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"THE TREASURY", PETRA, JORDAN

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# USAID PUBLIC FINANCIAL MANAGEMENT PFM PRIMER

Bureau of Economic Growth, Education and Environment

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# CONTENTS

## ACRONYMS

1. INTRODUCTION	1
1.1 THE PUBLIC FINANCIAL MANAGEMENT (PFM) PRIMER	1
1.2 WHAT IS PUBLIC FINANCIAL MANAGEMENT?	1
1.3 PFM AT THE SUB-NATIONAL LEVEL	1
1.4 STRUCTURE OF THE PFM PRIMER	2
2. BUDGET PLANNING AND PREPARATION	3
2.2 BUDGET PLANNING PROCESS	4
2.3 BUDGET PREPARATION PROCESS	5
3. BUDGET EXECUTION	8
3.1 BUDGET AUTHORIZATION AND APPORTIONMENT	8
3.2 PROCUREMENT, CONTRACT MANAGEMENT AND PAYMENT	8
3.3 COMMITMENT OF FUNDS AND COMMITMENT CONTROLS	9
3.4 PAYMENT PROCEDURES	10
3.5 ASSET MANAGEMENT AND INVENTORY	10
3.6 PAYROLL	10
3.7 REVENUES	11
3.8 TREASURY OPERATIONS AND CASH MANAGEMENT	13
4. PUBLIC SECTOR ACCOUNTING	15
4.1 BASIS OF ACCOUNTING	15
4.2 CHART OF ACCOUNTS	15
4.3 FINANCIAL MANAGEMENT INFORMATION SYSTEMS	16
5. INTERNAL AND EXTERNAL AUDIT	16
5.1 INTERNAL AUDIT	17
5.2 EXTERNAL AUDITS	17
6. SEQUENCING PFM REFORMS	18
6.1 PFM ASSESSMENTS	18
6.2 SEQUENCING APPROACHES	18
ANNEX 1: RESOURCES	20
ANNEX 2: GLOSSARY	0



## ACRONYMS

COA	Chart of Accounts
COFOG	Classification of the Functions of Governments (United Nations)
CSO	Civil Society Organization
FAR	Fixed Asset Register
FMIS	Financial Management Information System
GDP	Gross Domestic Product
IA	Internal Audit
IFAC	International Federation of Accountants
IMF	International Monetary Fund
IFRS	International Financial Reporting Standards
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
ISSAI	International Standards on Supreme Audit Institutions
MDA	Ministries, Departments and Agencies
MOF	Ministry of Finance
MTBF	Medium-Term Budgetary Framework
MTEF	Medium-Term Expenditure Framework
OECD	Organization for Economic Cooperation and Development
PEFA	Public Expenditure and Financial Accountability
PIP	Public Investment Program
PFM	Public Financial Management
SAI	Supreme Audit Institution
TSA	Treasury Single Account
USAID	U.S. Agency for International Development
VAT	Value Added Tax



# I. INTRODUCTION

## I.1 THE PUBLIC FINANCIAL MANAGEMENT (PFM) PRIMER

The Public Financial Management (PFM) Primer is an introductory guide for USAID field officers on the basic concepts and components of the PFM system. Strong PFM systems are critical for the effective, transparent, and accountable use of public funds. It is recommended that the Primer be used as a desk reference on the general parameters of good practices in each PFM subject area. This Primer is based on the *USAID Guide to PFM (2014)*, which is a helpful reference when more detailed information might be required. Annex 1 provides additional suggested reference materials categorized by topic. Annex 2 provides a glossary of terms.

## I.2 WHAT IS PUBLIC FINANCIAL MANAGEMENT?

PFM encompasses the mobilization of government revenue, allocation and spending of resources by public entities, and their accounting and reporting on those revenues and expenditures. In other words, a PFM system includes all the components of a country's fiscal situation and budget process — upstream (strategic planning, medium term expenditure frameworks, annual budgeting) and downstream (revenue management, budget execution, control, accounting, reporting, monitoring and evaluation, audit and oversight).

There are three primary objectives for public financial management:

1. **Fiscal discipline**, or the ability to control budget totals by setting ceilings on expenditures that are binding at both the aggregate level and on individual ministries, departments, and agencies (MDAs—also commonly referred to as spending units).
2. **Allocative efficiency**, or the ability of the government to allocate budget resources in accordance with established government priorities defined in strategic planning documents and principles of program, fiscal and operational efficiency.
3. **Operational efficiency**, or the ability of the government to implement programs at the lowest cost per unit of output while maintaining desired service quality levels.

A sound PFM system that aims to achieve the above three objectives is an essential (but not sufficient) component of good governance and is vital for the achievement of public policy objectives. Without a robust PFM system, governance will be unsustainable and service delivery will be compromised.

## I.3 PFM AT THE SUB-NATIONAL LEVEL

The objectives and characteristics of a sound PFM system are similar at the national and sub-national levels. In general, the PFM standards and practices followed at the national level should be followed at the sub-national level. A country's PFM legal framework should define the rights and responsibilities of both the national and sub-national governments.

The most significant aspect of sub-national PFM systems to be considered in PFM reforms is the degree of decentralization, devolution and/or deconcentration permitted under the laws of the partner country. USAID defines each of these:

1. **Deconcentration** may be defined as the national government reassigning responsibilities to the field offices of national ministries without placing these offices under the control of sub-national

governments. It tends to shift operational responsibilities from central government officials in the capital city to those working in regions, provinces or districts under the direct supervision of central government ministries. Deconcentration may be more appropriate in some post-conflict or fragile environments, and for services that should not be fully devolved due to scale, externalities and/or where redistribution of wealth and national standards are important.

2. **Delegation** shifts responsibility for specifically defined functions to subnational governments or sub-national administrative units or other entities. Delegation may be an intermediate step towards devolution.
3. **Devolution** is the most expansive form of decentralization. Unlike deconcentration and delegation, devolution requires political decentralization in addition to fiscal decentralization. After devolution, elected decision makers in sub-national governments may be largely independent of the national government, but are still bound by the provisions of national laws, policy priorities, and standards.<sup>1</sup>

To be effective, each of these forms of decentralization should align revenue assignment and transfers from the central government with service delivery responsibility so that decentralized service delivery functions are adequately funded.

## **I.4 STRUCTURE OF THE PFM PRIMER**

The remaining sections of the PFM Primer will explain each of the major components of the PFM system in turn, including:

- Budget planning and preparation
- Budget execution
- Public sector accounting
- Audit and evaluation
- Sequencing of PFM reform

Annex 1 to this Primer provides a list of additional resources for more information on all of these topics. Annex 2 provides a glossary of terms. For more detailed guidance on the full range of PFM topics, please reference the *USAID Guide to PFM (2014)*.

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<sup>1</sup> USAID, Democratic Decentralization Programming Handbook, 2009.

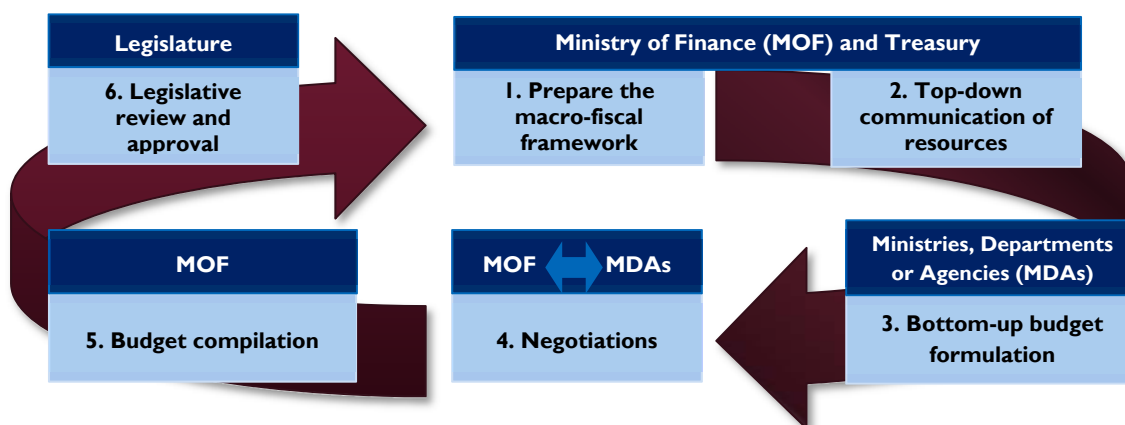


## 2. BUDGET PLANNING AND PREPARATION

Budget planning and preparation is the process by which a government develops, approves, and enacts a budget. The budget contains the government’s annual financial plan and articulates how the government will pay for its programs and ongoing operations. To be meaningful, a good budget should not simply list planned expenditures; rather it should describe how the government will generate the needed funds, serve its citizens, and support national and MDA priorities and objectives through its expenditures. The budget should describe the government’s plan to move towards the country’s long-term vision within the current year and should aggregate the plans and priorities of all government MDAs.

Figure 1 shows the budget planning and preparation process and stakeholder involvement. The process begins with preparing the macro-fiscal framework that forecasts major economic parameters such as inflation, economic growth, and public revenues and establishes the resource envelope. Using these forecasts, the Ministry of Finance (MOF) or other designated agency<sup>2</sup> communicates the respective budget ceilings to MDAs, who develop draft budgets within these funding constraints. The draft MDA budgets are finalized through an iterative negotiation process between the MDA and the MOF. The draft MDA budgets are consolidated into a draft government-wide budget for submission to the legislature, which reviews, amends, and approves the final budget.

Figure 1: Budget Planning and Preparation Process



### 2.1 LEGISLATIVE FRAMEWORK

While every country’s legislation defines its budget planning and preparation process, there are some general principles that should apply to most countries. Legislation should include provisions requiring preparation of an annual budget, guidelines for implementing a centralized budgeting process, identification of the agency responsible for producing a consolidated draft budget, and what to do in the event of a lapse in appropriations without a new budget in place.

<sup>2</sup> While certain countries may assign responsibility for coordinating the budget preparation process to a separate Ministry of Budget or other agency, Ministry of Finance will be used throughout for simplicity

Budget planning and preparation legislation can stipulate the fiscal rules that must be followed in enacting the budget. A fiscal rule imposes a long-lasting constraint on fiscal policy through numerical limits on budgetary aggregates. Fiscal rules may include limits on the amount of debt that can be incurred, requirements to balance the budget, expenditure limits in absolute terms or growth rates, or revenue-based rules that set ceilings or floors. Not all countries impose fiscal rules, but those that do may use one or more as fiscal control mechanisms.

Budget preparation processes may be defined in law or regulation. The Organization for Economic Cooperation and Development (OECD) recommends that laws should delineate responsibilities and issues of separation of government powers; executive regulations should detail budget preparation processes; and parliamentary regulations should define budget enactment or appropriation processes.<sup>3</sup>

## **2.2 BUDGET PLANNING PROCESS**

The national development plan, sector strategic plans, and macro-fiscal framework are inputs that help a government produce a budget that reflects economic and fiscal realities along with strategic priorities.

### **2.2.1 NATIONAL DEVELOPMENT PLAN**

The national development plan identifies long-term vision of the country and government, usually ten years or more, and the priorities, policies, and investments needed to progress toward the vision. Ideally, the plans and priorities of all government MDAs should be aligned with national ones and contribute to achieving the national vision.

### **2.2.2 MACRO-ECONOMIC FRAMEWORK**

The macroeconomic framework and the fiscal framework contribute to the development of a macro-fiscal framework. A macroeconomic framework contains projections of macro-economic indicators for the two to five year period that defines the short to medium-term, with projections for economic variables such as GDP, inflation, and unemployment. A medium-term fiscal framework (fiscal framework) contains revenue and expenditure projections over the medium-term and the fiscal position (deficit, balance or surplus), fiscal sustainability, and fiscal vulnerability. The macro-fiscal framework draws on economic forecasts and the fiscal framework to establish a resource envelope that set expenditure estimates for a three to five year span. These amounts provide guidance in the preparation of medium-term expenditure framework (MTEF) and annual budgets.

### **2.2.5 MEDIUM-TERM EXPENDITURE FRAMEWORK**

The medium-term expenditure framework (MTEF) is a fiscal outlook developed from the macro-fiscal framework and the national development plan. It is generally estimated on a rolling basis for a 3 to 5 year period, and updated annually. The MTEF connects available resources and the strategic objectives or priorities of the government in the form of budget ceilings for MDAs. Although the MTEF sets funding amounts, it does not authorize the government to spend money for the three to five year period; rather the annual appropriations (budget) law provides that authorization.

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<sup>3</sup> The Legal Framework for Budget Systems: An International Comparison," *OECD Journal on Budgeting*, Vol. 4, No. 3: 2004, p. 11, <<http://www.oecd.org/gov/budgeting/43487903.pdf>>.

## 2.3 BUDGET PREPARATION PROCESS

The purpose of the budget preparation process is to compile the detailed funding needs of government agencies and seek legislative action to set aside the funds for future MDA spending in a fiscal year. The budget preparation process includes the following steps:

1. **Dissemination of budget instructions**, often referred to as a budget circular, which includes expenditure ceilings based on the MTEF and a budget calendar;
2. **Preparation of budget submissions** by MDAs in accordance with the budget instructions and within the expenditure ceilings set by the Ministry of Finance or equivalent;
3. **Submission of draft budgets** by the MDAs, often utilizing an automated system;
4. **Negotiations** between the MDAs and the MOF and, ideally, sectoral working groups to reconcile MDA requests and expenditures ceilings defined in the MTEF;
5. **Compilation of the budget**, either before or after final legislative approval;
6. **Submission of the draft budget** to the legislature; and
7. **Legislative approval** and amendment (if necessary) of the budget.

### 2.3.1 BUDGET CIRCULAR

The budget circular is a set of guidelines issued to MDAs to develop their requests for future funding. The MOF should issue the budget circular early to allow time for MDAs to prepare their budgets and for MOF to compile the budget for the legislature. The budget circular will typically describe:

- The government's priorities;
- The laws and policies that govern the budget preparation process;
- The responsibilities of various agencies involved in the process;
- The MDAs that should submit a budget request;
- Resource envelopes for MDAs
- The information that should be in an MDA's request for funding;
- The format for budget preparation;
- The means through which it should be submitted;
- How expenditures should be estimated;
- The types of justification that should be provided; and
- The timing of key dates in the budget process.

After issuing the budget circular, the MOF should begin its discussions with MDAs on budget issues, and MDAs prepare and submit their budget requests following the budget circular guidelines. After the MOF makes initial decisions on budget requests, MDAs may be allowed to appeal the decisions through budget negotiations with the MOF.

### 2.3.2 TYPES OF BUDGET APPROACHES

While all countries prepare a budget, the format and approach can differ. Usually the budgeting approach depends on the highest priority budget objective, and the capacity of the MOF and MDA budgeting staff. Table I shows several different budget approaches. These can be utilized in conjunction with one another (for example, performance information is often attached to programs/activities).

**Table I: Budget Approaches**

Budget Type	Purpose	Advantages	Disadvantages
<b>Line Item</b> <i>Focus of budget is on the inputs (e.g. wages, capital, etc)</i>	<ul style="list-style-type: none"> <li>• Spending resources according to plan</li> <li>• Reduce risk of misappropriation of funds</li> <li>• Promote financial accountability</li> </ul>	<ul style="list-style-type: none"> <li>• Minimum amount of staff time and expertise needed to create and track the budget</li> <li>• Works well under time constraints and when there are multiple stakeholders and a high potential for conflict</li> </ul>	<ul style="list-style-type: none"> <li>• Not well-suited for assessing efficiency, effectiveness, and future and/or previously neglected concerns</li> <li>• Tends to become additive and discourages major changes</li> </ul>
<b>Program or Activity Based</b> <i>Focus on program plans, goals, and objectives</i>	<ul style="list-style-type: none"> <li>• Ensure that programs are achieving goals and objectives</li> <li>• Promote accountability</li> <li>• Align management responsibility with resources</li> </ul>	<ul style="list-style-type: none"> <li>• Provides a clear linkage between program activities, budget allocations, and government priorities</li> </ul>	<ul style="list-style-type: none"> <li>• Requires considerable resources to develop program plans, goals, and objectives</li> <li>• Has a high potential for conflict due to varying interpretations between MDAs</li> </ul>
<b>Performance or Results Oriented</b> <i>Metrics used to determine efficiency and effectiveness (these can be tied to programs/activities and so overlap with the above)</i>	<ul style="list-style-type: none"> <li>• Ensure that programs are effective (generating results) and efficient (least-cost)</li> </ul>	<ul style="list-style-type: none"> <li>• Provides a framework for monitoring and evaluating government achievement of goals, objectives, and priorities</li> <li>• Clarifies the trade-offs between funding of different government programs</li> </ul>	<ul style="list-style-type: none"> <li>• Requires considerable resources to develop reliable measures and time to develop the skill sets of those responsible for developing measurements</li> <li>• Creates incentives for distorted reporting of performance.</li> </ul>

These budgeting approaches reflect advancing levels of complexity with each approach serving as a building block for the successive level. Line-item budgeting provides the platform for all other budget approaches. Program and performance budgets are still developed through a line item budget, but cross-cutting information is presented for programs, rather than MDAs or their sub-units to better align costs with service delivery functions. Performance budgeting goes further than program budgeting by estimating the results that can be achieved by each program and the funds expended.

Annual budgets may be developed using an incremental or a zero-basis approach, or a hybrid of the two. Conventional, or incremental budgeting tends to perpetuate the current level of funding, focusing on adjustments for inflation and justifications for other incremental changes. By contrast, the zero based approach requires all MDAs to justify the entire level of funding based upon what is needed for the upcoming fiscal year, regardless of whether the budget is higher or lower than prior allotments. The MDA must also reflect the various levels of service that could be provided at different funding levels. Zero based budgeting can be combined with any of the approaches described in the table above. Zero-based budgeting is resource intensive and as a result is rarely used.

### 2.3.3 CAPITAL BUDGET AND PUBLIC INVESTMENT PROGRAMS

In budget planning, capital expenditures are not necessarily treated differently than expenditures for personnel or operating costs but are often placed in the capital budget section of the budget. Capital expenditures are investments to acquire, construct, or repair assets with an expected life of greater than one year, including land, buildings, facilities, equipment, vehicles, and other infrastructure. A public investment program (PIP) can help guide capital investment decisions and implementation for better planning and execution over a three to five year (or longer) period. A PIP can also facilitate leveraging and management of donor and private sector financing, as well as setting priorities for future projects and tracking costs of multi-year capital projects. The PIP should estimate the current costs for operation, maintenance, and replacement of capital assets and the government's ability to fund them.

### 2.3.4 SUPPLEMENTARY BUDGET

A supplementary budget is the outcome of a formal process to approve changes to an enacted budget, including the appropriation of additional funds. In some countries, MDAs may be allowed to make small transfers between budget lines (e.g., up to 10 percent) by “virement” through a notification to or approval by MOF. MOF typically issues formal guidance on how to request supplementary funding and/or changes to an MDA budget, as well as the calendar for development, submission, negotiation, and consolidation of these requests.

### 2.3.5 TRANSPARENCY

A transparent budget is shared with the public with sufficient detail and clarity to enable the government to be held accountable for service delivery. It allows the government to engage stakeholders in budget implementation, which, in turn, helps to ensure that policy objectives are achieved.

Government priorities, economic/fiscal outlooks, and assumptions should be presented towards the beginning of the budget process. Budgets should be comprehensive to include all government MDAs and should be provided to the legislature to review with sufficient time and information. It should include a medium-term perspective with deviations from previous forecasts explained and distinguish between mandatory programs and discretionary spending. In the case of performance or program budgeting, it should also describe progress toward the achievement of key performance indicator targets.

In the middle of the fiscal year, the government should review performance against the budget plan, and prepare a midyear budget report that presents the same information as above, as well as the impact of changes in economic assumptions, legislative changes, and technical changes. A report similar to the mid-year report should be presented before elections, although the feasibility of such a report may depend on the constitution or other legislation.

At least once every five years, the government should analyze the long-term sustainability of current policies and should publish this information. Accounting policies should be summarized and presented and should be used for all reports. Each report should contain a statement of responsibility by the senior official responsible for producing the report.<sup>4</sup>

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<sup>4</sup> “Best Practices for Budget Transparency,” OECD: 2002, <http://www.oecd.org/gov/budgeting/best-practices-budget-transparency.htm>

## 3. BUDGET EXECUTION

Budget execution is the set of processes through which goods, services, and infrastructure are procured to achieve the programmatic objectives outlined in strategic planning documents and the annual budget.

### 3.1 BUDGET AUTHORIZATION AND APPORTIONMENT

Once an annual budget is approved by the legislature, the MOF will authorize MDAs to begin executing their budgets. The MOF typically apportions an MDA's budget into monthly or quarterly allocations (also referred to as warrant releases, allotments, or décret de répartition). While the nature and terms describing this differs country to country and varies depending on the degree of centralization of spending authority generally, the MOF requires MDAs to develop spending plans that project their cash needs for the year by month and/or quarter. This process also helps the MOF manage its cash flow and plan for short-term borrowing by comparing projected revenue plans against consolidated spending plans. The spending plans also allow budget officers within the MOF and MDA to monitor spending patterns and identify over- or under-spending since an MDA usually cannot carry forward unspent funds to the next fiscal year. This also allows the Government to introduce some measure of commitment controls (see below) such as the total value of contracts signed to warrants/allotments/apportionments.

### 3.2 PROCUREMENT, CONTRACT MANAGEMENT AND PAYMENT

Procurement is the use of public funds to purchase goods and services during budget execution. To achieve value for money, public procurement and expenditure systems should be based on open competition, transparency, and accountability while minimizing fraud, waste, and corruption.

Procurement systems vary by country, but tend to range between being more centralized or more decentralized. In a centralized procurement system, one entity is responsible for obtaining goods and services for all central government MDAs and, in some cases, sub-national government units as well. The benefits of centralized procurement include scale efficiencies in purchasing and administration of purchasing, and ability to maintain centralized control, while the downsides relate to the need for more advanced planning and difficulty in standardizing some products across government. In a decentralized procurement system, MDAs procure their own goods and services. The benefits of a decentralized system include flexibility and ability to place orders quickly, while the negative aspects include lack of economies of scale and the absence of effective central control.

MDAs should prepare procurement plans in line with their spending plans. This allows procurements to proceed in an orderly basis. Major procurements generally follow a six-step process:

- **Requisition Request.** A user department completes a requisition form and submits it to the procurement unit. The form should state the specifications of the goods or services and the quantity required. The level of approval required for the request generally varies based on the monetary value of the request.
- **Bid Solicitation.** Based on the requisition request and regulatory requirements, the procurement unit determines the type of procurement method to use. Typically, procurement regulations dictate that larger bids must use open competition, while smaller procurements may proceed on the basis of a direct request for quotations from a few companies or shopping.

- **Bid Evaluation.** The evaluation and selection of a successful bidder should be done by a Tender Committee, which evaluates bids based on the bidding specifications and the legally required evaluation method. Examples of evaluation methods include lowest cost technically acceptable, scoring systems that consider elements of quality and cost, quality based selection, and sole source selection.<sup>5</sup> The Committee should clearly document the evaluation process and the scores. Bidders should be notified on the outcome and unsuccessful bidders should be able to appeal first to the Tender Committee and, if applicable, to a national level body such as the central procurement agency through a secondary appeal.
- **Contract Negotiation and Signature.** The procurement unit will negotiate the terms of the contract with the first choice bidder. An MDA will typically have a standard contract that stipulates payment terms (time for the vendor to receive payment after submission of proper invoice) and other standard clauses, but may negotiate on specific issues such as delivery dates.
- **Contract Management.** These tasks include oversight of the vendor, periodic review of work performed, and monitoring contract performance to ensure that deadlines and quality specifications defined in the contract are being met.
- **Verification.** After the goods and services have been received, procurement staff must verify receipt or completion according to the contract specifications.

After all goods or services under the contract have been received and payments made, the procurement unit should close out a contract. This involves ensuring the procurement file is complete and up-to-date.

### 3.3 COMMITMENT OF FUNDS AND COMMITMENT CONTROLS

Procurement processes are implemented in parallel to accounting functions that track an expenditure against an approved budget line, and ensure the expenditure is approved by the appropriate manager. A commitment generally arises when a purchase order is made or a contract is signed, though this may vary slightly based on the accounting standards used. Controlling the ability to issue purchase orders or sign contracts helps avoid the accumulation of arrears and situations where the government incurs expenses not included in the budget. Many countries introduce a phase before this where potential commitments are recorded, even before a legal commitment is made (often called a reservation).

The MDA should designate specific senior officers (e.g., heads of departments) who can authorize the purchase of goods and services based on line items in the submitted/approved budget. These controls are more effective when automated within a computerized Financial Management Information System (FMIS) (see section 4.3), and when there are punitive measures for noncompliance. These commitment control processes may be centralized in MOF or decentralized to MDAs, depending on the institutional design and operational arrangements of the country.

Governments should typically track an uncommitted balance of funds (i.e. the portion of the appropriation or allotment not tied up with commitments), in order to ensure a MDA does not exceed

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<sup>5</sup> Generally only applicable if only one vendor is able to provide the goods or services that meet the exact specifications required

it budget authority or cash plan. Prior commitments, like multi-annual contracts, or ongoing arrangements, such as wages, can be offset automatically against the appropriation/allotment.

### **3.4 PAYMENT PROCEDURES**

After verification, an invoice can be processed for payment. For more centralized payment systems, MDAs initiate purchase orders and conduct verification, but payment is made by the MOF or Treasury. In a decentralized payment system, MDAs pay vendors directly. The MDA prepares the payment request form with supporting documentation (e.g., invoice, proof of delivery, purchase order) and submits it to the payments department in the MOF or the MDA's finance department. The relevant department first confirms that budget funds are available (usually through the FMIS), then approves and issues the payment. Best practice is for payment to be made by electronic transfer to reduce risk, provide an audit trail, and eliminate the need for the vendor or MDA to pick up the check at the MOF.

### **3.5 ASSET MANAGEMENT AND INVENTORY**

After goods are procured and their receipt is verified, the MDA's must record non-expendable property in a fixed asset register (FAR) and label items with a permanent ID tag linked to the FAR. A FAR is usually maintained by an MDA's asset management or finance department. In some countries, the FAR is integrated in the FMIS, which allows greater control.

A FAR can help prevent theft and/or the misappropriation of assets. It can also track the value of assets and help calculate depreciation. Depreciation is an important component of annual financial statements when using accrual accounting (see *Section 5 on Public Sector Accounting*), and allows MDAs to better understand their financial position and future obligations for replacing assets. Annual audits of the FAR help ensure items currently owned are cataloged, correctly valued, can be located, and are operable.

### **3.6 PAYROLL**

Payroll is often the government's largest expenditure category. Government payroll should be based on a personnel database that should be verifiable against the list of approved positions for the budget (i.e., the establishment list). These two databases are not always directly linked or up-to-date to reflect new hires, terminations, retirements, and transfers. This can result in so-called "ghost employees" who have left the institution or are perpetually absent yet continue to receive payment, or a single civil servant receiving multiple payments. This issue may be addressed through better linkages between the two systems, government employee censuses, periodic payroll audits, and/or requirements that staff be physically present to receive payment.

Internal controls and audits are the cornerstone of any payroll management system. Control systems should be able to:

- Effectively monitor employee time and absence, including through use of biometric controls;
- Mitigate payroll errors through requirements for multiple approvers and segregation of duties; and
- Establish checks to ensure employees are properly identified before payment.



In some countries, payroll is integrated into the FMIS through a payroll module. This allows for better tracking of salary and allowance expenditures.

## 3.7 REVENUES

A revenue system should generate sufficient and predictable revenue for the government, be simple and easily understood by taxpayers; impose minimal compliance costs for payers and minimal administrative costs to the government; limit distortions to the economy; and be equitable, distributing burdens fairly amongst payers. Often, it is impossible to achieve all these objectives, but domestic revenue mobilization systems should be designed to minimize any negative consequences insofar as possible.

### 3.7.1 REVENUE CONSIDERATIONS DURING THE BUDGET PROCESS

Revenue policy and revenue collection affect the level of expenditure possible, and borrowing needs. The MOF and the tax administration need expertise to forecast revenues and analyze the revenue impact of changes in legislation to develop the fiscal outlook for budget planning, and to monitor and report during budget execution on whether revenues and expenditures are aligned with the budget. Revenue policy units should develop and maintain databases of economic and fiscal variables. They also need tools that allow them to analyze those variables. Because no one tool can estimate every possible economic or legislative scenario, experience is essential.

### 3.7.2 MAJOR CATEGORIES OF REVENUES

Major sources of revenue for the government include taxes, fees, fines, penalties, social contributions, income from investments, sale of property, and grants, among others. Of these sources, taxes and fees are particularly important in the context of PFM.

- **Taxes** are the compulsory, unrequited payments to the general government sector — a definition adopted by the OECD,<sup>6</sup> the IMF, and the World Bank. The fact that taxes are imposed on taxpayers and not visibly proportional to the benefits or services that taxpayers receive from government can create challenges for compliance. Nevertheless, tax revenues are the primary source of revenue for the central governments of most countries.<sup>7</sup> Modern tax systems rely on a few categories of 'core' taxes, such as income taxes, value added tax (VAT) or general sales tax, excise taxes, property taxes, property transfer taxes, and customs duties.
- **Fees** are amounts a government may charge for a specific service. Unlike taxes, fees are not compulsory and there is a direct relationship between the benefit received and the payment. This implies that beneficiaries and services are identifiable, and that the payers are also the beneficiaries of the service. Fees may be charged by any level of government, but are most often levied by sub-national governments. The government entity that provides a service should charge and collect the fees for that service. To the extent that an MDA collects fees, it may remit them to the treasury or retain them, depending on statutory guidelines. In either case, the MDA should report fee collections so that the central government understands its overall financial position. During budget planning and preparation, if the fees are retained by an MDA,

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<sup>6</sup> "Revenue Statistics 1965–2011," The OECD Classification of Taxes and Interpretative Guide, OECD: 2012, p. 322.

<sup>7</sup> *IMF Data Library*, International Monetary Fund, <<http://elibrary-data.imf.org>>.

they should be forecasted and included in any budget requests. Fee collections should be monitored to ensure that overall revenues are in line to satisfy the budget.

### 3.8.4 TAX ADMINISTRATION

The responsibility of any tax administration agency is to collect the right amount of tax from the right taxpayer at the right time (according to legislation), and to do so at minimal costs of compliance to the taxpayer and minimal costs of administration to the government. Often, the tax administration is a part of the MOF or may be a separate autonomous or semi-autonomous agency.

Over time, tax administrations have moved from a narrow focus on tax compliance to broader strategies that recognize that it is more efficient to use their limited resources to promote voluntary compliance, then monitor and enforce compliance for those who do not comply voluntarily. To do so, modern tax administrations typically perform the following functions:

- **Maintain a register of taxpayers** — the collection, recording, and maintenance of basic taxpayer information permits the tax administration to understand its taxpayer base.
- **Provide services, support, and education to taxpayers** — tax related information, forms, publications, and education help taxpayers comply with their tax obligations, demonstrate that they are considered valued customers, and reduce the need for expensive enforcement efforts.
- **Process tax declaration filings and tax payments** — enable taxpayer to fulfil its obligations, collect revenue, and collect information to monitor compliance.
- **Audit taxpayers** — the processes used by the tax administration to monitor compliance, by selecting filed tax returns to verify income, expenses, and supporting information reported by the taxpayer and to make additional assessments that require collection action.
- **Address taxpayer objections or appeals** — allow for a system of checks and balances to institute further trust in the tax system and enhance voluntary compliance.
- **Collect tax arrears (as opposed to current tax payments)** — collect taxes that are due, assessed, and not paid by the due date under the law, including use of enforcement measures, such as liens, levies, and seizure and sale of taxpayers' property.
- **Investigate fraud** —publicize cases of fraud and thus deter future non-compliance as well as institute further trust in the equity of the tax system.<sup>8</sup>

In performance of these functions, a Tax Administration needs effective IT systems able to integrate the taxpayer registry with tax filing, payments, audit, and appeals functions. It also needs effective supporting and compliance units such as internal audit, integrity investigations, and legal services.

Tax administrations face a complex operating environment. First, taxpayers are numerous and different. Large taxpayers, those responsible for a significant portion of the revenue, may have complex transactions, with solid accounting systems and records, while small taxpayers may operate simpler businesses without proper books and records. Many tax administrations recognize the need to vary services and the general treatment of taxpayers. Second, monitoring compliance is a constant challenge given the complex taxpayer population, the increasingly globalized world, and the limited resources of tax administrations. In all cases, tax administrations establish productive relationships with other

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<sup>8</sup> Terry Murdoch, Ronald McMorran, Anton Kamenov and Johan van der Walt, *Tax Administration Reform: A Primer*. USAID Bureau for Economic Growth, Education and Environment: 2012, <[http://pdf.usaid.gov/pdf\\_docs/PNAEA058.pdf](http://pdf.usaid.gov/pdf_docs/PNAEA058.pdf)>.

institutions, such as the judiciary, the private sector, and professional associations of accountants and attorneys. Finally, tax administrations all over the world are faced with powerful opportunities and challenges to use modern information technology in their operations.

### **3.8 TREASURY OPERATIONS AND CASH MANAGEMENT**

To purchase goods and services and pay its employees, a government must have money available to meet its obligations. This requires effective cash flow forecasting, or managing the timing of revenues and financing (cash inflows) so it can meet payments for expenditures (cash outflows). Key cash management objectives include safeguarding cash and investment assets (minimize financial, market, and operational risk), assuring the government is liquid at any time to pay its obligations, minimizing idle balances, reducing the cost of borrowing, minimizing transaction costs, and optimizing return on surplus funds.

As noted previously, the MOF in most countries will require MDAs to develop monthly or quarterly spending plans that lay out their expected expenditures. These plans guide cash payments and transfers and should be adjusted regularly to reflect the most up to date revenue and expenditure information.

A lack of a good cash management system can result in cash shortages, leading to the accumulation of budget arrears and/or cash rationing. Cash rationing, where Governments can often determine on a day to day basis which bills and cheques get paid, can be responsible for significant dislocations in spending priorities relative to those that were agreed to in the approved budget and lead to significant opportunities for rent-seeking.

#### **3.8.1 TREASURY SINGLE ACCOUNT**

The treasury single account (TSA) is an essential tool for successful government cash management. A TSA is a bank account or set of linked bank accounts through which the government transacts all its receipts and payments, and which allows the MOF to determine the government's consolidated cash position at the end of each day. Fragmented banking arrangements are suboptimal for several reasons. First, if MDAs are allowed to maintain their own bank accounts without access by the MOF, then the MOF will lack visibility into the government's consolidated cash position at any given point in time. Second, idle cash balances sitting in MDA bank accounts often fail to earn interest. Third, if the government is unaware of idle cash balances, it may unnecessarily incur borrowing costs to raise funds to cover a perceived cash shortage when in fact usable funds are sitting idle in another account. By consolidating government cash balances into one main account, a TSA gives the MOF/Treasury greater monitoring and oversight capabilities over all government cash flows.

Migrating to a TSA, however, can be challenging, due to the political will, capacity, banking environment, and information technology required to support its implementation. As with any PFM reform, implementing a TSA should move forward in stages. Some countries have found it useful to transfer certain disbursement categories over to the TSA first (e.g., salaries, capital expenditures, parastatals) with a full migration being phased in over time. Additionally, the introduction of electronic transaction processing (e.g., FMIS) and payment systems facilitates the establishment of a TSA.

TSAs can be implemented in different forms, using private banking or the central bank's systems depending on the available technology, reporting requirements and legislation in the country.

### 3.8.2 DEBT MANAGEMENT

Prudent debt management is essential for reducing risks and managing costs over the medium and long term. High levels of debt accumulation raise the risk that debt will become unsustainable and/or that exogenous shocks will result in reversals of capital flows, cause currencies to fluctuate, or foreign assistance levels to drop. Poorly-structured debt in terms of maturity, currency, or repayment terms, and large unfunded liabilities can also create significant macroeconomic risks.

Developing countries have been particularly affected by poor debt management, largely due to underdeveloped domestic financial systems, weak governance, lack of transparency, and shortage of skilled debt managers. Strengthening debt management may include limiting the ability of MDAs and sub-national governments to incur debt, improving sharing of information between debt managers and fiscal and monetary authorities, increasing transparency and accountability in debt management activities, and applying appropriate tools such as cash flow simulation and debt recording and reporting systems.

It is important to highlight that sound debt management in and of itself is not a substitute for sound macroeconomic and fiscal policies, and if not managed properly, debt can harm the larger economy.

## 4. PUBLIC SECTOR ACCOUNTING

Accounting is the process of recording, classifying, and summarizing the financial transactions of an organization. Financial reports and statements summarize this data for review and decision-making. Accounting data must be accurate, timely, and verifiable. Public sector accounting aims to ensure efficient, effective, and transparent use of resources.

### 4.1 BASIS OF ACCOUNTING

The basis of accounting is the method and timing of recording transactions in the books and records. The three primary bases for accounting are the cash, accrual, and modified accrual/cash basis. Table 1 below summarizes some of the main aspects of cash and accrual accounting.

**Table 1 – Main Aspects of Cash and Accrual Accounting**

	Cash Accounting	Accrual Accounting
<b>When revenue is recognized</b>	<ul style="list-style-type: none"> <li>When cash is received</li> </ul>	<ul style="list-style-type: none"> <li>When service is performed or when right to receive payment is obtained</li> </ul>
<b>When expenditure is recognized</b>	<ul style="list-style-type: none"> <li>When cash is paid out</li> </ul>	<ul style="list-style-type: none"> <li>When the expense occurs or expires or when you are obligated to pay</li> </ul>
<b>Type of information recorded</b>	<ul style="list-style-type: none"> <li>Cash receipts and cash payments</li> </ul>	<ul style="list-style-type: none"> <li>Receipts, payments, receivables, payables, assets, and liabilities</li> </ul>
<b>Benefits</b>	<ul style="list-style-type: none"> <li>Easy to implement</li> <li>Accurately tracks cash on hand</li> <li>Focuses on stewardship and compliance</li> <li>Demonstrates performance in an individual budget year</li> </ul>	<ul style="list-style-type: none"> <li>Accountability and transparency</li> <li>More accurate assessment of available funds</li> <li>Considers the medium and long term implications of operations and policy</li> </ul>
<b>Weaknesses</b>	<ul style="list-style-type: none"> <li>Does not accurately reflect outstanding receivables, payables, assets, liabilities, and other obligations</li> <li>Does not provide a medium or long term vision on finances</li> </ul>	<ul style="list-style-type: none"> <li>More complex and costly than cash basis to develop and implement</li> <li>Lack of capacity in many countries</li> <li>A longer time frame needed for implementation compared to shorter term political will</li> </ul>

Modified accrual/cash basis accounting combines elements of the two systems. A cash basis is used for revenues, and an accrual basis for expenditures, although there may be exceptions for specific purposes. This system recognizes revenues when they become available and expenditures as they are incurred.

### 4.2 CHART OF ACCOUNTS

A chart of accounts (COA) is a list of all financial accounts used by a government, including revenues, expenditures, and assets. The COA provides the structure of the general ledger, the primary accounting record of an organization, and is used in budgeting, recording transactions, and reporting. It also serves to standardize governmental financial information and accounting rules so that government-wide statements can be consolidated.

COAs should incorporate or be compatible with leading practices, such as the United Nation’s Classification of the Functions of Government (COFOG) and the IMF’s General Financial Statistics (GFS). COFOG and GFS provide a system to classify, codify, and organize the basic functions of a typical government for budget and accounting purposes. Compliance is often incorporated into basic fiscal and/or budget laws and should be made mandatory as soon as practical.

### 4.3 FINANCIAL MANAGEMENT INFORMATION SYSTEMS

A Financial Management Information System (FMIS) automates key components of the budget execution and accounting processes and provides information to facilitate budget preparation. An FMIS stores and organizes real-time financial information for current and past year spending and approved budgets, detailed inflows and outflows of funds, and inventories of financial assets and liabilities. An FMIS may incorporate controls to prevent overspending of the total budget of an MDA or specific sources and uses of funds, down to the line item level. It also creates an audit trail.

The scale and scope of an FMIS can vary from a simple general ledger system to a more comprehensive system addressing budget, revenue, expenditure control, debt, asset and resource management, human resources, payroll, accounting, financial reporting, and auditing. An FMIS can be used across central government institutions or expanded to include local governments and quasi-governmental entities, such as parastatals (entities wholly or partially owned or controlled by the government).

An FMIS should be tailored to the specific needs of the country. If it is too cumbersome, hard to maintain, or provides too much detail, it will become unwieldy and expensive to maintain. Phased implementation of an FMIS allows the system to be gradually expanded to different users groups, including to sub-national governments. The complexity of the system can be increased as financial, technological, and human resources allow.

## 5. INTERNAL AND EXTERNAL AUDIT

An audit is a systematic and independent examination of data, statements, records, operations, and performance of government entities for a stated purpose like regulatory compliance, operational effectiveness, and financial accuracy.

There are three primary types of audits that serve different functions, including:

- **Financial audit**, which determines whether the financial results were reported fairly, in compliance, and provide a fair view of the organization’s financial position.
- **Compliance audit**, which looks at the extent that legal or regulatory requirements, and donor and financial institutions’ terms and conditions are being met through proper management systems and procedures.
- **Performance audits**, which evaluate the effectiveness or value for money of a program, operation, or process of an organization.

Audits are also classified as either internal or external. Internal audits are conducted by a specialized unit within an organization. External audits are conducted by a third-party such as the Supreme Audit Institution (SAI) or a professional auditing firm.

## 5.1 INTERNAL AUDIT

The internal audit function provides assurance to management and stakeholders that the organization manages risks that might impede its objectives. It includes periodic or on-going monitoring to assess how well the internal controls are functioning. Some items internal auditors may review include:

- Tone and risk management culture of the organization;
- Effectiveness and efficiency of internal controls;
- Proper segregation of duties within processes;
- Proper authorization of transactions;
- Safeguards over inventory and assets;
- Efficiency of processes or operations; and
- Accuracy of record keeping and documentation.

Recently, internal audits in many countries have moved to a more risk based approach, in which internal auditors identify factors that could jeopardize the achievement of an organization's objectives and prioritize these risks based on their likelihood and impact. This allows the internal audit unit to focus its limited resources appropriately.

An internal audit unit is located within an organization and usually reports to the organization's management. An internal audit committee should provide oversight, set the budget for internal audits, and ensure that processes and reports are free from interference by management. However, some countries rely on a single government agency to coordinate and conduct government-wide internal audit activities, which are independent of the audited agencies.

## 5.2 EXTERNAL AUDITS

Unlike internal audits, external audits are performed by a firm or governmental body independent of the audited organization. They foster financial transparency and accountability and provide assurance to the government oversight bodies on operational integrity and financial reporting. These audits should be conducted in accordance with the guidance of the International Organization of Supreme Audit Institutions (INTOSAI), which issues General Standards for Governmental Auditing and International Standards on Supreme Audit Institutions (ISSAIs).

Supreme Audit Institutions (SAIs), financial enforcement bodies, ethics bodies, professional organizations, and parliamentary committees may provide oversight for the public sector. SAIs often have primary responsibility for external audits because of their relative independence from other agencies in the government. SAIs are most effective if the executive branch and legislature empower them fully and there are strong checks and balances between the executive and legislative branches.

## 6. SEQUENCING PFM REFORMS

Effective sequencing of reforms is important because developing countries generally cannot tackle all recommended reforms at the same time. The most effective strategy to sequence PFM reforms, however, has been widely debated. While there are some useful models and basic principles, there is little empirical evidence or research on which approaches are most effective and efficient.

### 6.1 PFM ASSESSMENTS

Before developing a sequencing strategy for PFM reforms, it is important to know the baseline and problems associated with the current system. Common assessment tools and processes for identifying the baseline and problems include the Public Expenditure and Financial Accountability (PEFA) assessment, the Public Expenditure Review (PER), the Country Financial Accountability Assessment (CFAA), USAID's Public Financial Management Risk Assessment Framework (PFMRAF), and DFID's Fiduciary Risk Assessment (FRA). The PEFA is the most widely used diagnostic tool for public financial management. It consists of 31 high-level indicators for budget credibility, comprehensiveness, and transparency; policy based budgeting; predictability and control in budget execution; accounting, recording, and reporting; and external audits. The PEFA does not include recommendations for specific reforms, but the assessments can be used to identify PFM reform needs for discussion or planning purposes.

### 6.2 SEQUENCING APPROACHES

In general, the PFM literature points to three conceptual approaches to sequencing of PFM reforms:

- **Basic First.** Focuses on implementing basic laws, policies, and practices for good PFM, such as governments being able to properly account for cash, before introducing more sophisticated PFM practices, such as accounting for accruals. This approach is particularly appropriate for governments whose technical or political capacities are weak. It does not, however, facilitate progression to more complex reforms, and tends to add to the duration of development assistance.
- **Platform Approach.** Sequences reforms starting with budget credibility and financial control, and moving to macro-stability and then service delivery. This approach can lead to more comprehensive and sustainable PFM systems than the basic-first approach. However, if the platform approach is donor driven, partner countries could have difficulty reaching an agreement on prioritizing actions and this could delay implementation.
- **Evolutionary Approach.** This variant of the platform approach promotes the gradual implementation of reform moving from transaction based, to policy and performance, and finally to legislative oversight. This approach benefits a country by emphasizing a systems approach within each platform rather than piecemeal actions.

Each of these approaches has its benefits, which might be more or less applicable in different contexts.

### 6.3 USAID INTEGRATED PHASE APPROACH (IPA)

These approaches focus on assistance in the PFM sector, while USAID's efforts also integrate sectoral efforts. In order to accomplish their objectives, USAID programs should use an Integrated Phase Approach (IPA). Each phase must be integrated across sectoral boundaries, focused on accomplishment



of system or sub-system reforms, and have clearly identified and realistic goals, milestones, and targets. The five phases of an IPA are:

- **Assessment.** In this phase, all available and reliable assessments of the environment for PFM and governance should be evaluated, including the Political Economy Analysis and/or PFMRAF. If neither are available, it is advisable to perform the assessments and to discuss programming issues with partner country government and donors.
- **Planning and Strategy.** During this phase, discussions should be held with the partner country government and potential donors for PFM. The partner government should be encouraged to generate a PFM reform strategy incorporating actions to implement reforms and enhancements identified in the assessments.
- **Core Systems.** This phase concentrates on ensuring financial transaction systems operate effectively and should address legislative basis, budget planning and development, transactions and budget execution, revenue systems, public administration, auditing, and the business-enabling environment.
- **Practice Enhancement.** This phase builds on the previous one by focusing on the adoption and implementation of international good practices. It could take 3 -10 years to fully execute these changes based on partner country capacity, political will, and availability of funds.
- **Institutionalization.** This final phase ensures that the various adopted systems all work together and do not lead to negative incentives or unintended consequences. Vigilant monitoring will also be necessary to prevent degradation of systems.

All of these approaches to sequencing PFM reforms emphasize implementing reforms at a pace that partner country institutions can absorb effectively. Country ownership of the reform process is essential for effective implementation and sustainability. The partner country, rather than donors, should develop a PFM reform strategy and action plan that donors can then support.

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## ANNEX 2: GLOSSARY<sup>9</sup>

**Accountability:** The systems, procedures, and mechanisms designed to ensure that public officials and institutions perform their duties and responsibilities while recognizing restraints on their power and authority. Accountability also refers to the processes that enable governments to be held responsible for their actions by their citizens, a central tenet of governance.

**Accounting:** The process of recording, classifying, and interpreting financial transactions that occur within an organization.

**Accrual Basis of Accounting:** An accounting method where revenues are recognized when goods and services are provided or the right to receive payment is obtained. Similarly, expenses are recognized when the expense occurs or expires or when there is an obligation to pay for goods and services.

**Audit:** An independent review and examination of system records and activities. Audits are used to verify financial records and statements, evaluate internal controls, assess compliance with internal processes and procedures and legal and donor requirements, detect fraud, and identify potential improvements in processes and procedures.

**Automated Directives System (ADS):** is a standardized system consisting of (1) USAID internal policy directives and required procedures; (2) external regulations applicable to USAID; and (3) non-mandatory guidance to help employees interpret and properly apply internal and external mandatory guidance.

**Budget Authority:** The legal authority to incur financial obligations that result in expenditures. It can also refer to a ministry, department or unit of government that receives a budget through the government budget process and is accountable for that budget to the legislature.

**Budget Cycle:** A key process in any public financial management system governed by the legal framework that can be organized into four components: budget planning, budget preparation, budget execution, and auditing. Reporting occurs throughout the four components.

**Budget Planning:** The first component of the budget cycle, developing a short- to medium-term budget plan based on the established resource envelope. This component also includes the development of longer term strategic plans and medium term macroeconomic and macro-fiscal frameworks then linked to the budget plan. During budget planning, specific programs are defined at sectoral and activity levels to achieve national goals.

**Budget Preparation:** The second component of the budget cycle. It generally begins the development of an MTEF and/or with a budget circular published by the agency responsible for budgeting (usually, the Ministry of Finance), providing guidance for administrative and sectoral units on developing their budgets according to an approved Budget Plan.

**Cash Basis of Accounting:** An accounting method in which revenues are recognized when cash is received and expenditures are recognized when cash is paid for services and/or goods.

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<sup>9</sup> This annex, Annex 2, “Glossary,” includes the full glossary appended to the *USAID Guide to Public Financial Management (2014)*.



**Chart of Accounts:** The basic building blocks of any accounting system, listing all accounts (categories) used in budgeting, recording, and reporting revenues, expenditures, assets, and liabilities. The COA includes codes that indicate key information, such as the the department or unit responsible for the transaction, the program or purpose, and nature of the transaction. This is also referred to as accounts classification

**Civil Society:** The non-governmental and private sector organizations and institutions that manifest the interests and will of various publics.

**Debt:** The outstanding amount that the government owes to lenders at any given point in time. Thus debt essentially represents the total of all annual deficits, minus any annual surpluses, over the years.

**Deficit:** The difference between one year's revenues and expenditures when expenditures exceed revenues. It only reflects that fiscal year's imbalance. Deficits are funded either with savings or through borrowing or external funding.

**Debt Sustainability Analysis:** An assessment of the government's ability to make the fiscal policy adjustments (revenue collection and expenditures) needed to achieve solvency. A debt sustainability analysis looks at how the ratio of the debt to Gross Domestic Product, will change over time based on the outlook for the primary deficit, or fiscal deficit, and the interest rate-growth differential.

**Expenditures:** Government spending (outlays). Expenditures are made to fulfill a government obligation, generally by issuing a check or disbursing cash in physical or electronic forms. Expenditures may pay for obligations incurred in previous fiscal years or in the current year as permitted by law. Expenditures are often subdivided into capital and recurrent. Capital expenditures are those for the acquisition of assets with more than one year of useful life, while recurrent expenditures are those that must be repeated on a regular basis, such as wages, utilities, etc.

**External Audit:** A periodic or specific-purpose audit performed by a qualified professional independent of the entity being audited , in accordance with laws or rules on the financial statements of a company, government entity, donor, or other legal entity or organization The objective is to verify the accuracy and completeness of the entity's financial information, its compliance with laws, rules, and/or regulations governing its financial and other operations, and sometimes its performance vis-à-vis established goals, objectives, and/or indicators.

**Effectiveness:** The extent that the development intervention's objectives were achieved or are expected to be achieved, taking into account their relative importance. In partner governments, effectiveness is measured as the extent to which the government's goals, objectives, and indicators are achieved over a defined time period.

**Executive Branch:** The executive branch of government is that segment of government organizations charged with the management and administration of government functions. The executive branch is thus the administrative arm of government. It is often referred to as the 'administration' or the 'administrative branch of government'. It generally includes most public employees because it operates, implements and enforces all the laws created by the legislative branch, and as interpreted by the judiciary branch.

**Financial Management Information System (FMIS):** Stores, organizes, and facilitates access to financial information. It supports the reliable collection and dissemination of information throughout the public financial management cycle and provides decision makers with a set of tools to control, prioritize, and use public resources more effectively. It stores financial information related to current and past year spending as

well as the approved budgets for the current year, details on inflows and outflows of funds and complete inventories of financial assets and liabilities. The FMIS may also be integrated with functions including asset controls, budget preparation, human resources, payroll, procurement, and other PFM sub-systems as needed.

**Financial Reporting:** The communication of financial information to inform interested parties about the decision-making process and enhance government transparency throughout the entire budget cycle.

**Fiscal Deficit:** A fiscal deficit is caused when expenditures exceed revenues during a budgetary period once all government obligations have been paid and without deducting transfer payments. The payments made include debt obligations.

**Fiscal Framework:** A tool to establish medium-term fiscal targets with a focus on fiscal position, fiscal sustainability, and fiscal vulnerability. The fiscal framework is informed by the macroeconomic framework, and includes revenue and expenditure projections disaggregated by various categories.

**Fiscal Sustainability:** The ability of a government to sustain its current spending, tax and other policies in the medium to long term (3 to 10 or more years) without threatening government solvency or defaulting on its liabilities or projected expenditures.

**Fiscal Vulnerability:** When government fails to ensure adequate financial resources to meet all its payment obligations. Large fiscal deficits or public debt are leading indicators that fiscal policy is vulnerable.

**Fixed Asset Register:** An accounting method used to keep track of the fixed assets of a firm or government. The register shows the value of assets, date of acquisition and other details necessary to compute for depreciation, control and tax purposes. Fixed assets include land, buildings, machineries and other items used in the business that are not for sale in the ordinary course of operations.

**General Ledger:** An organization's primary accounting records containing a complete record of financial transactions over its life. Information from the general ledger is used to prepare financial statements. The general ledger generally includes accounts for budget, assets, liabilities, revenues, and expenses consistent with the chart of accounts.

**Good Governance:** Governance that respects the democratic rights and interests of stakeholders while promoting government accountability, transparency, and efficient and effective delivery of public services and the rule of law.

**Governance:** The exercise of authority, involving the process and capacity to formulate, implement, and enforce laws and public policies and provide public services.

**Government Cash Management:** The management of cash inflows and outflows to maintain liquidity so that the government is always in a position to meet its obligations as they become due. Government cash management deals with both collections (sources of funds) and disbursements (use of funds).

**Gross Domestic Product (GDP):** The market value of all finished goods and services produced within a country during a specific time period. It includes all private and public consumption, government outlays, investments, and exports less imports. Real GDP, as opposed to nominal GDP, is adjusted to remove the effects of inflation. Per capita GDP is the GDP divided by the population of the country.

**Imprest Fund:** A cash fund with a fixed amount established through an advance of funds to an authorized imprest fund cashier, without appropriation change, for immediate cash payments of relatively small amounts for authorized purchases of goods and non-personal services.

**Interest Rate-Growth Differential:** The differential between the interest rate paid to service government debt and the growth rate of the economy.

**Internal Audit:** Frequent or on-going audits conducted by an entity's own accountants, rather than independent external auditors. The objective of internal audit is to identify risks and weaknesses in the financial and operational control environments and to develop recommendations to mitigate or rectify them.

**Internal Controls:** Systems, policies, and procedures to reasonably ensure orderly, ethical, and efficient operations in accordance with the organization's mission; compliance with laws and regulations; and reduce risks of waste, fraud, abuse, and mismanagement. These include segregation of duties within processes; appropriate authorization of transactions; safeguards over inventory and assets; efficiency of processes or operations; good record keeping and documentation; and reporting and use of the information.

**International Public Sector Accounting Standards (IPSAS):** A set of accounting standards issued by the IPSAS Board recommended for the preparation of financial statements by all public sector entities in. These standards are based on International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). They are used to improve the quality of general purpose financial reporting by public sector entities for better informed assessments of the resource allocation decisions made by governments for greater transparency and accountability.

**International Organization of Supreme Audit Institutions (INTOSAI):** A governing and participatory body dedicated to the improvement of public external auditing standards and practices. Many national Supreme Audit Institutions belong to this group

**Judicial Branch:** The segment of governing institutions that includes courts or other bodies charged with making rulings based on laws or interpreting the laws of a country. In certain governance systems may include prosecutorial and other bodies whose responsibilities include participation in the system of adjudication. In some countries the judicial branch may be effectively part of the executive branch of government or be partially under its control through appointments or influence.

**Legislative Branch:** The segment of government, whether elected or appointed, that is responsible for the passage of primary legislation, or the laws under which a country is governed. Ideally, legislatures are primarily elected by the citizens. In good practice public financial management legislatures approve government revenues and expenditures through a budget law. The primary institutional components of legislative branches include parliaments, congresses, assemblies, councils, or similar bodies and their integral supporting units.

**Line Item Budgeting:** Budgets are based on the cost of specific categories of inputs (e.g., salaries, electricity, and fuel). Line item budgets focus on the resources spent, but do not provide information on the intended results. Also known as Input Budgeting.

**Macroeconomic Framework:** Projections of the real, external, fiscal, and monetary sectors based on a set of macroeconomic goals and policy framework. The macroeconomic framework assesses domestic and global economic trends to estimate the resources that will be available to the government.

**Macro-Fiscal Framework:** The macro-fiscal framework draws on the macroeconomic and fiscal frameworks to estimate a resource envelope based on projected revenues and expenditures for a 3–5 year period. These revenue and expenditure amounts appear in the medium-term expenditure framework and

annual budgets and are an integral part of the budgeting process and the PFM system. These may also be referred to as medium-term fiscal frameworks.

**MDA:** Ministries, Departments, and Agencies. MDA are organizations and/or institutions that are primarily funded through a government's budget and are responsible for government operations, policies, and the provision of government services with those funds. Such organizations may additionally include those identified by any and all terms used to refer to government entities, including departments, offices, etc.

**Medium Term, Short-Term, and Long-Term:** In general PFM and governance practice, short term refers to periods of less than 3 years, medium term to periods of between 3 and 5 years, and long term to periods exceeding five years.

**Medium Term Expenditure Framework (MTEF):** The expenditure portion of a Medium Term Budget Framework and a critical tool during the budget preparation process that translates strategic objectives and priorities into financial figures over the medium-term. It links the top-down resource envelope (what is affordable based on the aggregate expenditure ceiling established through the medium-term fiscal framework) to the bottom-up cost estimates (what is needed) prepared by spending agencies. It provides a medium-term framework for policy makers to decide on program priorities and make political choices as the budget is being prepared.

**Medium Term Budget Framework (MTBF):** A framework for integrating fiscal policy and budgeting over the medium-term by linking aggregate fiscal forecasting to a disciplined process of maintaining detailed medium-term budget estimates by ministries that reflect existing government policies.

**National Budget:** A legal document authorizing government officials to spend public funds within pre-agreed constraints. The budget allocates resources and thereby expresses the policy priorities of the government. Such documents may include items directly related to the achievement of goals and objectives by government as well as program descriptions and performance reporting

**Office of Management and Budget (OMB):** The Office of Management and Budget (OMB) is an agency of the United States of America's federal government that evaluates, formulates, and coordinates management procedures and program objectives within and among departments and agencies of the executive branch.

**Organization for Economic Co-operation and Development:** The OECD is an international economic organization of 34 countries founded in 1961 to stimulate economic progress and global trade. It is a forum for countries committed to democracy and a market economy that offers a platform to compare policy experiences, seek answers to common problems, identify good practices, and coordinate domestic and international policies of its members.

**Parastatals:** A company, entity, organization or agency owned or controlled wholly or partly by the government. Examples might include state owned enterprises, universities, joint stock companies, etc.

**Petty Cash:** A small fund of money for rapid reimbursement of incidental expenses of an operating unit.

**Primary Deficit:** A country's primary deficit is caused when expenditures exceed revenues during a budgetary period once all government obligations have been paid before deducting interest payments on debt or government obligations.

**Program Budgeting:** A type of budget that groups revenues and expenditures by program, regardless of the number of budget institutions involved and shifts the focus from resource input to service delivery.

**Public Expenditure and Financial Accountability (PEFA):** A multi-donor partnership of seven donor agencies and international financial institutions founded in 2001 to assess the conditions of country public expenditure, procurement and financial accountability systems and develop a practical sequence for reforms and capacity development. A steering committee manages the program and a secretariat implements the activities.

**Public Financial Management (PFM) System:** The national or sub-national government policies, procedures, and infrastructure for planning, directing, controlling, monitoring, and reporting on public financial resources intended to result in efficient and effective operations.

**Public Investment Program (PIP):** A phased, multi-year (3-5) program within an administrative unit or sector that aims to facilitate efficient and effective capital investments or improve management of donor financing.

**Public Procurement:** The use of public funds by public entities for purchasing goods and services from the domestic or international private sector or civil society organizations. Also, the processes used for such transactions.

**Responsiveness:** The extent to which a government meets the needs perceived by its citizens and can react to changing conditions.

**State Owned Enterprises:** A shareholding arrangement in which a government entity has a controlling or minority ownership interest that allows it to exercise management control over a business providing services to non-state entities.

**Strategic Plan:** A plan that covers an extended period (usually 5 years or more) and that identifies national priorities and policies, generally without fiscal components. Sectoral or institutional strategic plans can also be developed in line with a national strategic plan.

**Supreme Audit Institution (SAI):** A national organization that sets standards for audit work and generally controls the external audit processes for the government.

**Transparency:** A form of accountability that is based on accessibility and openness of information. Transparency may be internal or external (public).

**Treasury Single Account (TSA):** A unified structure of government bank accounts that gives a consolidated view of government cash resources. Based on the principles of the unity of cash and the treasury, a TSA is a bank account or a set of linked accounts that all governmental entities use in for revenue and payment transactions.

**Zero-Based Budgeting (ZBB):** A budgeting technique based on the principle that all prior allocations need to be re-justified every year, rather than assuming continued baseline funding. Zero-based refers to the fact that each major budget item is reviewed as thoroughly as if it had not been funded in the previous year. Since this is a time-consuming and data-intensive approach that does not take political realities into account, it is rarely used in practice, although partial or modified ZBB is often a component of a single budget process.