate reports out of integrated, computerized accounting systems. The important requirement is that data is sufficiently accurate to be of real use to all parties.

**Dimensions to be assessed (Scoring Method M1):**

- (i) Scope of reports in terms of coverage and compatibility with budget estimates
- (ii) Timeliness of the issue of reports
- (iii) Quality of information

Score	Minimum requirements (Scoring methodology: M1)
A	(i) Classification of data allows direct comparison to the original budget. Information includes all items of budget estimates. Expenditure is covered at both commitment and payment stages. (ii) Reports are prepared quarterly or more frequently, and issued within 4 weeks of end of period. (iii) There are no material concerns regarding data accuracy.
B	(i) Classification allows comparison to budget but only with some aggregation. Expenditure is covered at both commitment and payment stages. (ii) Reports are prepared quarterly, and issued within 6 weeks of end of quarter. (iii) There are some concerns about accuracy, but data issues are generally highlighted in the reports and do not compromise overall consistency/ usefulness.
C	(i) Comparison to budget is possible only for main administrative headings. Expenditure is captured either at commitment or at payment stage (not both). (ii) Reports are prepared quarterly (possibly excluding first quarter), and issued within 8 weeks of end of quarter. (iii) There are some concerns about the accuracy of information, which may not always be highlighted in the reports, but this does not fundamentally undermine their basic usefulness.
D	(i) Comparison to the budget may not be possible across all main administrative headings. (ii) Quarterly reports are either not prepared or often issued with more than 8 weeks delay. (iii) Data is too inaccurate to be of any real use.

**PI-25. Quality and timeliness of annual financial statements**

Consolidated year-end financial statements (for French heritage countries: ‘le loi de reglement’ supported by ‘les comptes de gestion’ or ‘CGAF’) are critical for transparency in the PFM system. To be complete they must be based on details for all ministries, independent departments and deconcentrated units. In addition, the ability to prepare year-end financial statements in a timely fashion is a key indicator of how well the accounting system is operating, and the quality of records maintained. In some systems, individual ministries, departments and deconcentrated units issue financial statements that are subsequently consolidated by the ministry of finance. In more centralized systems, all information for the statements is held by the ministry of finance. Validation of the financial statements through certification by the external auditor is covered in indicator PI-26. Submission of annual financial statements from AGAs that are part of central government are covered in indicator PI-9.

In order to be useful and to contribute to transparency, financial statements must be understandable to the reader, and deal with transactions, assets and liabilities in a transparent and consistent manner. This is the purpose of financial reporting standards. Some countries have their own public sector financial reporting standards, set by government or another authorized body. To be generally acceptable, such national standards are usually aligned with international standards such as the International Federation of Accountants’ International Public Sector Accounting Standards (IPSAS), of which some are relevant for countries that adopt accrual based accounting, while others are relevant for cash-based systems.

**Dimensions to be assessed (Scoring Method M1):**

- (i) Completeness of the financial statements
- (ii) Timeliness of submission of the financial statements
- (iii) Accounting standards used

Score	Minimum requirements (Scoring methodology: M1)
A	(i) A consolidated government statement is prepared annually and includes full information on revenue, expenditure and financial assets/liabilities. (ii) The statement is submitted for external audit within 6 months of the end of the fiscal year. (iii) IPSAS or corresponding national standards are applied for all statements.
B	(i) A consolidated government statement is prepared annually. They include, with few exceptions, full information on revenue, expenditure and financial assets/liabilities (ii) The consolidated government statement is submitted for external audit within 10 months of the end of the fiscal year. (iii) IPSAS or corresponding national standards are applied.
C	(i) A consolidated government statement is prepared annually. Information on revenue, expenditure and bank account balances may not always be complete, but the omissions are not significant. (ii) The statements are submitted for external audit within 15 months of the end of the fiscal year. (iii) Statements are presented in consistent format over time with some disclosure of accounting standards.
D	(i) A consolidated government statement is not prepared annually, OR essential information is missing from the financial statements OR the financial records are too poor to enable audit. (ii) If annual statements are prepared, they are generally not submitted for external audit within 15 months of the end of the fiscal year (iii) Statements are not presented in a consistent format over time or accounting standards are not disclosed.

## **PI-26. Scope, nature and follow-up of external audit**

A high quality external audit is an essential requirement for creating transparency in the use of public funds. Key elements of the quality of actual external audit comprise the scope/ coverage of the audit, adherence to appropriate auditing standards including independence of the external audit institution (ref. INTOSAI and IFAC/IAASB), focus on significant and systemic PFM issues in its reports, and performance of the full range of financial audit such as reliability of financial statements, regularity of transactions and functioning of internal control and procurement systems. Inclusion of some aspects of performance audit (such as e.g. value for money in major infrastructure contracts) would also be expected of a high quality audit function.

The scope of audit mandate should include extra-budgetary funds and autonomous agencies. The latter may not always be audited by the Supreme Audit Institution (SAI), as the use of other audit institutions may be foreseen. The scope indicates the entities and sources of funds that are audited in any given year. Where SAI capacity is limited, the audit program may be planned by the SAI in line with legal audit obligations on a multi-year basis in order to ensure that most important or risk-prone entities and functions are covered annually, whereas other entities and functions may be covered less frequently.

While the exact process will depend to some degree on the system of government, in general the executive (the individual audited entities and/or the ministry of finance) would be expected to follow up of the audit findings through correction of errors and of system weaknesses identified by the auditors. Evidence of effective follow up of the audit findings includes the issuance by the executive or audited entity of a formal written response to the audit findings indicating how these will be or already have been addressed. The following year's external audit report may provide evidence of implementation by summing up the extent to which the audited entities have cleared audit queries and implemented audit recommendations.

### **Dimensions to be assessed (Scoring Method M1):**

- (i) Scope/nature of audit performed (incl. adherence to auditing standards).
- (ii) Timeliness of submission of audit reports to legislature.
- (iii) Evidence of follow up on audit recommendations.

Score	Minimum requirements (Scoring methodology: M1)
<b>A</b>	<p>(i) All entities of central government are audited annually covering revenue, expenditure and assets/liabilities. A full range of financial audits and some aspects of performance audit are performed and generally adhere to auditing standards, focusing on significant and systemic issues.</p> <p>(ii) Audit reports are submitted to the legislature within 4 months of the end of the period covered and in the case of financial statements from their receipt by the audit office.</p> <p>(iii) There is clear evidence of effective and timely follow up.</p>
<b>B</b>	<p>(i) Central government entities representing at least 75% of total expenditures<sup>12</sup> are audited annually, at least covering revenue and expenditure. A wide range of financial audits are performed and generally adheres to auditing standards, focusing on significant and systemic issues.</p> <p>(ii) Audit reports are submitted to the legislature within 8 months of the end of the period covered and in the case of financial statements from their receipt by the audit office.</p> <p>(iii) A formal response is made in a timely manner, but there is little evidence of systematic follow up.</p>
<b>C</b>	<p>(i) Central government entities representing at least 50% of total expenditures are audited annually. Audits predominantly comprise transaction level testing, but reports identify significant issues. Audit standards may be disclosed to a limited extent only.</p> <p>(ii) Audit reports are submitted to the legislature within 12 months of the end of the period covered (for audit of financial statements from their receipt by the auditors).</p> <p>(iii) A formal response is made, though delayed or not very thorough, but there is little evidence of any follow up.</p>
<b>D</b>	<p>(i) Audits cover central government entities representing less than 50% of total expenditures or audits have higher coverage but do not highlight the significant issues.</p> <p>(ii) Audit reports are submitted to the legislature more than 12 months from the end of the period covered (for audit of financial statements from their receipt by the auditors).</p> <p>(iii) There is little evidence of response or follow up.</p>

<sup>12</sup> This percentage refers to the amount expenditure of the entities covered by annual audit activities. It does not refer to the sample of transactions selected by the auditors for examination within those entities.

**PI-27. Legislative scrutiny of the annual budget law**

The power to give the government authority to spend rests with the legislature, and is exercised through the passing of the annual budget law. If the legislature does not rigorously examine and debate the law, that power is not being effectively exercised and will undermine the accountability of the government to the electorate. Assessing the legislative scrutiny and debate of the annual budget law will be informed by consideration of several factors, including the scope of the scrutiny, the internal procedures for scrutiny and debate and the time allowed for that process.

Adequacy of the budget documentation made available to the legislature is covered by PI-6.

In-year budget amendments constitute a common feature of annual budget processes. In order not to undermine the significance of the original budget, the authorization of amendments that can be done by the executive must be clearly defined, including limits on extent to which expenditure budgets may be expanded and re-allocated and time limits for the executive’s presentation of amendments for retro-active approval by the legislature. These rules must also be adhered to.

**Dimensions to be assessed (Scoring Method M1):**

- (i) Scope of the legislature’s scrutiny.
- (ii) Extent to which the legislature’s procedures are well-established and respected.
- (iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined).
- (iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature.

Score	Minimum requirements (Scoring methodology: M1)
<b>A</b>	(i) The legislature’s review covers fiscal policies, medium term fiscal framework and medium term priorities as well as details of expenditure and revenue. (ii) The legislature’s procedures for budget review are firmly established and respected. They include internal organizational arrangements, such as specialized review committees, and negotiation procedures. (iii) The legislature has at least two months to review the budget proposals. (iv) Clear rules exist for in-year budget amendments by the executive, set strict limits on extent and nature of amendments and are consistently respected.
<b>B</b>	(i) The legislature’s review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue. (ii) Simple procedures exist for the legislature’s budget review and are respected. (iii) The legislature has at least one month to review the budget proposals. (iv) Clear rules exist for in-year budget amendments by the executive, and are usually respected, but they allow extensive administrative reallocations.
<b>C</b>	(i) The legislature’s review covers details of expenditure and revenue, but only at a stage where detailed proposals have been finalized. (ii) Some procedures exist for the legislature’s budget review, but they are not comprehensive and only partially respected. (iii) The legislature has at least one month to review the budget proposals. (iv) Clear rules exist, but they may not always be respected OR they may allow extensive administrative reallocation as well as expansion of total expenditure.
<b>D</b>	(i) The legislature’s review is non-existent or extremely limited, OR there is no functioning legislature. (ii) Procedures for the legislature’s review are non-existent or not respected. (iii) The time allowed for the legislature’s review is clearly insufficient for a meaningful debate (significantly less than one month). (iv) Rules regarding in-year budget amendments may exist but are either very rudimentary and unclear OR they are usually not respected.

**PI-28. Legislative scrutiny of external audit reports**

The legislature has a key role in exercising scrutiny over the execution of the budget that it approved. A common way in which this is done is through a legislative committee(s) or commission(s), that examines the external audit reports and questions responsible parties about the findings of the reports. The operation of the committee(s) will depend on adequate financial and technical resources, and on adequate time being allocated to keep up-to-date on reviewing audit reports. The committee may also recommend actions and sanctions to be implemented by the executive, in addition to adopting the recommendations made by the external auditors (ref. PI-26).

The focus in this indicator is on central government entities, including autonomous agencies to the extent that either (a) they are required by law to submit audit reports to the legislative or (b) their parent or controlling ministry/department must answer questions and take action on the agencies' behalf.

Timeliness of the legislature's scrutiny can be affected by a surge in audit report submissions, where external auditors are catching up on a backlog. In such situations, the committee(s) may decide to give first priority to audit reports covering the most recent reporting periods and audited entities that have a history of poor compliance. The assessment should favourably consider such elements of good practice and not be based on the resulting delay in scrutinizing reports covering more distant periods.

**Dimensions to be assessed (Scoring Method M1):**

- (i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years).
- (ii) Extent of hearings on key findings undertaken by the legislature.
- (iii) Issuance of recommended actions by the legislature and implementation by the executive.

Score	Minimum requirements (Scoring methodology: M1)
<b>A</b>	(i) Scrutiny of audit reports is usually completed by the legislature within 3 months from receipt of the reports. (ii) In-depth hearings on key findings take place consistently with responsible officers from all or most audited entities, which receive a qualified or adverse audit opinion. (iii) The legislature usually issues recommendations on action to be implemented by the executive, and evidence exists that they are generally implemented.
<b>B</b>	(i) Scrutiny of audit reports is usually completed by the legislature within 6 months from receipt of the reports. (ii) In-depth hearings on key findings take place with responsible officers from the audited entities as a routine, but may cover only some of the entities, which received a qualified or adverse audit opinion. (iii) Actions are recommended to the executive, some of which are implemented, according to existing evidence.
<b>C</b>	(i) Scrutiny of audit reports is usually completed by the legislature within 12 months from receipt of the reports. (ii) In-depth hearings on key findings take place occasionally, cover only a few audited entities or may include with ministry of finance officials only. (iii) Actions are recommended, but are rarely acted upon by the executive.
<b>D</b>	(i) Examination of audit reports by the legislature does not take place or usually takes more than 12 months to complete. (ii) No in-depth hearings are conducted by the legislature. (iii) No recommendations are being issued by the legislature.

## D-1. Predictability of Direct Budget Support

Direct budget support constitutes an important source of revenue for central government in many countries. Poor predictability of inflows of budget support affects the government’s fiscal management in much the same way as the impact of external shocks on domestic revenue collection. Both the shortfalls in the total amount of budget support and the delays in the in-year distribution of the in-flows can have serious implications for the government’s ability to implement its budget as planned.

Direct budget support consists of all aid provided to the government treasury in support of the government’s budget at large (general budget support) or for specific sectors. When received by the government’s treasury, the funds will be used in accordance with the procedures applying to all other general revenue. Direct budget support may be channeled through separate or joint donor holding accounts before being released to the treasury.

The narrative should explain possible reasons for the observed deviation between forecasts and actual disbursements, which could include non-implementation or delay of actions agreed with the government as condition for disbursement.

### Dimensions to be assessed (Scoring Method M1):

- (i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body).
- (ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)

Dimension (ii) should be assessed on the basis of the quarterly distribution of actual budget support inflows compared to the distribution according to the agreed plan. The weighted disbursement delay would be calculated as the percent of funds delayed multiplied by the number of quarters of the delay (so if 10% of the actual inflows arrive in the fourth quarter instead of the first quarter as planned, the weighted delay is 30%).

Score	Minimum requirements (Scoring methodology: M1)
<b>A</b>	(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 5%. (ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in two of the last three years.
<b>B</b>	(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 10%. (ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in two of the last three years.
<b>C</b>	(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 15%. (ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 50% in two of the last three years.
<b>D</b>	(i) In at least two of the last three years did direct budget support outturn fall short of the forecast by more than 15% OR no comprehensive and timely forecast for the year(s) was provided by the donor agencies. (ii) The requirements for score C (or higher) are not met.

**D-2. Financial information provided by donors for budgeting and reporting on project and program aid**

Predictability of disbursement of donor support for projects and programs (below referred to only as projects) affect the implementation of specific line items in the budget. Project support can be delivered in a wide range of ways, with varying degrees of government involvement in planning and management of resources. A lower degree of government involvement leads to problems in budgeting the resources (including presentation in the budget documents for legislative approval) and in reporting of actual disbursement and use of funds (which will be entirely the donor’s responsibility where aid is provided in-kind). While the government through its spending units should be able to budget and report on aid transferred in cash (often as extra-budgetary funding or through separate bank accounts), the government is dependent on donors for budget estimates and reporting on implementation for aid in-kind. Donor reports on cash disbursements are also important for reconciliation between donor disbursement records and government project accounts.

**Dimensions to be assessed (Scoring Method M1):**

- (i) Completeness and timeliness of budget estimates by donors for project support.
- (ii) Frequency and coverage of reporting by donors on actual donor flows for project support.

Score	Minimum requirements (Scoring methodology: M1)
A	(i) All donors (with the possible exception of a few donors providing insignificant amounts) provide budget estimates for disbursement of project aid at stages consistent with the government’s budget calendar and with a breakdown consistent with the government’s budget classification. (ii) Donors provide quarterly reports within one month of end-of-quarter on the all disbursements made for at least 85% of the externally financed project estimates in the budget, with a break-down consistent with the government budget classification.
B	(i) At least half of donors (including the five largest) provide complete budget estimates for disbursement of project aid at stages consistent with the government’s budget calendar and with a breakdown consistent with the government’s budget classification. (ii) Donors provide quarterly reports within one month of end-of-quarter on the all disbursements made for at least 70% of the externally financed project estimates in the budget with a break-down consistent with the government budget classification.
C	(i) At least half of donors (including the five largest) provide complete budget estimates for disbursement of project aid for the government’s coming fiscal year, at least three months prior its start. Estimates may use donor classification and not be consistent with the government’s budget classification. (ii) Donors provide quarterly reports within two months of end-of-quarter on the all disbursements made for at least 50% of the externally financed project estimates in the budget. The information does not necessarily provide a break-down consistent with the government budget classification.
D	(i) Not all major donors provide budget estimates for disbursement of project aid at least for the government’s coming fiscal year and at least three months prior its start. (ii) Donors do not provide quarterly reports within two month of end-of-quarter on the disbursements made for at least 50% of the externally financed project estimates in the budget.

**D-3. Proportion of aid that is managed by use of national procedures**

National systems for management of funds are those established in the general legislation (and related regulations) of the country and implemented by the mainstream line management functions of the government. The requirement that national authorities use different (donor-specific) procedures for the management of aid funds diverts capacity away from managing the national systems. This is compounded when different donors have different requirements. Conversely, the use of national systems by donors can help to focus efforts on strengthening and complying with the national procedures also for domestically funded operations.

The use of national procedures mean that the banking, authorization, procurement, accounting, audit, disbursement and reporting arrangements for donor funds are the same as those used for government funds. All direct and un-earmarked budget support (general or sector based) will by definition use national procedures in all respects. Other types of donor funding such as e.g. earmarked budget support, basket funds and discrete project funding may use some or no elements of national procedures.

**Dimensions to be assessed (Scoring Method M1):**

(i) Overall proportion of aid funds to central government that are managed through national procedures.

This proportion should be arrived at as an average of the proportion of donor funds that use national systems for each of the four areas of procurement, payment/ accounting, audit and reporting respectively.

<b>Score</b>	<b>Minimum requirements (Scoring methodology: M1)</b>
<b>A</b>	(i) 90% or more of aid funds to central government are managed through national procedures.
<b>B</b>	(i) 75% or more of aid funds to central government are managed through national procedures.
<b>C</b>	(i) 50% or more of aid funds to central government are managed through national procedures.
<b>D</b>	(i) Less than 50% of aid funds to central government are managed through national procedures.

# Annex 2

## The PFM Performance Report



## Annex 2

### The PFM Performance Report

This document aims to assist in the preparation of the Public Financial Management Performance Report (PFM-PR) by providing a description of the information provided by the report and how this information is recorded. It is complementary to the document on the set of high-level PFM performance indicators.

The PFM-PR aims to provide a comprehensive and integrated assessment of PFM performance of a country, based in particular on an indicator-led analysis of the key elements of a PFM system, and to assess the extent to which institutional arrangements within government support timely planning and implementation of PFM reforms. It is a concise document, which does not exceed 35 pages. All relevant information is included in the body of the report, and its annexes are generally not used to elaborate on detailed aspects of the report.

The structure of the report is the following:

<b><i>STRUCTURE OF THE PFM-PR</i></b>	
<b>Summary assessment</b>	
<b>1.</b>	<b>Introduction</b>
<b>2.</b>	<b>Country background information</b>
<b>2.1.</b>	<b>Description of country economic situation</b>
<b>2.2.</b>	<b>Description of budgetary outcomes</b>
<b>2.3.</b>	<b>Description of the legal and institutional framework for PFM</b>
<b>3.</b>	<b>Assessment of the PFM systems, processes and institutions</b>
<b>3.1.</b>	<b>Budget credibility</b>
<b>3.2.</b>	<b>Comprehensiveness and transparency</b>
<b>3.3.</b>	<b>Policy-based budgeting</b>
<b>3.4.</b>	<b>Predictability and control in budget execution</b>
<b>3.5.</b>	<b>Accounting, recording and reporting</b>
<b>3.6.</b>	<b>External scrutiny and audit</b>
<b>3.7.</b>	<b>Donor practices</b>
<b>3.8.</b>	<b>Country specific issues (if necessary)</b>
<b>4.</b>	<b>Government reform process</b>
<b>4.1.</b>	<b>Description of recent and on-going reforms</b>
<b>4.2.</b>	<b>Institutional factors supporting reform planning and implementation</b>
<b>Annex 1: Performance Indicators Summary</b>	
<b>Annex 2: Sources of information</b>	

The rest of the document gives indications on the information provided by the report and how it is reported in the document. It follows the structure of the PFM-PR.

## Summary Assessment

*This section aims to provide an integrated and strategic picture of PFM performance, including the extent to which the PFM system impacts on the achievement of outcomes of aggregate fiscal discipline, strategic allocation of resources and efficient service delivery.*

The indicative length of this section is three to four pages.

The summary assessment provides the following information:

### *(i) Integrated assessment of PFM performance*

The detailed indicator-led assessment is summarized along the six core dimensions of PFM performance identified in the Performance Measurement Framework:

1. **Credibility of the budget** - The budget is realistic and is implemented as intended.
2. **Comprehensiveness and transparency** - The budget and fiscal risk oversight are comprehensive and fiscal and budget information is accessible to the public.
3. **Policy-based budgeting** - The budget is prepared with due regard to government policy.
4. **Predictability and control in budget execution** - The budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds.
5. **Accounting, recording and reporting** – Adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes.
6. **External scrutiny and audit** - Arrangements for scrutiny of public finances and follow-up by the executive are operating.

In synthesizing the performance of the PFM system, the analysis aims at identifying the main PFM weaknesses and does not simply repeat the detailed list of weaknesses identified in section 3. The analysis captures in particular the interdependence between the different dimensions, i.e. the extent to which poor performance for one of the core dimensions is likely to influence the performance of the PFM system in relation to the other dimensions.

### *(ii) Assessment of the impact of PFM weaknesses*

This part analyzes the extent to which the performance of the assessed PFM system appears to be supporting or affecting the overall achievement of budgetary outcomes at the three levels, i.e. aggregate fiscal discipline, strategic allocation of resources or efficient service delivery. In other words, it provides an understanding of why the weaknesses identified in PFM performance matter for this country. The assessment does not examine the extent to which budgetary outcomes are achieved (e.g. whether expenditures incurred through the budget have their desired effect on reducing poverty or achieving other policy objectives), but rather uses information from fiscal and expenditure policy analysis (as captured in the section 2 of the report) to assess the extent to which the PFM system constitutes an enabling factor for achievement of the planned budgetary outcomes.

The **table** in Appendix 1 (at the end of this document) is provided as an aid for making this assessment. It outlines how poor PFM performance may impact the achievement of aggregate fiscal discipline, strategic allocation of resources and service delivery. It is organized along the six core dimensions of PFM performance and the three levels of budgetary outcomes. Appendix 1 does not prescribe a mechanical link between weaknesses of the PFM system and achievement of the three levels of budgetary outcomes, but aims rather to support the thinking over the impact of PFM weaknesses and why they matter for the country.

**(iii) Prospects for reform planning and implementation**

This part assesses the extent to which institutional arrangements within the government support a timely and adequate reform planning and implementation process.

In addition, for aid-dependent countries, a statement is included on existing donor practices and on the extent to which they affect PFM performance.

## **Section 1: Introduction**

The objective of the introduction is to understand the context and the process by which the PFM-PR was prepared and to outline the scope of the PFM assessment.

The indicative length of this section is one page.

The introduction includes the following:

- **Objective of the PFM-PR**, including why it has been undertaken at this time and its contribution to on-going country activities.
- **Process of preparing the PFM-PR**, including (i) the donors associated in the preparation of the report, with a description of their role and contribution (lead donor, participating donors, financing, consultations, etc) and, (ii) involvement of government in the preparation of the report.
- **The methodology for the preparation of the report**, such as reliance on information sources, interviews, etc.
- **The scope of the assessment as provided by the PFM-PR**: Public financial management at the level of central government (including ministries, departments, autonomous agencies and deconcentrated entities) may cover only a limited amount of public expenditures that take place in a country, depending of the devolution of responsibilities to sub-national governments and public enterprises. Therefore, the report identifies the share of public expenditures that is made by central government. The importance of autonomous agencies in central government operations is specified due to their operations being outside the budget management and accounting system of the central government unit. In addition, the report provides information on the relative shares of public expenditures made by other entities.

Institutions	Number of entities	% of total public expenditures
Central government*		
Autonomous government agencies		
Sub-national governments		

\* Includes ministries, departments and deconcentrated entities.

## Section 2: Country Background Information

*The objective of this section is to provide information on the country whose PFM system is being assessed, to allow sufficient understanding of the wider context to PFM reforms as well as the core characteristics of the PFM system in that country.*

The indicative length of this section is four to five pages.

The section is structured along the following lines and provides the following information:

### ***SUB-SECTION 2.1: DESCRIPTION OF THE COUNTRY ECONOMIC SITUATION***

- ***Country context***, including population, income level, percentage of population living below the poverty line, growth rate, inflation, economic structure and main challenges for development.
- ***Overall government reform program***, with a focus on the main issues that are likely to influence public financial management.
- ***Rationale for PFM reforms*** in relation to the overall government reform program.

### ***SUB-SECTION 2.2: DESCRIPTION OF BUDGETARY OUTCOMES***

The information for this sub-section is drawn from existing fiscal and expenditure policy analysis or other relevant studies.

- ***Fiscal performance***: The report includes a short comment on the main trends in fiscal aggregate discipline for the last three years, based on the information provided by the following table. It also integrates other relevant information, for example on the debt stock.

<b>Central government budget (in percent of GDP)</b>			
	<b>FY1</b>	<b>FY2</b>	<b>FY3</b>
Total revenue			
- <i>Own revenue</i>			
- <i>Grants</i>			
Total expenditure			
- <i>Non-interest expenditure</i>			
- <i>Interest expenditure</i>			
Aggregate deficit (incl. grants)			
Primary deficit			
Net financing			
- <i>external</i>			
- <i>domestic</i>			

- **Allocation of resources:** The report includes information on the trends in sectoral and, if possible, economic allocation of resources. It also provides a statement on the priorities embodied in the national strategy (e.g. PRSP) and the extent to which budget allocations reflect the priorities of government.

<b>Actual budgetary allocations by sectors (as a percentage of total expenditures)</b>			
	<b>FY-1</b>	<b>FY-2</b>	<b>FY3</b>
<i>Health</i>			
<i>Education</i>			
<i>Agriculture</i>			
<i>Etc.</i>			

<b>Actual budgetary allocations by economic classification (as a percentage of total expenditures)</b>			
	<b>FY-1</b>	<b>FY-2</b>	<b>FY3</b>
Current expenditures			
- <i>Wages and salaries</i>			
- <i>Goods and services</i>			
- <i>Interest payments</i>			
- <i>Transfers</i>			
- <i>Others</i>			
Capital expenditures			

- **Additional information**, such as proportion of funds allocated at the local level or any information related to service delivery or operational efficiency, would be added, if available.

### ***SUB-SECTION 2.3: DESCRIPTION OF THE LEGAL AND INSTITUTIONAL FRAMEWORK FOR PFM***

- **The legal framework for PFM:** the report describes the legal provisions, that determine the fundamental rules that are guiding the PFM system. It would involve a brief description of recent changes made to the legal framework, if relevant.
- **The institutional framework for PFM:** the report describes the responsibilities of the main entities involved in PFM, including for the different levels of government (central and sub-national governments), the different branches of government (executive, legislative, and the judiciary) as well as for the public enterprises or autonomous government agencies. Additional information on the broad responsibilities for public financial management in the Ministry of Finance and between the Ministry of Finance and the line ministries is welcome. Recent changes in responsibilities can be mentioned, including trends towards decentralization of expenditures.
- **The key features of the PFM system:** the report describes the key features of the PFM system, including the degree of centralization of the payment system or the type of jurisdictional control exercised by the external audit body.

The information provided is descriptive and does not intend to make a statement on compliance with existing rules or effective roles played by the legislature and external audit. Such issues are captured in the detailed assessment of the PFM system (section 3).

### **Section 3: Assessment of the PFM systems, processes and institutions**

*The objective of this section is to provide an assessment of the key elements of the PFM system, as captured by the indicators, and to report on progress made in improving those.*

**The structure of the section** is the following:

- 3.1. Budget credibility**
- 3.2. Comprehensiveness and transparency**
- 3.3. Policy-based budgeting**
- 3.4. Predictability and control in budget execution**
- 3.5. Accounting, recording and reporting**
- 3.6. External scrutiny and audit**
- 3.7. Donor practices**
- 3.8. Country specific issues (if necessary)**

The indicative length of this section is about eighteen to twenty pages.

#### ***SUB-SECTIONS 3.1 TO 3.7***

**Each sub-section discusses the relevant indicators.** For example, the subsection 3.2 on comprehensiveness and transparency reports on indicators 5 to 10. Reporting reflects the order of the indicators.

The discussion of each of the indicators **distinguishes between the assessment of the present situation (the indicator-led analysis) and a description of the reform measures being introduced to address the identified weaknesses.** The assessment based on the indicator and the reporting on progress are separated in two different paragraphs, in order to avoid confusion between what the situation is and what is happening in terms of reforms.

### ***Reporting the indicator-led analysis***

Reporting on the indicator-led analysis is undertaken in the following manner :

- The text gives a clear understanding of **the actual performance of each of the PFM dimensions captured by the indicators** and the rationale for its scoring. Each dimension of the indicator is discussed in the text and addressed in a way that enables understanding of the specific level (A, B, C or D) achieved by the dimension.
- The report indicates the factual evidence (including quantitative data), that has been used to substantiate the assessment. The information is specific wherever possible (e.g. in terms of quantities, dates and time spans).
- Any issues of **timeliness or reliability of data or evidence** is noted.
- If **no information** exists either for a whole indicator or one of its dimension, the text explicitly mentions it. If it is felt that scoring is still possible despite a lack of information for one of the dimension, the rationale for the scoring is made explicit.
- At the end of the discussion of each indicator, **a table** specifies the scoring along with a brief explanation for the scoring.

**As a complement to the indicator scoring, reporting on progress<sup>13</sup> is made in relation to each of the indicator topics** (if relevant, i.e. when there are recent or on-going reform measures). It aims to capture the dynamic of reforms in the country while retaining sufficient rigor in assessing on-going changes:

Reporting on progress is based on **factual evidence** and focuses on:

(i) **Small improvements in PFM performance not captured by the indicators**

For example:

- **Indicator 4** (stock and monitoring of expenditure payment arrears): In Year 1, a country rated B on this indicator, partly because the stock of arrears stood at 7% and partly as a result of efforts made recently in reducing the stock of arrears. In Year 3, the stock of arrears stands at 3%. The rating of the indicator remains B, but the report should note the progress made in reducing the stock of arrears.
- **Indicator 12** (multi-year perspective in fiscal planning, expenditure policy and budgeting): In Year 1, a country has two out of ten sector strategies that are fully costed. The two sectors represent 35% of total primary expenditure. In Year 3, one additional sector strategy is costed. The sector represents 10% of total primary expenditure. The progress made does not influence the rating of the indicator, but the report should note the progress made in improving the performance.

<sup>13</sup> The level of performance of the PFM system, as captured by the indicators, reflects a combination of historical, political, institutional and economic factors and is not necessarily representative of recent or on-going **efforts made by government to improve PFM performance**. Improvement in the scoring of the indicators may take some years given the four-point scale by the high-level indicators. This is why the PFM-PR introduces some reporting on progress made in improving PFM performance as captured by the indicators.

(ii) **Reforms implemented to date, that have not yet impacted PFM performance or for which no evidence exists on their impact on PFM performance**

For example:

- Indicator 21 (effectiveness of internal audit): In Year 1, the country rated D on this indicator as no internal audit function existed. In Year 3, an internal audit department has been created in the Ministry of Finance, but is still very weak. The reform – creation of the internal audit department – has not yet impacted PFM performance, but should be noted in the report.
- Indicator 19 (competition, value for money and controls in procurement): A new procurement law was adopted one year ago, but no analysis has been made since then to assess its impact on the use of open competition for award of contracts, etc. Since no evidence is available on the impact of this new legislation, the rating of the indicator should be based on the latest evidence of procurement practices, i.e., prior to the adoption of the new legislation. The report should note the existence of the new procurement law and the lack of evidence collected to assess its impact.

Reference to government reform plans or description of existing conditionality selected by the international finance institutions or donors (i.e. reform measures yet to be implemented) are not considered as sufficient evidence for demonstrating progress.

An **upward arrow** can be used next to the score (e.g., **D▲**) to indicate progress, but its use is limited to cases as described above under (i) small improvements in PFM performance not captured by the indicators, and (ii) reforms implemented to date that have not yet impacted PFM performance or for which no evidence on their impact on PFM performance exists.

### ***SUB-SECTION 3.8***

The PFM-PR provides information on **country-specific issues** that are essential for a comprehensive picture of PFM performance and that are not fully captured by the indicators. This sub-section is based on available information. Below are some examples of such country specific issues:

**1) Sub-national governments:**

The performance indicators capture local government issues in relation to the clarity of inter-governmental fiscal relations (PI-8), the comprehensiveness of fiscal risk oversight (PI-9) and the extent to which spending ministries and agencies are able to plan and commit expenditures in accordance with budgets and work plan (PI-16). In countries where a significant proportion of expenditures are executed at the sub-national level and where information is available, the PFM-PR provides some information on PFM performance at the local level. This section does however not seek to substitute for any assessment done at the sub-national level.

**2) Public enterprises**

The performance indicators capture public enterprise issues in relation to the comprehensiveness of aggregate fiscal risk oversight (PI-9). Depending on the importance of these entities, a comprehensive overview of the PFM system may therefore require a description of the relationships between the central government and

those entities or the performance of those entities in terms of PFM, to the extent information exists.

**3) Management of revenues in natural resources rich countries**

Revenues from natural resources may constitute an important source of income for certain countries and may be subject to specific financial management arrangements. This section may in such cases present a description the performance of those arrangements.

**4) Any other issues relevant for a comprehensive picture of PFM performance.**

## **Section 4: Government reform process**

This section aims to describe the overall progress made by government in improving PFM performance and to provide some forward-looking perspective on the factors that are likely to affect future reform planning, implementation and monitoring.

The indicative length of this section is about two to three pages.

### ***SUB SECTION 4.1: DESCRIPTION OF RECENT AND ON-GOING REFORMS***

The most important recent and ongoing reforms are briefly summarized (as a detailed description of those takes place in section 3) to give a thrust of the main progress made by government in strengthening the PFM system.

### ***SUB-SECTION 4.2: INSTITUTIONAL FACTORS SUPPORTING REFORM PLANNING AND IMPLEMENTATION***

This part of the report provides a **forward-looking perspective** of the extent to which **institutional factors** are likely to support the reform planning and implementation process.

The following identifies several factors that are likely to be relevant in supporting an effective reform process in many country contexts. In each case, this part of the PFM-PR takes into account recent and ongoing reform experiences and identifies, where appropriate, additional country specific factors to those suggested below.

- **Government leadership and ownership** is likely to contribute to a more effective PFM reform process by setting the objectives, direction and pace of reforms, clarifying organizational responsibilities for the reform process and addressing, in a timely manner, any resistance to change. Consideration may be given to the level and nature of political engagement in the reform process, the extent to which the government articulates a compelling case for PFM reforms, the dissemination of the government vision in public documents (PRSPs, specific PFM strategy or action plan, etc.) and the provision of resources by government to PFM reforms. Cross reference to the extent to

which the reform process is progressing according to government plans can be included if found relevant.

- **Coordination across government** is likely to contribute to a more prioritized and sequenced reform agenda, as existing capacities of different entities and levels of government are taken into account in planning and implementing reforms. In assessing the extent to which arrangements for coordination are in place, consideration may be given to the extent to which relevant entities, especially line ministries, are associated in the reform decision making process, the existence of mechanisms to ensure timely decisions-making especially for cross-cutting reforms, the clarity of roles and responsibilities in the implementation of reforms and the existence of a focal point in government for coordination of donors in relation to PFM reforms. Association of the Parliament and the external audit in the PFM reform process may also be considered when relevant.
- Impact of the PFM reforms is likely to depend on the extent to which existing arrangements support **a sustainable reform process**. In this context, consideration may be given to the extent to which the reform process is driven by government experts or technical assistance, whether reforms are being associated with comprehensive capacity-building programs and consideration is being given to retaining trained staff. Any information on funding of the recurrent costs, resulting from the implementation of reforms, may also be included, if relevant.

**The assessment of those institutional factors** is as factual as possible and does not rely on government plans or commitments. **The report does not make recommendations** for the reform program of the government and does not include a judgment as to whether the government reform program addresses the right PFM weaknesses or whether the proposed reform measures are adequate.

### PFM-PR Annex 1

This annex provides a summary table of the performance indicators. For each of the indicators, the table specifies the scoring assigned along with a brief explanation for the scoring.

Indicator	Scoring	Brief Explanation and Cardinal Data used
<i>Illustrative Example:</i>		
1. Aggregate expenditure out-turn compared to original approved budget	<b>B</b>	Actual primary expenditure (excluding donor funded projects) in 2003 was 8 percent below the originally budgeted expenditure, whereas in 2002 and 2004 expenditure was below budget by 4% and 3% respectively.
2.		

### PFM-PR Annex 2

The annex indicates all existing analytical work that was used to develop the PFM Performance Report. Examples might include government reports, Country Financial Accountability Assessments (CFAA), Public Expenditure Reviews (PERs), Country Procurement Assessment Reports (CPAR), audit reports, etc.

## Appendix 1: Links between the six dimensions of an open and orderly PFM system and the three levels of budgetary outcomes

(for the use of this table, refer to page 57)

	<b>Aggregate fiscal discipline</b>	<b>Strategic allocation of resources</b>	<b>Efficient service delivery</b>
<b>Budget credibility</b>	<i>In order for the budget to be a tool for policy implementation, it is necessary that it is realistic and implemented as passed.</i>		
<b>The budget is realistic and is implemented as intended</b>	A lack of credibility increases the likelihood of <b>overshooting the deficit target or increasing the level of arrears</b> . This can arise from pressures created by over-optimistic revenue forecasts and under-budgeting of non-discretionary expenditures (e.g. utilities, salaries, entitlement payments). It can also arise from non-compliance in budget execution (e.g. revenue leakages or unbudgeted expenditures).	A lack of credibility in the budget may lead to <b>short falls in the funding of priority expenditures</b> . This may arise from expenditure ceiling cuts resulting from revenues shortfalls, under-estimation of the costs of the policy priorities or the non-compliance in the use of resources.	Adjustments may fall disproportionately on <b>non-salary recurrent expenditures</b> , which is likely to have significant impact on the efficiency of resources used at the service delivery level.  Non-compliance with the budget may lead to a <b>shift across expenditure categories</b> , reflecting personal preferences rather than efficiency of service delivery.
<b>Comprehensiveness and transparency</b>	<i>Comprehensiveness of budget is necessary to ensure that all activities and operations of governments are taking place within the government fiscal policy framework and are subject to adequate budget management and reporting arrangements. Transparency is an important institution that enables external scrutiny of government policies and programs and their implementation.</i>		
<b>The budget and fiscal risk oversight are comprehensive and fiscal and budget information is accessible to the public</b>	Activities that are not managed and reported through <b>adequate budget processes</b> are unlikely to be subject to the same kind of scrutiny and controls as are operations included in the budget. This increases the risk that those activities take place without reference <b>to the fiscal targets</b> decided by government and that potential risks linked to those activities are not accounted for, thereby increasing the risk of overshooting the deficit and creating unsustainable liabilities for government.  Lack of transparency limits the availability of information regarding the performance of the government in maintaining fiscal discipline and managing fiscal risks. For example, incomplete or untimely financial statements limit the scrutiny by <b>financial markets</b> .	Strategic allocation is strengthened if <b>all claims can compete with each other</b> in a transparent manner during budget preparation. Extra-budgetary funds, and earmarking of some revenues to certain programs are in particular likely to affect the efficiency of strategic planning against government priorities.  Lack of transparency limit the availability of information on the use of resources in line with government publicized priorities. This limits the capacity of <b>the legislature, civil society and media</b> to assess the extent to which the government is implementing its policy priorities.	Lack of comprehensiveness is likely to increase <b>waste of resources and decrease the provision of services</b> . It limits competition in the review of the efficiency and effectiveness of the different programs and their inputs. It may also facilitate the development of patronage or corrupt practices by limiting the scrutiny of operations, expenditures and procurement processes not integrated in budget management and reporting arrangements.  Lack of transparency limits the availability of information on the resources available for the service delivery units. This weakens the capacity of <b>local communities</b> to exercise any scrutiny on the resources allocated and used at the service delivery units.

	<b>Aggregate fiscal discipline</b>	<b>Strategic allocation of resources</b>	<b>Efficient service delivery</b>
<p><b>Policy-based budgeting</b></p> <p>The budget is prepared with due regard to government policy</p>	<p><i>A policy-based budgeting process enables the government to plan the use of resources in line with its fiscal policy and national strategy.</i></p> <p>A <b>weak planning process</b> may lead to a budget that does not respect the fiscal and macroeconomic framework defined by government. In particular, limited involvement by Cabinet may reduce the weight carried by the fiscal targets in the final budget negotiations. Limited integration of <b>medium-term implications of fiscal decisions</b> (spending and revenue decisions, approval of guarantees and entitlements programs, etc) in the annual budget process can lead to unsustainable policies.</p>	<p><b>The lack of participation by line ministries, limited involvement by Cabinet or a chaotic budget process</b> is likely to constrain allocation of the global resource envelop in line with government priorities and to increase the likelihood of ad-hoc decisions. <b>The lack of a medium-term perspective</b> could undermine allocative decisions, as the timespan of an annual budget is too short to introduce significant changes in expenditure allocations, so that costs of new policy initiative may be systematically under-estimated.</p>	<p>A poor budget process does not allow <b>discussions over efficiency in the use of resources</b>. In particular, it does not allow an orderly review of existing policies and new policy initiatives. <b>The lack of multi-year perspective</b> may contribute to inadequate planning of the recurrent costs of investment decisions and of the funding for multi-year procurement.</p>
<p><b>Predictability and control in budget execution</b></p> <p>The budget is executed in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds.</p>	<p><i>Predictable and controlled budget execution is necessary to enable effective management of policy and program implementation.</i></p> <p>Lack of orderliness in execution, such as poor synchronization of cash inflows, liquidity and outflows, may <b>undermine fiscal management</b> by for example leading to unnecessary interest charges or supplier surcharges. Disorderly execution of the budget makes it difficult to undertake <b>appropriate in-year adjustment</b> to the budget totals in accordance with the fiscal framework, as information is likely to be inadequate and implementing decisions more challenging.</p> <p>Weak control arrangements may allow <b>expenditures (including the wage bill) in excess of budget or revenue leakages</b>, leading to higher deficit, debt levels or arrears.</p>	<p>Disorderly execution could lead to <b>unplanned reallocations</b> because it may allow resources to be captured by low priority items and reduce availability of resources for priorities.</p> <p>Weak controls arrangements may allow <b>unauthorized expenditures and fraudulent payments</b>, and may therefore result in patterns in resources utilization, that are significantly different from initial allocations.</p>	<p>Lack of predictability in resource flows undermines the ability of front-line service delivery units <b>to plan and use those resources in a timely and efficient manner</b>. It may also foster an environment in which controls are habitually by-passed.</p> <p><b>Non-observance of competitive tendering process practices</b> for the procurement of goods and services are likely to limit the efficiency of existing programs by increasing the costs of procuring the goods or leading to supply of goods of inadequate quality.</p> <p>Inadequate controls of payrolls, procurement and expenditure processes may create the <b>opportunity for corrupt practices, leakages and patronage</b>.</p>

	<b>Aggregate fiscal discipline</b>	<b>Strategic allocation of resources</b>	<b>Efficient service delivery</b>
<p><b>Accounting, recording and reporting</b></p> <p><b>Adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes</b></p>	<p><i>Timely, relevant and reliable financial information is required to support all fiscal and budget management and decision-making processes.</i></p> <p>The lack of timely and adequate information on revenue forecasting and collection, existing liquidity levels and expenditures flows <b>constrain the capacity of government to decide and control budget totals</b>. Information is also necessary regarding debt levels, guarantees, contingent liability and forward costs of investment programs to allow management for long-term fiscal sustainability and affordability of policies.</p>	<p>A lack of information on cost of programs and use of resources would <b>undermine the ability to allocate resources</b> to government priorities. Regular information on budget execution allows monitoring on the use of resources, but also facilitates identification of bottlenecks and problems which may lead to significant changes in the executed budget.</p>	<p>A lack of information on how resources have been provided and used for service delivery is likely <b>to undermine the planning and management of services</b>. Inadequate information and records would reduce the availability of evidence that is required for <b>effective audit and oversight of the use of funds</b> and could provide the opportunity for leakages, corrupt procurement practices or use of resources in a unintended manner.</p>
<p><b>Effective external scrutiny and audit</b></p> <p><b>Arrangements for scrutiny of public finances and follow up by executive are operating.</b></p>	<p><i>Effective scrutiny by the legislature and through external audit is an enabling factor in the government being held to account for its fiscal and expenditures policies and their implementation.</i></p> <p><b>Limited scrutiny</b> of government macro-fiscal policy and its implementation may reduce the pressure on government to consider long-term fiscal sustainability issues and to respect its targets.</p>	<p><b>Limited scrutiny</b> is likely to reduce the pressure on government to allocate and execute the budget in line with its stated policies.</p>	<p><b>Limited scrutiny</b> may reduce the extent to which government is held accountable for efficient and rule-based management of resources, without which the value of services is likely to be diminished. In addition, inadequate audit means that the accounting and use of funds is not subject to detailed review and verification.</p>

(for the use of this table, refer to page 57)