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USAID GUIDE TO PUBLIC FINANCIAL MANAGEMENT

BUREAU FOR DEMOCRACY, DEVELOPMENT, AND
INNOVATION

DEMOCRACY, HUMAN RIGHTS, AND GOVERNANCE
CENTER, GOVERNANCE TEAM

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Technical leadership and quality assurance for the Guide is provided by the Governance Team in USAID's Center for Democracy, Human Rights, and Governance (DRG). The Governance Team maintains responsibility for future updates of the Guide and for development of related tools and resources. For questions about this Guide, or for help addressing PFM issues at any phase of the program cycle, contact the Governance Team.

ACRONYMS AND ABBREVIATIONS

AICPA	American Institute of Certified Public Accountants
CBO	Congressional/Central Budget Office
COA	Chart of Accounts
COFOG	Classification of the Functions of Governments (United Nations)
CPA	Comprehensive Peace Agreement
CSO	Civil Society Organization
DDLG	Decentralization and Democratic Local Government
EU	European Union
FAR	Fixed Asset Register
FMIS	Financial Management Information System
GASB	Governmental Accounting Standards Board
GAAP	Generally Accepted Accounting Principles
GCIA	Government Chief Internal Auditor
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Country
IA	Internal Audit
IAAS	International Auditing and Assurance Standards
IAASB	International Auditing and Assurance Standards Board
IAESB	International Accounting Education Standards Board
IASB	International Accounting Standards Board
ICB	International Competitive Bidding
ICT	Information and Communications Technology
IESBA	International Ethics Standards Board for Accountants
IFAC	International Federation of Accountants
IFI	International Financial Institution
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
IFRS	International Financial Reporting Standards
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
IPSASB	International Public Sector Accounting Standards Board
ISA	International Standards on Auditing
ISSAI	International Standards on Supreme Audit Institutions
ISSB	International Sustainability Standards Board
IT	Information Technology
LDA	Local Development Authority (Tanzania)

LIB	Limited International Bidding
MDA	Ministries, Departments and Agencies
MOF	Ministry of Finance
MOFEP	Ministry of Finance and Economic Planning
MTBF	Medium-Term Budgetary Framework
MTEF	Medium-Term Expenditure Framework
NCB	National Competitive Bidding
NGO	Non-Governmental Organization
OECD	Organization for Economic Cooperation and Development
OMB	Office of Management and Budget
PAC	Public Accounts Committee
PAO	Professional Accountancy Organization
PBO	Parliamentary Budget Office
PEFA	Public Expenditure and Financial Accountability
PIP	Public Investment Program
PFM	Public Financial Management
SAI	Supreme Audit Institution
SOE	State Owned Enterprises
TSA	Treasury Single Account
USAID	U.S. Agency for International Development
VAT	Value Added Tax
ZPPA	Zambia Public Procurement Agency

I. INTRODUCTION

This is the second edition of the USAID Guide to Public Financial Management (PFM). This edition recognizes innovations in PFM techniques and tools and new challenges facing USAID partner countries, as well as changes in the ways the international development community and USAID engage in this area. This edition also reinforces USAID's approach to cross-sectoral, integrated, and comprehensive programming to enhance the sustainability of our support.

This edition of the Guide aims to be more accessible and targeted for practitioner use, in order to inform program designs, implementation, and monitoring, evaluation and learning. To enhance accessibility, each section of the 2nd Edition can be accessed separately via links in this Guide and on the Guide's [landing page](#).

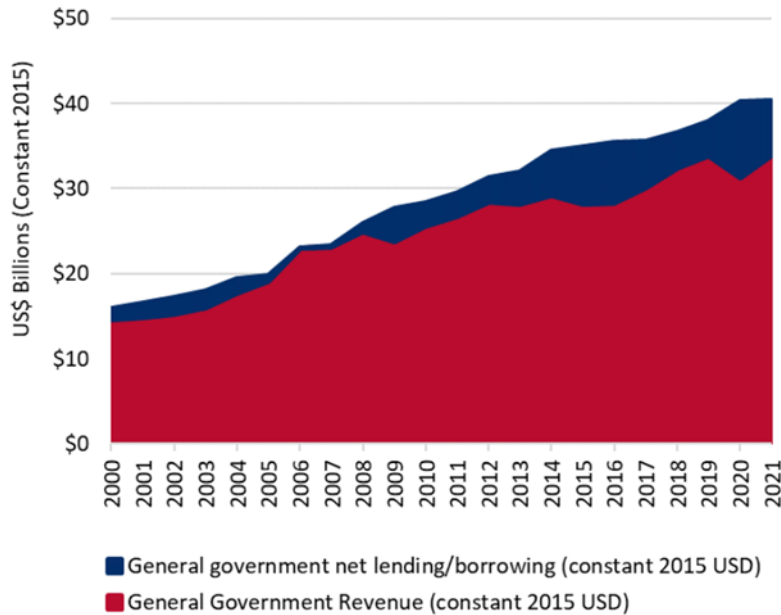
I.1 THE PURPOSE OF THE GUIDE TO PUBLIC FINANCIAL MANAGEMENT (PFM)

The PFM Guide is designed to give USAID field officers a foundational understanding of PFM to empower them to apply a PFM lens to USAID policy and programming in all sectors. Strong PFM systems are critical for the effective, transparent, and accountable use of public funds and underpin good governance. They are also vital to partner countries' ability to sustain gains achieved under development partner-funded programs. Moreover, PFM system strengthening is a key component of USAID's commitment to locally-led development—to empowering local actors to set their own agendas, develop solutions, and bring the capacity, leadership, and resources to make those solutions a reality.

USAID's approach to PFM system strengthening recognizes the importance of local ownership, results orientation, inclusivity, and transparency and accountability, as expressed in the [Paris, Accra, Addis Ababa, and Busan](#) declarations on aid effectiveness. USAID's approach to PFM systems strengthening also prioritizes countries' ability to manage and finance their own development. Sustainable country financing will be of increased importance as domestic sources of financing become the predominant means for economic and social development (see Exhibit 1).

While taxes and other public revenues are essential to robust PFM systems, this Guide focuses on the expenditure side of the budget. More extensive materials on taxation and domestic revenue mobilization (DRM) are contained in the [USAID Tax Policy Reform Primer \(2021\)](#) and the [USAID Tax Administration Reform Primer \(2021\)](#).

Exhibit 1: Trends in Public Finance in USAID Partner Countries



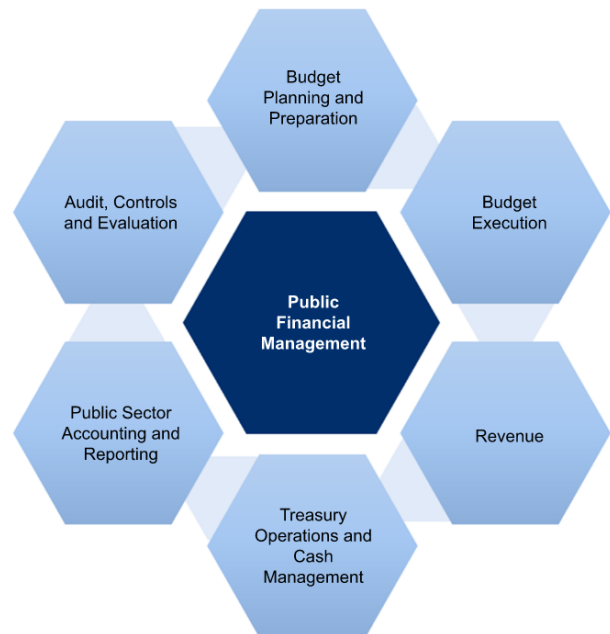
Source: World Development Indicators

I.2 Structure of the PFM Guide

Chapter II of the PFM Guide sets out a foundation of key concepts and objectives of the PFM system. Chapters III through V of this PFM Guide are structured around the core elements of the PFM system (see Exhibit 2):

- [Budget Planning and Preparation](#)
- [Budget Execution](#)
- [Revenue](#)
- [Treasury Operations and Cash Management](#)
- [Public Sector Accounting and Reporting](#)
- [Audit, Controls and Evaluation](#)

Exhibit 2: Core Elements of the PFM System



Chapters VI through X cover common cross-cutting considerations that relate to the entire PFM system.

- [Sub-National PFM](#)
- [Stakeholders for Effective PFM](#)
- [Designing and Sequencing PFM Reforms](#)
- [Conclusions](#)

It is recommended the PFM Guide be used as a desk or on-line reference on the general parameters of good practices in each subject area of public financial management. The references and resources cited in each section or on-line module can be used to guide you to further details and more extensive materials on each topic. A full set of references is included at the end of the guide.

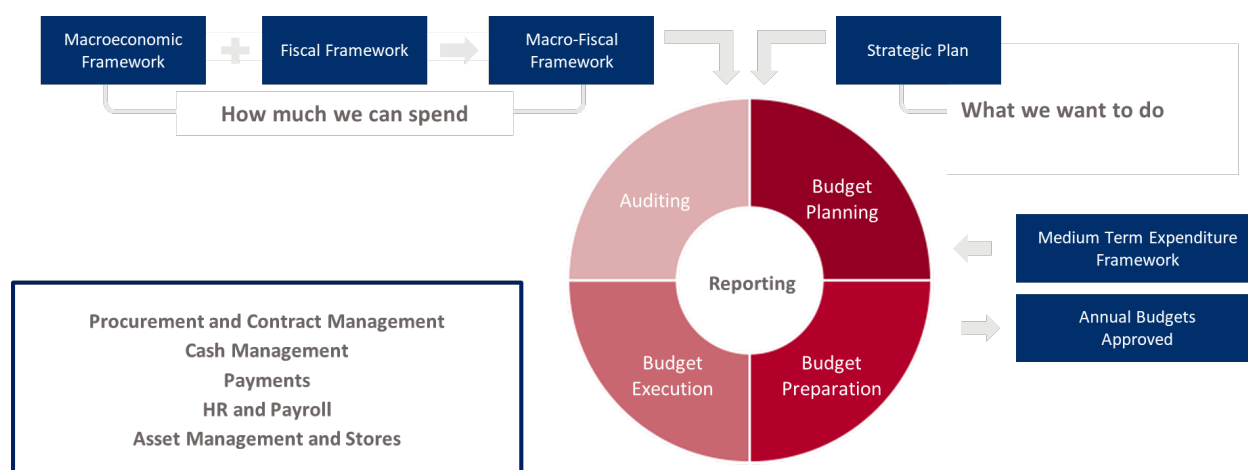
[Annex 1](#) provides links to several useful technical resources, [Annex 2](#) provides links to several case studies of specific reform programs and lessons learned. [Annex 3](#) describes commitments regarding PFM Reforms from major aid effectiveness accords. Finally, [Annex 4](#) includes a glossary of terms.

The 2nd Edition of the Guide (2022) was designed to update section contents and links to external sources, incorporate new and additional case material, expand the Guide's insights on cross-sectoral integration of PFM, and to allow each section to stand alone as the basis for separable on-line modules.

II. WHAT IS PUBLIC FINANCIAL MANAGEMENT?

PFM refers to the set of laws, regulations, systems and processes used by national (and sub-national) governments to mobilize government revenue, allocate public funds, undertake public spending, and account for and report on the use of those funds. As Exhibit 3 below illustrates, it encompasses a broader set of functions than financial management and is commonly conceived as a cycle of several phases, beginning with strategic planning and policy design and ending with external audit and evaluation. A large number of actors engage in this “PFM cycle” to ensure it operates effectively and transparently, whilst preserving accountability.

Exhibit 3: The PFM Cycle



II.1 THE OBJECTIVES OF PFM

PFM is all about making sure the resources of the public that are entrusted to the government are used well. But what does that mean in practice? To assess how well a PFM system is working, we first need to define its end objectives—the final outcomes by which performance can be measured. In this regard, it is generally accepted that a PFM system should achieve three primary objectives:

1. Fiscal discipline
2. Efficiency in the allocation of resources (allocative efficiency)
3. Efficiency in the delivery of public services (operational or technical efficiency)

Each of these core PFM objectives is described in turn below.

II.1.1 FISCAL DISCIPLINE

Fiscal discipline is 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). These are defined as those organizations that receive funds

from the consolidated government budget and include the broad array of government entities that use budget funds to pay for operations, regardless of whether these funds cover 100 percent of their expenditures. An effective PFM system has firm budget ceilings with safeguards that prevent MDAs from overspending. Changes to budget ceilings should be restricted by legislation and ideally approved through a consultative legislative process.

While fiscal discipline may seem straightforward, many countries struggle with achieving it. MDAs and the Ministry of Finance (MOF) may violate budget ceilings if budget execution controls are inadequate or otherwise fail to accurately track expenditures against the budget. Countries will have difficulty maintaining fiscal discipline if politics intrude into the budget execution process, allowing persons in authority to authorize extra-budgetary expenditures or increases in MDAs' budgets in violation of legislated mandates. Where governments lack fiscal discipline – where repeated deviations undermine the credibility of the budget – this can diminish public confidence in the government and create mistrust around its commitments.

II.1.2 EFFICIENCY IN THE ALLOCATION OF RESOURCES

Allocative efficiency is the ability of the government to allocate budget resources in accordance with established government priorities as defined in strategic planning documents and principles of fiscal and operational efficiency. The government should be able to reallocate resources from old priorities to new ones and from less to more efficient programs and activities in accordance with government priorities.

There are many reasons why countries struggle to achieve allocative efficiency, including an inability to articulate priorities clearly, a budget process not linked to a strategic planning process, a weak budget execution system that does not force MDAs to adhere to approved budgets, or a political environment that empowers some sectors over others in contradiction to stated national priorities. An example of weak allocative efficiency would be a country with health care and education as the government's stated priorities, but which allocates most of its budget to the military.

II.1.3 EFFICIENCY IN THE DELIVERY OF PUBLIC SERVICES

Operational or technical efficiency is the ability of the government to deliver good value for money for the public. PFM systems maximize operational efficiency by implementing programs at the lowest cost per unit of output while maintaining desired service quality levels. Operational efficiency can be difficult to evaluate. Many governments lack the data to measure the unit cost of a service. While they may know the total cost, the number of units provided and the desired and actual quality of services might not be clearly articulated or known.

The appropriateness of the design of goods, services or works can impact its cost. For example, what service levels are desired for potable water? Is it having tap water in each house or water pumps located on the street? If street level water pumps are sufficient, what should be the distance between them? Should water be available at all times? What is the desired water quality? The achievement of desired service levels depends on what the budget can sustain as well as the level of taxes or user fees that the public is willing to pay, in addition to the level of competence of the water provision entity and its staff.

The strength of the PFM system also affects technical or operational efficiency. For example, overreliance on non-competitive forms of procurement in Honduras led to the Ministry of Health purchasing 57 percent Honduras's essential medicines from a single supplier at costs that were

significantly higher than international averages.¹ Alternatively, a country may incur fees and penalties for late payment of suppliers when its cash management and payments systems are weak. These “lost” funds could be used to help the country achieve critical service delivery goals.

II.2 CHARACTERISTICS OF A SOUND PFM SYSTEM

In delivering on the three objectives of PFM, outlined above, it is important that PFM systems are able to achieve certain performance standards that influence the credibility and effectiveness of the systems, including:

1. **Accuracy.** Is the budget realistic and implemented as intended? Is the budget prepared on a realistic assessment of available resources (i.e., resource envelope) and spending needs? Are revenue projections accurate? Do MDAs tend to over- or under-spend on their budgets?
2. **Comprehensiveness.** Does the budget include all revenues and expenditures - extending to all institutions and programs that collect or use public funds? Does the budget include expenditures from multi-year commitments (e.g., large construction projects) as well as spending commitments included in legislation? Does the budget include both capital and development expenditures and include estimates of the future cost implications of construction? Do financial management and audit systems extend to all entities that collect and use public funds? Do financial records include assets (financial and non-financial) and liabilities (including contingent)
3. **Timeliness.** Are MDAs provided budget instructions with enough time to prepare their submissions? Is the consolidated budget proposal submitted to Parliament with sufficient time for scrutiny and approval? Is the budget approved before the beginning of the fiscal year? Are budget implementation and audit reports prepared and released on a timely basis?
4. **Transparency.** Is fiscal and budget information accessible to the public? Are comprehensive reports on revenues, budget execution and fiscal planning available and published? Is there a freedom of information law, and is it applied effectively and efficiently to issues of public finance? Are adequate financial records maintained and financial statements prepared and disclosed that fairly reflect transactions for operations, including intergovernmental transfers?
5. **Participatory.** Are there opportunities for citizens or civil society to engage on spending priorities? Can citizens provide feedback regarding whether planned spending in their communities is proceeding on the basis of legal requirements and planned priorities?
6. **Accountability.** Are there effective arrangements for the rigorous scrutiny of public finances and follow up of audit findings by the legislature and executive? Does the political system of the country provide for acceptable separation of powers between the branches of government? How independent are accountability institutions such as the Supreme Audit Institution (SAI) (de jure and de facto)? Are there mechanisms for citizens and/or service delivery users to demand accountability?

¹ Amin, Lucas (2017). [Making the Case for Open Contracting in Healthcare Procurement](#). London (UK): Transparency International; 2017. update 2019 May 21.

The three objectives and six characteristics of an effective PFM system detailed above play out across the whole budget cycle. The sections below describe the main aspects and functions of each stage of the budget cycle along with examples of good practice and leading approaches.

II.3 DEMOCRATIC DEVELOPMENT AND PUBLIC FINANCIAL MANAGEMENT

Efficient, effective, transparent, participatory, and accountable PFM systems enable democratic governments to deliver on the aspirations of their people and renew the social contract.

Moreover, transparency, oversight and controls within the PFM system limit the opportunities for corruption and influence by external malign actors to take place - reducing the risks of democratic backsliding. A well functioning PFM system strengthens the effectiveness and legitimacy of democratic governments, and the lack of effective systems is a real risk to regime survival. As noted in the December 2021 edition of the IMF's [Finance and Development](#) magazine, “ The demographic and political trends in African states suggest that unresponsive governments will increasingly come under populist pressure and if they fail to respond, risk popular revolt and removal through coups or mass uprisings.” Democracies also appear to be more likely to invest in improving PFM performance; a [2017 World Bank report](#) found democratic governments, particularly those with programmatic parties, have better PFM system performance.

III. BUDGET PLANNING AND PREPARATION

“Top Three” Reference Materials: Budget Planning and Preparation

1. [Beyond the Annual Budget: Global Experience with Medium Term Expenditure Frameworks. World Bank, 2013.](#)
2. [Introducing the new PPB: Pragmatic Program Budgeting. World Bank 2022](#)
3. [Budget Transparency Toolkit, OECD: 2017](#)

Budgeting is a core part of any PFM system. Yet, the formulation of a national or sub-national budget entails more than enumerating the expenses a government intends to make in a given period. Before any public resources can be spent, governments must have good forecasts of expenditure needs and the revenues that will be available to fund them (thus contributing to fiscal discipline). Trade-offs and prioritization among programs must be made to ensure that the budget fits government policies and priorities (thus contributing to allocative efficiency). And finally, the most cost-effective means of fulfilling those priorities must be selected (thus achieving technical efficiency or ‘value for money’). (See the Guide’s Introduction ([Chapter II](#)) for more on the core objectives of PFM). Of course, none of these objectives can be fully accomplished without transparency and accountability, where there are legally binding mechanisms for budget review, negotiation, and approval, and where there are opportunities for public participation during the budget cycle.

This chapter focuses on the core processes of budget planning and preparation. Budget execution issues are discussed in a separate module (see [Chapter IV](#)).

III.1 OVERVIEW

Budget planning and preparation is the process by which a government develops, approves, and enacts a budget. The budget is the government’s current year 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. It should contain sufficient information to enable government officials, legislators, and civil society stakeholders to discuss whether it is realistic and appropriate, and to hold the government accountable for the use of funds. It should describe how the government will:

- Generate the needed funds through revenues, borrowing, or user fees;
- Serve the needs of citizens and contribute to a better future; and
- Support national, sub-national (as applicable), and sectoral priorities, policies, and objectives through its expenditures.

Many countries have a national strategy to define the country’s long-term vision and a medium-term plan that describes how the government expects to contribute to progress towards that vision. The budget should describe how the government plans to progress towards achieving this strategy in the current year and, ideally, in summarized form, over the subsequent 2-4 years. To provide a clear articulation of medium-term strategy, the budget should aggregate the plans and priorities of all government MDAs, what services they plan to deliver, and how much each service will cost. An ideal means to reflect these parameters is the annual development and adoption of a Medium-Term Expenditure Framework (MTEF) that informs the annual budget documents. The budget development process should facilitate the engagement of a broad range of stakeholders in coordinating plans and priorities.

Exhibit 4: Budget Planning and Preparation Process

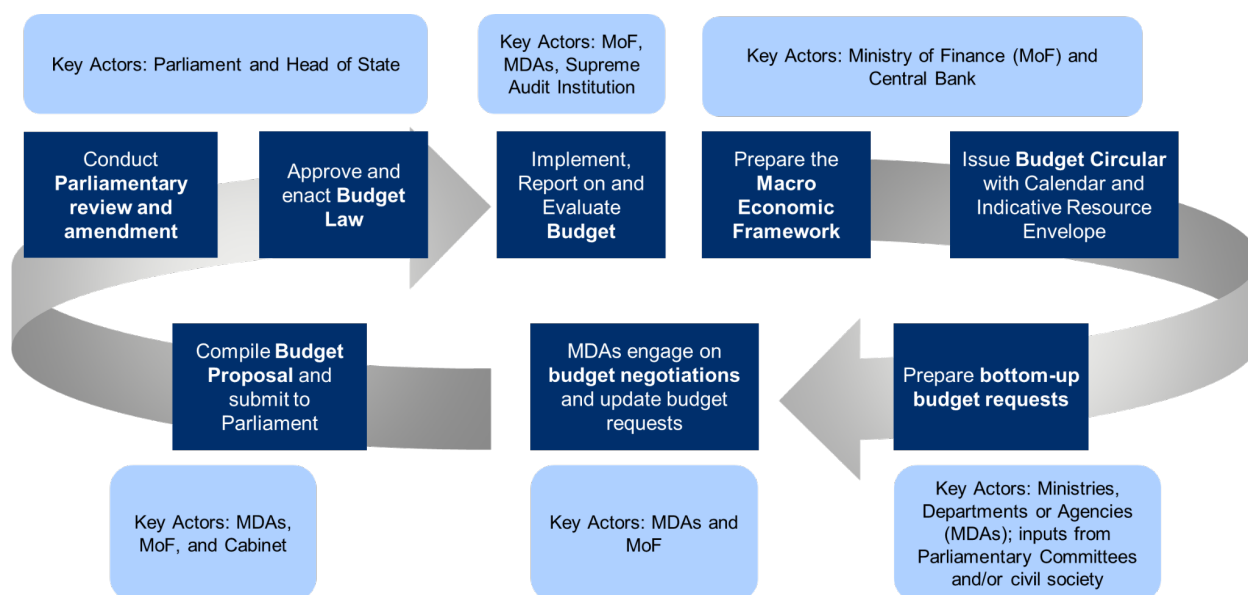


Exhibit 4 shows the budget planning and preparation process and the involvement of multiple stakeholders. The process begins with the development of a macro-economic framework to help forecast fundamental economic parameters such as inflation, economic growth, and available revenues. Using these forecasts, the MOF or other organizations with budget planning responsibilities communicate the resource envelopes to MDAs who develop draft budgets within these funding constraints. The draft MDA budgets are then discussed and clarified through an iterative process between the MDA and the MOF or other organizations with budget preparation responsibility. Then, the draft MDA budgets are consolidated into a draft budget for submission to the legislature. This document is commonly referred to as the Executive Budget Proposal. [An example of an Executive Budget Proposal from Ghana](#) is available. The legislature reviews, amends (as needed), and approves the budget in the form of a Budget Law (or Appropriations Law).

Exhibit 5: Parliamentary Budget Offices

Legislative bodies play a critical role in the analysis, legislative approval, and oversight of public budgets. Some legislatures have independent fiscal analysis units, frequently called Parliamentary Budget Offices

(PBOs) to support their review and approval of the budget. These are traditionally non-partisan units whose leadership is immune from political shifts and serve to aid in effective budgetary and fiscal decision-making and the formation of consensus for passage of the budget and should include staff with capabilities in macroeconomic forecasting, and revenue and budget analysis. Sometimes PBOs also contain sectoral budget specialists, legal advisors, and audit specialists. The PBO staff examine legislative and budget proposals from legislators and the executive branch, report on their costs, and generally also report on both their programmatic and financial impacts. They may also assist with analysis of and reactions to audit reports where these are received by the legislature.

Similar to the Congressional Budget Office (CBO) in the United States, the analysis may disagree with the executive's analysis as well as those from various groups and parties within the legislature and the PBO and its staff will be pressured on their positions regularly. USAID and other donors, either through PFM or legislative strengthening programming, have had some success in assisting partner countries to establish PBOs where sufficient political space exists.

In cases where there is no political competition between the legislature and the executive, the PBO is likely to have less influence over decision making but may still provide better information for policymaking and implementation and sometimes can assist legislatures to strengthen their roles by increasing access to information and analysis.

III.2 LEGISLATIVE FRAMEWORK

An appropriate legal framework is the foundation of a well performing budget process. In most countries, the legal framework for budgeting draws on several sources, usually including the country's constitution, a specialized PFM law, and implementing regulations and guidelines.

A country's constitution generally outlines responsibilities for core government functions, including authority for budget planning and budget approval (or enactment). For example, Chapter 7 on Financial Matters of the [Constitution of the Hashemite Kingdom of Jordan](#) contains several specific provisions related to the budget process including requirements, limitations, and specific processes to be followed.

Many countries have detailed budget legislation that provide more detailed requirements regarding budget responsibilities and processes; these are sometimes referred to as "Public Finance Acts," "Organic Budget Laws," or "Financial Management/Administration Acts." Legislation should include provisions requiring preparation of an annual budget, guidelines for implementing a centralized budgeting process, and identification of the agency responsible for producing a draft consolidated budget proposal to submit to the Legislature. In Jordan, the Organic Budget Law (2008) stipulates that the General Budget Department within MOF is responsible to formulate the annual budget and the Council of Ministers reviews, revises, and approves the policy statements and the draft annual budget.² In Uganda, the Public Finance Act (2015) sets specific deadlines and formats for the Minister (or equivalent) of each MDA to submit to the Secretary of the Treasury, who is charged with compiling the full budget and

² Leo Sommaripa, [Jordan Budget Manual: A Guide to Policy, Process and Analytic Techniques](#), USAID: 2012, p. 69

submitting it to Parliament by the stipulated date. This Act also explicitly requires MDAs to consider balanced development, gender and equity responsiveness in the preparation of their budgets.

Legislation should also define the process to be followed when a budget is not enacted. In France and many francophone countries, if Parliament does not reach a decision on the proposed budget, the budget may come into force by an executive regulation. In the Philippines, if Congress fails to pass the general appropriations bill, the general appropriations law for the preceding fiscal year is considered reenacted and remains in effect until the general appropriations bill is passed. In the United States, the government must either shut down or approve budgets for specific MDAs through individual appropriation bills.

The legal framework for PFM may also stipulate opportunities for citizens and other stakeholders to engage in the budget process to enhance accountability and transparency. For example, this could include a legal requirement to allow citizens to observe budget hearings. Particularly in sub-national (and thus smaller) budgetary jurisdictions, adding legal provisions for citizen budgeting has been effective in enhancing accountability and transparency. An example of how the legal framework may establish an expectation for public participation is provided in the box below.

Exhibit 6: Provisions for Public Participation in Kenya's PFM Act (2012, Rev. 2020)

Kenya's 2012 PFM Act included several elements to encourage public participation in the budget preparation process. For example, the act indicates the legal responsibilities of the Parliamentary Budget Office (PBO) include: "(2) In carrying out its functions under subsection (1), the Parliamentary Budget Office shall observe the principle of public participation in budgetary matters." (sec 10). For the national budget preparation process, the act provides that, "(2) The Cabinet Secretary shall ensure public participation in the budget process provided for under subsection (1)" (sec 35). It further requires the Cabinet Secretary to describe the procedures for public participation in the annual budget circular. At the sub-national level, the PFM Act requires that, "(2) The County Executive Committee member for finance shall ensure that there is public participation in the budget process" (sec 125).

Further, the Act anticipates that regulations be made to implement the act to more clearly define,

- (a) structures for participation;
- (b) mechanisms, processes and procedures for participation;
- (c) receipt, processing and consideration of petitions, and complaints lodged by members of the community;
- (d) notification and public comment procedures;
- (e) public meetings and hearings;
- (f) special needs of people who are illiterate, people with disabilities, women and other disadvantaged groups;
- (g) matters with regard to which community participation is encouraged;
- (h) the rights and duties of members of community; and

(i) any other matter that enhances community participation. (sec 207)

While the modalities for participation may vary from year to year, the PFM Act sets out clear responsibilities for creating opportunities for public participation.

Source: Government of Kenya (2020). [Public Financial Management Act, No. 18 of 2012](#), Revised Edition 2020

Exhibit 7: West Africa's Fiscal Rule and COVID-19

In 2015, the West African Economic and Monetary Union (WAEMU), which includes Benin, Burkina Faso, Côte D'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo, adopted a fiscal rule with a global fiscal deficit ceiling of 3 percent and a 70 percent of GDP ceiling on government debt. WAEMU countries were required to be in compliance with the new fiscal rule by 2019. Over the period 2016 to 2019, WAEMU countries were able, on average, to reduce their fiscal deficits from 3.6 percent of GDP in 2016 to 2.3 percent of GDP in 2019, mainly through increased revenue mobilization. Average debt levels during this period were below 50 percent of GDP.

However, the COVID-19 pandemic created new and unprecedented needs and resulted in lower than anticipated revenues. This shock necessitated a temporary shift in approach. To meet the health and social protection needs of their citizens, the Conference of Heads of States of WAEMU declared a temporary suspension of the fiscal rule.

Well designed fiscal rules include “escape clauses,” that allow for greater flexibility to manage economic crises, recover from natural disasters and other external shocks. The design should also include a process and timeline to return to the normal application of the fiscal rule. COVID-19 fits well into the category of external shocks a country might want to include in their fiscal rule. WAEMU did not include a formal “escape clause” and process to reinstate the fiscal rule, which complicates the reimposition of the arrangement after the pandemic normalizes.

Source: IMF (2021). [West African Economic and Monetary Union, Selected Issues](#), International Monetary Fund, March 2021

Countries often also include more detailed requirements in secondary legislation or regulation. In many countries, detailed instructions for budget planning and preparation are communicated to budget entities through an annual budget circular. Finally, it is worth noting that the annual budget, as approved by the legislature, is a law in and of itself. This annual “appropriations law” may also include special provisions that are applicable to the implementation of that year’s law.

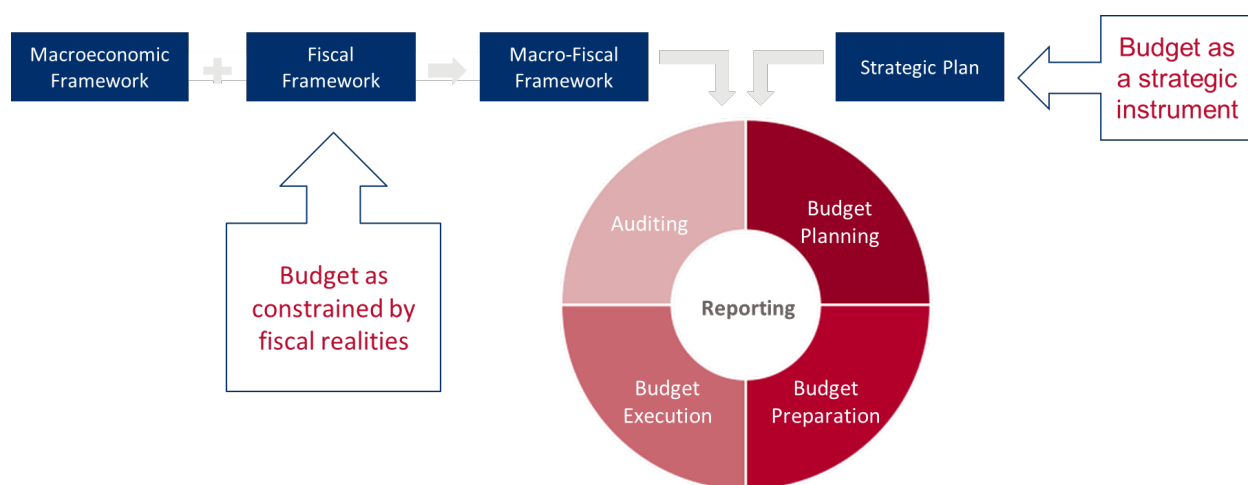
III.3 BUDGET PLANNING PROCESS

To produce a budget that reflects the economic and fiscal realities as well as the strategic priorities of the country, a government’s budget planning process (see Exhibit 8) should take into consideration:

- National development plans and strategies;
- The macro-economic framework;
- The fiscal framework; and
- The macro-fiscal framework.

The sub-sections that follow describe each of these inputs in more detail.

Exhibit 8: Inputs to the Budget Planning Process



III.3.1 NATIONAL DEVELOPMENT PLAN AND SECTOR STRATEGIES

A national development plan articulates a long-term vision for the country, and generally covers a seven (7) to ten (10) year period. National development plans are often complemented by sector strategies developed by Ministries, Departments, and Agencies (MDAs) that support the implementation of the national development plan, often over a three (3) to five (5) year period.

Ideally, the plans and priorities of all MDAs should align with national policy priorities and contribute to achieving the national vision. Some budgeting approaches may require MDAs to explain agency goals, how these goals conform to the national priorities, and how progress towards achieving these goals will be measured. The budget should be an aggregation of the plans and priorities of MDAs, describing what the government plans to deliver and how much it is expected to cost within a given period.

To improve the inclusiveness, effectiveness, and legitimacy of national development plans and sector strategies, governments should maximize opportunities for citizen and other stakeholder involvement and input. This is generally done by including public meetings and comment in the plan development process—sometimes by citizen inclusion in boards, committees, and councils—and may even include direct democratic processes such as votes and referenda. Such involvement may also increase the probability of non-governmental (citizens, CSO, NGO, etc.) engagement in transparency, verification, citizen audit, and other accountability processes. However, to be effective, stakeholder engagement in strategy development should be sufficiently broad and inclusive to be representative and must have a meaningful impact on the priorities expressed in the final strategy. For example, in Malawi, while the development of the country’s Health Sector Strategic Plan II (HSSP II; 2017–2022) included a consultative phase, stakeholders observed that the process was designed for stakeholders to learn about and endorse an already finalized policy rather than to influence its content. Moreover, some civil society

organizations representing health system users with specialized needs (e.g., people with disabilities) were not included in the consultations.³

III.3.2 MACROECONOMIC FRAMEWORK

While national development plans and strategies provide a multi-year roadmap for government policies and programs, the first step in budget planning is estimating the macroeconomic framework for the budget year (and ideally at least the next two fiscal years). A macroeconomic framework is a set of economic projections of key economic variables, such as GDP (and components such as consumption and investment), inflation, exports and imports, exchange rates, and oil prices. The macroeconomic framework attempts to realistically assess domestic and global economic trends and forecasts that affect a country's economy. Changes in the economy can affect both the government's revenue base and the demand for government services, and thus the macroeconomic framework's projections are used to estimate the funding that will be available to the government as well as the need for aggregate government spending in the medium-term.

The macroeconomic framework is constructed based on available information and realistic assumptions and is updated continuously as information becomes available or assumptions are refined, or as policy changes are made that may impact the future economy.

Key considerations in preparing the macroeconomic framework include:

- **Availability of reliable data**, including social and economic statistics generated by statistical agencies, the central bank, and census offices. Reliability can be compromised in situations where such statistics entities are politicized, and thus not acting independently of political considerations.
- **Availability of analytic infrastructure**, including econometric or other macroeconomic forecasting models and the capacity and experience of analysts to use and update them.
- **Changes in laws and regulations**, including those that may impact fiscal accounts or the broader economy. Changes in the tax code, for instance, may affect not only the government's future revenue yield, but also levels of consumption, investment, and employment in the economy.
- **Global factors, such as fluctuations in import/export commodity prices**, which could have future implications for inflation or other trends in the domestic economy.

The government's macroeconomic forecasts, together with the underlying assumptions, should be included in budget documentation submitted to the legislature. They should also be made public once they are finalized and whenever they are updated. This allows stakeholders and citizens to have information about the government's assumptions, projections, and plans.

III.3.3 FISCAL FRAMEWORK

A fiscal framework (often called a medium-term fiscal framework, or MTFF) determines the aggregate resources available as an input into budget formulation. The MTFF establishes multi-year projections of key fiscal aggregates (revenues, expenditures, financing, and debt), consistent with and supportive of the overall macroeconomic framework, and their impact on the country's fiscal position (deficit or surplus).

³ Masefield et al. (2021). "[Stakeholder engagement in the health policy process in a low income country: a qualitative study of stakeholder perceptions of the challenges to effective inclusion in Malawi.](#)" BMC Health Services Research, 2021 21:984.

In this regard, the MTFF is a key component of a government's fiscal strategy and provides the context for aligning fiscal policy objectives and targets with budget preparation.

A comprehensive MTFF comprises both baseline projections on the basis of existing tax and expenditure policies, and projections of the impact of new fiscal policies decided by policymakers. Therefore, information on changes to policies, laws, and regulations are important inputs into medium-term fiscal forecasts. Other important considerations include the availability of reliable data and the access to forecasting tools, capacity, and expertise.

In developing the MTFF, governments should consider the following factors:

- **Fiscal position:** The budget deficit is often a primary fiscal target. It quantifies the amount of money the government plans to borrow from domestic and/or foreign sources to cover the difference between revenues and expenditures in each year. The government deficit is also often subject to a fiscal rule, such as a deficit ceiling, imposed either domestically or externally by regional or international stakeholders. For instance, Paraguay's fiscal responsibility law imposes a 1.5 percent GDP deficit ceiling for the central government; Congress can approve a deficit of up to 3 percent of GDP in cases of shocks or emergencies. In another example, countries of the West African Economic and Monetary Union (WAEMU) agreed in 2015 to limit their respective fiscal deficits to 3 percent of GDP (and their debt to 70 percent of GDP).
- **Fiscal space:** Fiscal space refers to the budgetary room that allows a government to provide resources for a desired purpose without jeopardizing the sustainability of its financial position or the stability of the economy. A government can create fiscal space by mobilizing more revenues, reprioritizing or improving efficiency of expenditures, borrowing, or securing external grants. Two additional factors — legislation and economic growth — may affect the fiscal space. Legislation may define government programs, such as mandatory spending on health or social security, or impose fiscal rules that limit the size of deficits or the government's ability to borrow. Economic growth can increase the tax base as well as the government's room to borrow. Fiscal space is often used as a conceptual "yardstick" for fiscal sustainability, as described in the following point.
- **Fiscal sustainability:** Fiscal sustainability refers to the ability of the government to sustain its planned revenue and spending without jeopardizing its solvency. A government that faces large amounts of debt as a percentage of GDP often faces larger interest payments as well as, potentially, higher interest rates. The indicators of fiscal sustainability are long-term indicators such as debt-to-GDP, primary surplus/deficit-to-GDP, and tax-to-GDP ratios. A more detailed discussion of public debt is provided in [Section IV.8.2](#), as well as in USAID's Public Debt Primer.
- **Fiscal vulnerability:** Fiscal vulnerability describes a situation where a government is exposed to the possibility of failure to meet its aggregate fiscal policy objectives. To reduce vulnerability, governments carefully monitor unfunded expenditures and contingent liabilities (e.g., pension contributions) that could generate future payment obligations. Ideally, fiscal projections should cover not only the central government budget, but also those of subnational governments and extrabudgetary funds controlled by governments. An even more comprehensive MTFF would include all public sector entities, since transfers to or from State-Owned Enterprises (SOEs) and other non-budgetary units can play a significant role in implementing fiscal policy. Sub-national governments can also utilize fiscal frameworks effectively, especially when those governments have sufficient fiscal autonomy to set their own revenue and expenditure policies and objectives. Exhibit 9 summarizes Jamaica's fiscal framework for 2022 as an example.

Exhibit 9: Jamaica’s Fiscal Framework, Medium-Term Fiscal and Debt Indicators (Percent of GDP), 2022

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
	ACTUAL		ESTIMATED	PROJECTED			
Revenue & Grants	30.6%	29.5%	31.8%	30.3%	30.7%	30.3%	30.3%
of which (o/w) Tax	27.3%	26.0%	26.9%	27.1%	27.8%	27.6%	27.6%
Expenditure	29.7%	32.6%	31.5%	30.0%	30.4%	29.9%	29.1%
o/w Wages & Salaries	9.2%	10.7%	9.9%	10.8%	11.4%	11.5%	11.5%
o/w Interest	6.2%	6.6%	6.0%	5.6%	5.0%	4.6%	3.9%
Cent Govt Fiscal Balance	0.9%	-3.1%	0.3%	0.3%	0.3%	0.3%	1.1%
Cent Govt Primary Balance	7.1%	3.5%	6.3%	5.9%	5.3%	4.9%	5.1%
Total Debt	94.8%	109.7%	96.3%	87.3%	80.1%	73.9%	68.9%
Domestic Debt	35.9%	40.8%	36.6%	32.4%	31.5%	29.2%	28.3%
External Debt	55.9%	66.5%	58.5%	53.9%	48.5%	45.6%	41.8%
Net Public Bodies	3.1%	2.4%	1.1%	1.0%	0.2%	-0.8%	-1.2%

Note: Totals may not add due to rounding.

Source: Ministry of Finance and the Public Service, Government of Jamaica Fiscal Policy Paper, FY 2022/23

III.3.4 MACRO-FISCAL FRAMEWORK

A macroeconomic framework projects and summarizes the macroeconomic conditions under which the budget is to be prepared, while a fiscal framework uses data from the macroeconomic framework, in combination with fiscal data, to develop spending and revenue projections and targets. Together, these contribute to the development of a **macro-fiscal framework**.

The macro-fiscal framework draws on the macroeconomic and fiscal frameworks to establish an aggregate “resource envelope” representing the upper limit for expenditure for the upcoming budget based on expected revenues and deficit and debt targets. Because it defines the ceilings for budgetary spending in a given year, the macro-fiscal framework is an integral part of the budgeting process and the PFM system. And because sudden and severe economic and policy shocks can quickly affect the resources available to a government, responsiveness through recalculations and forecast updates can be vital to successful coping strategies.

Macro-fiscal frameworks sourced in accurate and verifiable data are a vital component in PFM. They are often generated using various econometric models developed in statistical software packages, but if the source materials are inadequate the planning and execution of PFM and government operations can be significantly compromised. Countries without well-prepared frameworks run substantial risks of making errors that can have serious impacts on economies and government support of their citizens and development. Moreover, studies have found that politicians frequently attempt to manipulate macroeconomic and macro-fiscal projections to boost their electoral prospects.⁴ It is thus extremely important that the processes used for data collection and statistical modeling are of the highest quality

⁴ See Aragão & Linsi (2022), Bohn and Veiga (2021), Bohn (2018)

possible within the local context. It is also useful to have a means to externally validate the robustness of the macro-fiscal framework - for example by subjecting it to a review by the legislative budget office.

Exhibit 10: Organizational Arrangement for the Macro-Fiscal Function

There is no single “model” for where the macro-fiscal functions should be performed. In many countries, a single MOF department performs all major macro-fiscal functions, including preparing the official forecasts. In others, macro-fiscal functions are shared between a “finance” ministry and a “planning” ministry, where the planning ministry often “owns” the national development plan and the investment (capital) budget, and also prepares the macroeconomic forecasts. Some advanced economies even have independent agencies that prepare alternative fiscal forecasts and policy analyses, which can enhance the accountability of the government and the realism of its official forecasts. However the macro-fiscal function is constituted, the credibility of its forecasts and analysis is of paramount concern.

Adapted from Israel Fainboim Yaker and Ian Lienert (2018), “[The Macroeconomic Function and its Organizational Arrangements](#),” IMF Technical Notes and Manuals, TNM/18/04.

III.3.5 MEDIUM-TERM EXPENDITURE FRAMEWORK

A medium-term expenditure framework (MTEF) is a structured approach to integrating fiscal policy and budgeting over a multi-year horizon. Prepared annually on a rolling basis covering three to five years, MTEFs translate macro-fiscal objectives and constraints into broad budget aggregates and detailed expenditure plans, guided by strategic priorities. Consequently, the macroeconomic framework, the medium-term fiscal framework, and national development plans and strategies are key inputs into the MTEF process. In addition to linking available resources to policy priorities, thus fostering improved budget planning, an MTEF also provides budget authorities with spending predictability through estimates of available resources for the subsequent two to four years.

Although MTEFs set funding amounts over the medium term, the MTEF itself does not authorize the government to spend money. Instead, this authorization is provided through the annual budget (or appropriations) law. Nevertheless, the MTEF should form part of the package when the budget law has been submitted to the legislature for enactment (in some countries, the MTEF is even voted on by the legislature). Moreover, the MTEF should be visible to the public, and there should be opportunities for citizens to engage in discussion of the policy and expenditure priorities that the MTEF process surfaces.

Exhibit 1 I: Kosovo's Medium-Term Expenditure Framework

Kosovo's first MTEF was prepared in 2007 by the Kosovo Ministry of Finance with the help of USAID's Economic Management for Sustainability and Growth Project. A rolling, annual MTEF is now a standard part of Kosovo's budget preparation process. Kosovo's MTEF not only provides estimations for future government revenues and expenditures, but frames those figures in the context of the country's economic and policy environment. Kosovo's 2021–2023 MTEF, issued in September 2020, has four main parts.

- Part I of the MTEF describes the government's short and medium-term strategic goals, principles for preparing the MTEF, and priority sectors and key policy actions within those sectors.
- Part II of the MTEF presents Kosovo's macro-fiscal framework. It notes the main features of Kosovo's economy and describes recent developments, medium-term projections, and corresponding assumptions. Projections of the government's revenues, expenditures, and fiscal balance are included, with detail on large current expenditure items, the capital budget, intergovernmental fiscal relations, and financing options. Fiscal risks are also summarized.
- Part III of the MTEF describes the government's sector spending strategies (energy, education, transportation, etc.), and provides sector by sector medium-term estimates regarding spending disaggregated by economic classification (e.g., wages, goods and services, capital expenditure) and financing disaggregated by source.
- Part IV of the MTEF estimates municipal financing both in terms of own-source revenue as well as major transfer and grants programs administered by the central government.

At a minimum, an MTEF should include the government's policy priorities and a description of the government's vision and broad strategic goals; the economic outlook for the next three to five years; the government's policy framework, including any expected policy changes that would impact the fiscal outlook over the next three-to-five years; and a macro-fiscal framework containing summary projections of revenues and expenditures, clearly defined assumptions, and risks. Since most public programs and infrastructure investments require funding and yield benefits over a period of years, MTEF projections should explicitly include the recurrent costs and revenues associated with the operation of those programs and infrastructure assets.

A well-developed MTEF builds on several components that together help to reconcile the “top-down” budget constraints with a “bottom-up” consideration of sectoral needs and performance targets.

- A **medium-term fiscal framework (MTFF)** provides the total resources estimated revenues and borrowing anticipated over a 3–5 year period based on economic conditions and the policy environment.
- A **medium-term budgetary framework (MTBF)** allocates resources drawn from the MTFF in accordance with MDA or programmatic strategic priorities and fiscal objectives.

- A **medium-term performance framework (MTPF)**, which is a more advanced feature of an MTEF, enhances the MTBF with an emphasis on the measurement and evaluation of performance down to programmatic levels.

An MTEF may need to change within a fiscal year as national priorities change, competing policies are reconciled, and as new economic or fiscal information becomes available. Often, the macroeconomic framework and MTEF are periodically updated through an iterative process. Ideally, the projections of a previous year's MTEF should be reexamined in the preparation of subsequent years' projections to improve their reliability.

Although more than two-thirds of countries around the world have some form of MTEF, their success and impact on budget management and fiscal performance vary significantly. Particularly in low-income countries, MTEF reforms have not paid sufficient attention to basic aspects of budget management. Nor have they adequately addressed the political and institutional realities of budget reform; for instance, political leaders often find it difficult to reconcile their ambitions with the constraints implied by resource scarcity. In countries where an MTEF is performing poorly, or is underdeveloped, reform should focus on:

- Improving budget realism by improving revenue and new borrowing forecasts;
- Allowing spending to be driven by medium-term sectoral strategies based upon those used for the national development plan, rather than incrementally increasing annual budgets without reconciling them with national priorities;
- Empowering spending agencies to design their sector strategies and manage their resources flexibly. Effective sector strategies linked to the national development plan are vital to successful PFM systems, and must be developed by MDA, optimally with stakeholder inputs;
- Linking budget allocations to performance and results; and
- Greater fiscal transparency and accountability about government performance against approved plans to hold the government accountable for fiscal policies.

To capitalize on the potential benefits of an MTEF (longer-term planning, enhanced fiscal discipline, and better prioritization of spending and policies), reforms should improve adherence to budget constraints. Budget ceilings should be enforced and MDA spending constrained accordingly. In countries that do not use an MTEF, it may be advisable to take an incremental approach by first adopting a Medium-Term Fiscal Framework (MTFF), followed over time by a Medium-Term Budget Framework (MTBF) and then a Medium-Term Performance Framework (MTPF) to fully develop an MTEF. The adoption of an MTBF or an MTPF also helps in setting priorities for expenditures and encouraging policy-makers to allocate scarce resources in accordance with national and sector strategies and performance. Exhibit 12 summarizes good practices for an MTEF.

Medium-Term Fiscal Framework (MTFF)

- Debt and deficit targets are established using model-based debt sustainability analysis, taking into account constraints imposed by policy rules.
- Revenue forecasts are based on revenue department or other tax and non-tax receipt models.
- Independent macroeconomic forecasts are used, and fiscal forecasts are subject to scrutiny by an audit office, fiscal council, or similar consultative body.
- Aid commitments are covered by debt sustainability analysis and revenue forecasts.
- The Ministry of Finance issues a background paper on macro-fiscal objectives to inform budget decision making and form part of the budget documentation.

Medium-Term Budget Framework (MTBF)

- The MOF issues a budget strategy paper describing the macro-fiscal framework and providing a broad indication of national development and budgetary priorities for the medium term.
- A budget circular is sent to spending agencies outlining the basis on which they should prepare their medium-term budget requests. This circular indicates the availability of budget resources, usually in the form of provisional agency or program expenditure ceilings, and the aggregate cost assumptions to be used, including changes in inflation and public sector pay.
- The budget requests of spending agencies reflect strategic objectives, the cost of current and new activities, expected cost recovery, and other relevant factors.
- Final expenditure ceilings are reflected in the annual budget submitted to the legislature for consideration.
- Spending agency budgets are finalized, and sector strategies are revised to reflect budget realities.
- Spending agency budgets and sector strategies are published.

Medium-Term Performance Framework (MTPF)

- Sector strategies discuss program outputs, outcomes, and performance.

- Agency output, outcome, and performance indicators are used to establish budget targets.
- Spending agencies report on results relative to targets. Comprehensive spending reviews are conducted periodically.

Source: [Beyond the Annual Budget: Global Experience with Medium Term Expenditure Framework](#), World Bank: 2013

A significant amount of effort and substantial capacity development are generally required to achieve these good practices for an MTEF. To develop good forecasts, a well-functioning fiscal analysis unit (FAU) within the MOF should serve as the locus of analyses and reports on policy issues, tax collection and administration, and MOF budget development. Many developing countries do not have an FAU or it may lack sufficient capacity. Implementing good practices may require organizational changes, capacity development, and above all else, political commitment to making the changes. USAID has helped to establish FAUs in Jordan, Libya, Tunisia and Egypt, among other countries.

In addition to implementing reforms at the MOF, support also needs to be given to MDAs to implement new reforms, including the development of strategic plans and the skills to develop realistic budgets that allocate funds in accordance with the strategic priorities of the government and MDA; and fit within available funding resources.

III.4 BUDGET PREPARATION PROCESS

The purpose of the budget preparation process is to compile the detailed funding needs of government agencies for the next fiscal year and seek legislative action to set aside the funds for MDA spending over that period. In this regard, budget preparation and approval involves intensive collaboration and negotiation among executive branch agencies and between the executive branch and the legislature or parliament. Yet, for the budget formulation process to be truly transparent and inclusive, it needs to integrate a much larger set of stakeholders outside government. In particular, it must incorporate mechanisms for public and meaningful participation (e.g., public hearings, public comment periods, participatory budgeting processes, and analysis of gender, environment, and social inclusion impacts).

Generally, the budget preparation process entails the following steps:

1. Dissemination of a **budget circular**, which includes instructions for the preparation of sector budgets and expenditure ceilings based on the MTEF by sector;
2. Preparation of budgets by MDAs in accordance with the budget instructions and within the expenditure ceilings set by the MTEF, often with stakeholder inputs considered;
3. Submission of draft budgets by the MDAs;

4. Negotiations between the MDAs and the MOF and, ideally, sectoral working groups to reconcile MDA requests and expenditure ceilings defined in the MTEF and budget circular;
5. Compilation of the budget, which may occur after final legislative approval if the budget is considered in parts;
6. Submission of the draft budget to the legislature; and
7. Legislative approval of the budget.

Budget preparation processes that are based on an MTEF, MTBF or MTPF (see [Section III.3.5](#) of the Guide) follow the same basic processes, but the additional layers of detail included in those frameworks should also be evaluated as part of the proposals submitted during the budget preparation process and included as needed.

III.4.1 BUDGET CIRCULAR

The budget circular is a set of guidelines issued to MDAs by the agency responsible for overseeing the budget planning and preparation process. The individual MDAs must use these guidelines to develop their requests for future funding. It is vital to a successful process that the MOF or other central budget authority ensures that the budget circular guidelines are followed.

A budget circular should describe:

- The government's priorities;
- The laws and policies that govern the budget preparation process;
- The responsibilities of various agencies that oversee the process and may assist individual MDAs during the process;
- The MDAs that should submit a budget request. In principle, the government benefits from a single picture of its financial situation. Budget coverage (or comprehensiveness) should be as broad as possible and should include the agencies in the public sector within the control of the specific level of government;
- The information that should be in an MDA's request for funding (estimates of the MDAs own revenue, expenditures, assumptions, justifications, etc.);
- The format for budget preparation;
- Requirements for public consultation or civil society engagement or inputs;
- The means through which information should be submitted (e.g., through the government's FMIS);
- How expenditures should be estimated. For example, a budget circular typically contains information on suggested personnel cost increases since personnel costs tend to be the most significant item in a MDAs budget;
- The types of justification that should be provided (e.g., program evaluations by the agency or outside groups); and
- The timing of the budget process, especially budget requests.

A budget circular is often amended or updated several times throughout the budget process. The example for the Philippines in the box below demonstrates how the COVID-19 pandemic contributed to multiple updates to the budget circular.

Exhibit 13: National Budget Memoranda in the Philippines

In 2019–2020, the Department of Budget and Management of the Philippines issued five budget circulars for the preparation of the FY 2021 budget. This example demonstrates how evolving conditions in the country due to the COVID-19 pandemic required an adjustment to the budget ceilings and priorities.

- [National Budget Memorandum No. 133](#) described the government’s ongoing budget reforms and the framework for the preparation of the budget, estimated budget ceilings for fiscal year 2021 and indicative targets for FY22 and FY23, submission requirements, templates, and approaches for budget formulation, and the budget calendar,
- [National Budget Memorandum No. 134](#) updated the provisions described in the initial budget circular to extend deadlines in light of the COVID-19 pandemic.
- [National Budget Memorandum No. 135](#) provided a reminder regarding requirements for submission of budget documents through the online budgeting system.
- [National Budget Memorandum No. 136](#) updated the macro-fiscal framework, refining policy priorities in light of the COVID-19 pandemic and updating budget ceilings for each budgetary unit.
- [National Budget Memorandum No. 137](#) extended the budget deadlines for the observance of Eid’l Fitr.

The budget circular should be issued early to allow sufficient time for individual MDAs to plan, prepare, and consult; as well as for the central budget authority to compile the budget for the legislature. Some countries may issue successive budget circulars to guide MDA staff in preparing their budget. For example, a policy guidance letter may be sent to each agency at the beginning of the current fiscal year for the next fiscal year’s budget to assist senior management in MDAs with planning and internal policy guidance. A detailed circular with information on how data should be submitted may be issued at a later date, often in the next quarter.

III.4.2 BUDGET CALENDAR

The preparation of the budget for the next fiscal year may begin as early as the start of the current fiscal year, and sometimes even prior to its start. Often, a country’s budget calendar is specified in legislation. Among the important dates specified in a typical budget calendar are when the budget circular (i.e. the guidelines for budget preparation) must be issued, when budget requests are due to the MOF or central budget authority, and when the budget is due to the legislature. Exhibit 14 is an illustrative budget

preparation calendar. Non-compliance with budget calendars is one of the most common deficiencies in budget system implementation.

Exhibit 14: Illustrative Budget Calendar

Policy guidance letter / circular	First quarter of the fiscal year for next-year budget
Discussions of options	Ongoing: First and second quarter
Consultations with civil society on sectoral priorities	Ongoing: First and second quarter
Detailed circular	Beginning of second quarter
Budget requests	Beginning of third quarter
Analysis of budget requests	Third quarter
Briefing to senior officials	Mid third quarter
Agencies informed of budget decisions	Mid third quarter
Agencies appeal and may negotiate	Second half of third quarter
Agencies prepare justification materials for the legislature	Second half of third quarter, fourth quarter
The budget is submitted to legislature	Mid fourth quarter
The legislature holds budget hearings	Mid fourth quarter
Legislature enacts broad spending and revenue levels	End of fourth quarter

III.4.3 BUDGET REQUESTS AND NEGOTIATION

After issuing the budget circular, the government agency responsible for overseeing the budget process (referred to hereafter as “central budget authority”), often a budget office within the Ministry of Finance, engages with MDAs on budget issues, options, and plans for addressing issues. MDAs then prepare and submit requests for future funding (i.e., budget requests). Development of the budget requests should follow the guidance in the budget circular. The processes used to develop requests, particularly at the MDA level, should be both iterative and as inclusive as possible to permit citizen involvement, accountability, and transparency. The box below describes an example of how a USAID partner country might be able to build more engagement into its budget preparation process.

Exhibit 15: Civil Society Budget Advocacy in Uganda

Uganda’s national budget preparation process includes a stage in the budget process where the line ministry consults a thematic working group composed of civil society, academia and other experts for each major budgetary sector (e.g., health, education, agriculture, etc.). The Civil Society Budget Advocacy Group (CSBAG), established in 2004, is one of the major CSO networks that participates in this process. CSBAG engages with a broad range of CSOs across Uganda, including 127 CSOs that participate in the 9 Regional Budget Coalitions (RBCs) and that bring together the bottom up needs from grassroots civil society organizations. CSBAG continues to engage in the budgetary process through provision of alternative budget proposals for discrete sections of the budget and in targeted advocacy with Parliament. This approach has yielded results. Over five fiscal years from 2014 through 2018, CSBAG’s network submitted

503 CSO alternative budget proposals in 11 sectors, of which 177 were fully adopted by the relevant Parliamentary Committees.

Source: Civil Society Budget Advocacy Group. [Our Track Record \(stories of change\) : csbag.org](#)

The preparation of budget requests within the MDA should involve senior and middle-level managers. Historically, budget processes have taken a “top-down” approach, one in which detailed spending priorities are assigned by MOF before budget requests are prepared. This approach has significant drawbacks. Officials establishing the ceiling limits may be somewhat removed from the day-to-day budgetary challenges of implementing policies, programs and procedures. As a result, the budget might not adequately reflect the resources needed.

Under a “bottom-up” approach, the budget is created by MDAs following budget ceilings, guidance, and timelines provided in the budget circular by the MOF or central budget authority. With this approach, MDAs build their budget by compiling inputs from middle managers. Bottom-up budgeting may also have drawbacks because managers may overestimate the resources needed in anticipation of potential cuts during the review process. Since line managers may view things from the perspective of their individual programs, little appreciation may be given to the big-picture challenges of allocating resources for the entire country, or for the entire region or district in the case of subnational budgeting. Carefully formulated budget ceilings provided to the MDA and a well-defined budget preparation process that keeps MDAs within the ceilings except where increased budget requests are well justified will help control this problem.

When an MDA completes their draft budget request, they submit it to the central budget authority. This authority reviews each MDA’s budget request considering national or government priorities, legal requirements, and budget limitations. It continues to engage with MDAs to clarify issues and make revisions.

After initial MOF or government decisions on budget requests have been made, MDAs may be allowed to appeal the decisions and engage in negotiations with the central budget authority. An effectively formulated budget circular and carefully developed budget requests will stimulate discussions around the linkages among expenditures, programs, and priorities. Poorly formulated budget circulars and requests may result in discussions of budget ceilings and specific line items, rather than the services or results to be delivered. Appeals are typically resolved between the central budget authority and the MDA. When resolution is not possible, appeals may be sent up to higher level government officials responsible for preparing and submitting budget to the legislature.

After budget decisions and negotiations, it is generally the responsibility of individual MDAs to finalize budget justification materials and, in some cases, to explain budget requests to the legislature. While an MDA is preparing justification materials, it should also prepare its detailed budget request data in a format that can be compiled and entered into the government’s financial management information system (FMIS) (see [Section VII.3](#) of the Guide).

Prior to submission of the budget proposal to the legislature, the executive budget office will brief senior officials with responsibility for submitting the budget to the legislature (e.g., Minister of Finance, Director of the Budget Department, Prime Minister, or Executive). This office may also assist in the drafting of a budget speech to be given upon submission of the budget to frame deliberations around the budget in the legislature and describe the major priorities and parameters used in developing the budget. For an example, you can refer to the [Government of Uganda's Budget Speech for the 2022/23 fiscal year](#), delivered in June 2022.

III.4.4 BUDGET PREPARATION METHODOLOGIES

While all countries prepare a budget, the format and approach to budgeting may differ. Usually, the budgeting approach should depend on the highest priority budget objective (fiscal discipline, allocative efficiency, or operational efficiency) and the capacity of the central budget agency and budgeting staff of the Ministries, Departments, and Agencies. Until recently, the primary focus of national budgeting has been control over public resources. However, this focus is changing. Many countries have moved beyond line-item budgeting to program budgeting or performance budgeting. The budget circular defines the approach that MDAs must use.

A country's budget formulation defines the overall organization, structure, and presentation of the budget. Three budget formulations and their relative merits are described below:

- **Line-item budgeting:** Each MDA's revenue sources and major items to be purchased during the fiscal year are listed. Historically, the line-item budget has been the most widely used budget preparation approach because it is relatively easy to prepare and requires limited financial and analytic skills. Because of its focus on inputs, this approach to budgeting also enables stronger control of budget resources. The simplicity of the approach allows officials to easily monitor revenue and expenditures. The major deficiency of line-item budgeting is the difficulty to link expenditures to outputs or results. It is also difficult to establish priorities and determine the quantity or quality of services that could be provided at various expenditure levels.
- **Program budgeting:** Each MDA is asked to identify the total cost of each program and set spending limits and priorities. Program budgeting shifts the focus away from the inputs being purchased and the amounts spent on them, to what was achieved with the money spent. One downside, however, is that programs may straddle several parts of an MDA or cut across multiple MDAs, making the allocation and management of resources difficult. For example, School nutrition programs may involve operations that span both education and health MDAs. Or within the health sector, health sector staff may contribute toward the work of multiple programs, but their salary costs may only be able to be billed to a single program due to payroll system limitations. Additionally, MDAs may struggle to capture cross-cutting administrative support functions with the program structure.
- **Performance budgeting:** Building on the foundation of program budgets, with performance budgeting, each MDA links the budget of each program with performance information. Specific goals, and objectives are tied to expenditures for each program. The focus is on what will be accomplished with the resources provided, which can then be used to inform program adjustments and the preparation of future budgets. Performance budgets support the design and implementation of monitoring and evaluation mechanisms for projects and programs by setting initial parameters and metrics. The main disadvantage of performance budgeting is the considerable resources required to develop reliable metrics as well as the cost and scarcity of

skills needed for performance measurement. Carefully phased assistance is often necessary since this is quite difficult to execute properly and is rarely completely implemented in USAID partner countries.

The above budgeting approaches reflect advancing levels of maturity and complexity in a budgeting process, with each approach serving as a building block for the next level. Line-item budgeting provides the platform for all other budget formulations. For instance, a program budget is still developed through a line item-budget, but cross-cutting information is presented for programs, in addition to information on allocations to MDAs or their sub-units, to provide a clearer picture of what will be achieved with the money spent. For example, if a university budget is developed using a line-item approach it will include the cost of labor, capital works, and other direct costs for the university as a whole. However, if the university uses a program budgeting approach, it will present the labor and other costs separately for each program, such as academics, student life, athletics, and research.

Performance budgeting goes even further than program budgeting by setting results or targets to be achieved by each program and the funds to be expended in doing so. For example, a university's academic program may set targets around the number of students, the cost per student educated, and the ratio of public to private funding. Regardless of the level of budget disaggregation, specific line items, such as labor or other direct costs, still serve as the basis for developing a program or performance budget. Exhibit 16 provides additional detail on each budgeting approach. While line-item budgeting was widely used in the past, contemporary approaches put a greater emphasis on programs and performance.

There are also several methods MDAs use to develop their budget estimates. Most countries do not rely purely on one approach for estimating their budget, but tend to mix estimation techniques based on the category of expenditure. Some of the most common techniques include:

- **Incremental (conventional) budgeting:** This fairly common budgeting technique takes the current year's budget as a baseline and adjusts that amount for factors such as inflation, or planned increases in service level or quality. Incremental budgeting is simple and efficient to apply, but it generally leads to only small adjustments year by year, irrespective of changes in needs or priorities. It may also have the tendency to repeat the same costing errors year after year - especially when only budgeted amounts are considered. An improved version of this approach may base next year's budget estimates on "actual expended" levels rather than "initially budgeted" levels to improve accuracy. This approach might be considered as the most "conventional" way to calculate budget costs.
- **Zero based budgeting:** By contrast to incremental budgeting, the zero-based approach does not assume that existing programs will be continued indefinitely. It requires all MDAs to justify the entire level of funding for their programs each fiscal year. Those allocations can be higher or lower than in prior years and are driven by needs and priorities, not by past funding levels. MDAs may also be asked to estimate the various levels of service that could be provided at different funding levels with budget submissions. The justification document can thus be used to reflect the effects of the various possible funding levels (e.g., maintaining the current level, reducing funding by a certain percentage, or increasing funding by a certain percentage). A downside to zero-based budgeting is that it is resource intensive and as a result is rarely used or sustained. It can also give 'budget hawks' license to cut off funding to priority programs if enforced too rigidly.

- **Activity-based budgeting:** This budgeting technique allows the MDA to build up the costs of undertaking the various activities or services it provides, identify the cost drivers and cost per unit of delivering those services, and scale up or down their budget based on those cost drivers. While activity-based budgeting allows for flexibility and the ability to better align budgets and strategy, it may also cause MDAs to overlook core operating costs, such as personnel costs. For this reason, it is often used in combination with other budgeting techniques.

Costing for personnel may require a separate but complementary approach driven by the number of approved positions and the related salary and benefit costs per position. An approved establishment list indicating the authorized staff positions is an important part of the budget or a supplemental document. It should reflect vacancies to be filled and savings or cost increases resulting from normal staffing turnover. These may be reflected in the budget or a supplemental document. The establishment list indicates what positions are authorized and budgeted for and may include modifiers to for the vacancy and turnover savings resulting from normal staffing changes during a budget year.

Exhibit 16: Comparison of Budget Formulation Approaches

TYPE	PURPOSE	CHARACTERISTIC	SUCCESS FACTORS	ADVANTAGES	DISADVANTAGES
Line Item	<ul style="list-style-type: none"> Spend according to plan Low misappropriation risk Promote financial accountability 	Focus on prior year allocation as starting point	Low staff time and expertise	Works well when time is short and multiple stakeholders and a high potential for conflict	Not well-suited for improving efficiency or effectiveness. Discourage major changes (i.e., to adapt to emerging needs)
Program	<ul style="list-style-type: none"> Ensure that programs are achieving goals and objectives Promote accountability 	Focus on plans, goals, and objectives	Requires resources to develop plans, goals, and objectives	Clearly links program activities, allocations, and government priorities	Expensive and may cause conflict between MDAs. May require updates to financial management information systems to facilitate.
Performance	<ul style="list-style-type: none"> Ensure that programs are effective (generating results) and efficient (least-cost) 	Performance metrics to determine efficiency and effectiveness	Requires resources to develop reliable metrics and time to develop the skills and systems to collect and maintain data	Provides a way to document accomplishments, and link results to resources	Time-consuming and expensive; potential for resistance because of fear that performance measures will lead to reduced funding. Creates incentives for distorted performance reporting.

Exhibit 17: Comparison of Budget Preparation Approaches

TYPE	PURPOSE	CHARACTERISTIC	SUCCESS FACTORS	ADVANTAGES	DISADVANTAGES
Incremental	<ul style="list-style-type: none"> Enables a simple way to adjust an MDA's budget year to year 	Uses last year's allocations or spending as the baseline	Low effort required to prepare budget; requires accuracy of last year's allocation and stability in priorities year to year	Works well when cost information is not well known, and when time or skilled staff are scarce	Not well suited to linking the budget to strategic priorities or identifying opportunities for cost savings.
Zero-Based	<ul style="list-style-type: none"> Year to year funding of programs Focus on priorities and detailed input projections 	Annual evaluation of ongoing programs	High staff time and expertise required to assess all programs annually and justify decisions	Enables activities to be evaluated annually and reallocation of resources	High resource requirement and difficult to achieve comparability across organizational units
Activity-Based	<ul style="list-style-type: none"> Identifies the cost drivers and unit costs of major services by MDA 	Links budget to service delivery levels	Requires good understanding of all costs of service delivery	Links strategy and budget; complements program- or performance budgets.	If used in isolation, may neglect a MDAs fixed operating costs.

III.4.5 CAPITAL EXPENDITURES (“THE CAPITAL BUDGET”)

Capital expenditures refer to 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. Capital expenditure tends to be a focus in PFM reforms due to the potential for corruption, mismanagement or other inefficiencies. IMF analysis found that countries waste about one-third of their infrastructure spending due to inefficiencies, and the average low-income country can lose more than 50 percent.⁵

Capital expenditures have several attributes that require budget planners to exercise particular care throughout the budget cycle. Among others:

- Capital assets can be costly and time consuming to construct and are subject to risks of large cost overruns.
- Capital expenditures have high upfront costs, but their impacts are long-lived and may not be immediate. As a result, they often warrant careful cost-benefit or cost effectiveness analysis to ensure the costing is accurate, that they are in line with strategic priorities, and the expected benefits warrant the costs.
- Capital projects may have complex environmental or social impacts, and may be subject to climate risks that impact the design and cost of a project. All these issues should be carefully considered before a project is approved to proceed.
- Capital project planning may require the engagement of several government entities and/or levels of government to ensure coherent infrastructure planning (e.g., connections between local and national roads; connections of water, sewage and electricity to schools and hospitals).
- A common and appropriate financial management practice is to fund capital expenditures through the issuance of government bonds. Legislation external to annual budget laws may limit the term of bonds or significantly restrict how these funds may be spent.⁶
- Capital projects may require multi-year funding arrangements even in the case where appropriations can only be made on an annual basis. As a result, budgeting must be done carefully to avoid projects being stalled due to budget shortfalls.
- Capital expenditures can sometimes be deferred more easily than recurrent or operating expenses.

In addition to the above, capital investments often have implications for future operating, maintenance, and replacement costs. Changes in operating expenses, including personnel, debt service, taxes, or other operating expenses associated with capital investments should be included in annual budget submissions for future years. While capital budgets are sometimes separated from the recurrent budget, these

⁵ Schwartz, Gerd, Manal Fouad, Torben S Hansen, and Geneviève Verdier, “[Well Spent: How Strong Infrastructure Governance Can End Waste in Public Investment](#),” International Monetary Fund, Sep 3, 2020

⁶ For more on government bonds and public debt management, see [Public Debt: A Primer for Development Practitioners](#), USAID, June 2022.

recurrent costs associated with capital projects or initiatives may constitute significant future expenditures that can often be overlooked when capital budgets are separate from the operating budget or when budgets are constructed and accounted for on a cash as opposed to accrual basis (see [Section V.I](#) for more on cash and accrual accounting). Regardless of how the budget is presented, integrating the capital budget into the annual budget process, medium term expenditure frameworks, and other budget documents can help to capture these future costs in a way that provides the information decision-makers and other stakeholders need to understand, monitor, and hold the government accountable for the capital program.

III.4.6 PUBLIC INVESTMENT PROGRAMS

Fundamentally, a public investment program is a prioritized list of projects that a country plans to undertake to meet the goal outlined in their national development plan. A public investment program (PIP) can help guide capital investment decisions and implementation for better planning and execution over a 3-5 year or longer period. A PIP may also facilitate leveraging and management of donor and private sector financing.

The PIP can help in setting priorities for future projects and tracking future 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. The potential risk of a PIP is that it can create a dual budgeting approach that separates the capital budget from the regular operating budget. It could also result in a greater focus on the project rather than the program.

The World Bank and IMF actively promote the use of PIP to guide budgeting for public infrastructure. Good practice for using PIPs includes:

- PIPs should draw on a realistic resource framework that aligns medium term resource projections with the estimated project costs over the same period;
- PIPs should include only well prepared and screened projects - it should not be a wishlist to try to attract external or domestic financing;
- PIPs should include both ongoing and prioritized new projects being planned over the medium term including updated information regarding their estimated costs; and
- PIPs should align with and bring together national and sectoral planning and results documents with the medium term budget framework.⁷

Usage of PIP in low-income countries is becoming quite widespread. A 2020 IMF report found that more than 50 percent of low-income countries were using a full PIP, compared to less than 10 percent of advanced economies. The prevalence of PIP in low income countries is at least partly explained by the need to coordinate various development partners' funding of capital projects, but the mechanisms can

⁷ Schwartz, Gerd, Manal Fouad, Torben Hansen, and Geneviève Verdier, eds (2020). [Well Spent: How Strong Infrastructure Governance Can End Waste in Public Investment](#), Washington, DC: International Monetary Fund.

be further strengthened and integrated into the budget planning process to improve the efficiency of public investment decisions.⁸

Exhibit 18: Necessary Controls in the Budget Preparation Process

- The primary controls in budget preparation are the applicable legislative arrangements that assign responsibilities to specific government agencies, describe the budget process, and define specific fiscal rules.
- Most importantly, the budget preparation process benefits from the central role that one specific government agency (e.g., MOF) plays in reviewing budget requests and developing the final consolidated budget.
- The budget preparation process should be regulated through a transparent process and subject to stakeholder scrutiny.

III.4.7 BUDGET APPROVAL

The central budget authority presents the consolidated budget to the legislature for further review and approval (often through the executive's office, such as the Prime Minister or President). The legislature will review, comment on, and even revise the budget prior to approval. In some cases, the legislature may request verification information from fiscal or sectoral analytical units (such as the Congressional Budget Office in the United States of America or any integral fiscal or sectoral analytical units). Such units most effectively report directly to the legislature. The budget is typically analyzed by various legislative committees. In many developed countries, the legislature will often vote on the budget at least twice: once to accept the summary fiscal plan (MTEF) and one or more times during the year to set aside funds for spending (appropriation bills).

Typically, the rules, processes, and procedures to be followed in the legislature's review, consideration, and approval of the budget are set in the legislative rules. To promote civic involvement, legislative committee deliberations on budgets should be open to the public and the media. Some legislatures hold additional public hearings at the national and/or sub-national levels to receive public input before budget approval. Such hearings should be encouraged; preferentially at levels allowing in-person attendance by citizens but, if necessary, through electronic media.

Public outreach can be facilitated by the release of a summary budget document by the executive branch at the time of submission to the legislature. This shorter and easier-to-read document is often called a "Budget in Brief." These are often very effective tools for ensuring public understanding and participation.

The legislature prepares an Appropriations Law based on the consolidated budget request and any subsequent changes made by the legislature. An Appropriations Law (also known as a budget bill) lists

⁸ Ibid

the amount of funding available for a program or agency over the budget period. There may be multiple appropriation bills in a single year (as in the U.S.) or a single appropriation bill covering all MDAs.

The following are examples of how various legislatures review and approve draft budgets:

- In Jordan, the executive submits the budget to the National Assembly for analysis (by November 30). The budget scrutiny process starts in the Chamber of Deputies' Finance Committee, which then leads to debate in the full Chamber of Deputies in the presence of the Prime Minister. The Senate then reviews the budget in the same way as the Chamber of Deputies. Once a consensus version passes out of the National Assembly, the proposed budget is submitted to the King to authorize it to become law (Jordan Constitution, Article 93).
- In Mozambique, the executive must submit its proposed budget to the Assembly of the Republic (by September 30). The Assembly deliberates the proposed law until December 15th. The Planning and Budget Committee leads the process, drawing on analysis from other committees, advice from the Economic Studies Unit (PBO), debates held in the plenary, civil society consultations, and consultations at the provincial level. Then the Planning and Budget Committee prepares a report with questions for clarification on the proposed law that is submitted to the Presidency of the Assembly. When a consensus is reached, the budget is published as an annex to the Law that approves it, in the Republic Gazette. If the budget is not approved before the start of the new fiscal year, the budget of the previous financial year is renewed, including the revisions made during the year, and remains in force until the approval of a new budget.⁹
- In Serbia, the executive is required to submit several budgetary documents to the National Assembly, including the Fiscal Strategy (by June 5), the Revised Fiscal Strategy (by October 5), the Executive Budget Proposal (by November 1). The Fiscal Strategy includes the major objectives and assumptions of the Government's medium term economic and fiscal policy, including priorities areas and the medium-term expenditure framework covering the next budget year and the next two years. Any comments and recommendations about the proposal of the Fiscal Strategy made by the National Assembly need to be reflected in the revised Fiscal Strategy. During the budget scrutiny period, the sectoral line committees (e.g., health, education, agriculture) may submit initiatives for amendments to the draft budget law to the Finance Committee. During this period, other interested stakeholders such as civil society organizations may also file amendments to the budget proposal on paper or electronically. The Finance committee compiles all proposed amendments and moves to floor debate. After an analysis of all proposed amendments and related budget modifications, the National Assembly reviews and adopts the budget law.
- In the Philippines, the House of Representatives reviews macroeconomic assumptions and individual MDA budgets, and then undertakes three readings and enactment of a single General Appropriations Bill. The bill is then forwarded to the Senate. A bicameral conference committee is responsible for reconciling different versions, and then to the President for signing.¹⁰

⁹ PEFA (2021). [Despesa Pública e Responsabilidade Financeira \(PEFA\) Relatório de Performance 2019](#). PEFA Secretariat, 2021.

¹⁰ Philippines House of Representatives (2013), The Budget Process and the Philippine Congress, The Hrep Reference Librarian, March 7, 2013.

Exhibit 19 shows typical programmatic entries in the Appropriations Bill of the Philippines and how these are presented to the Parliament.

Exhibit 19: Extract of the Philippines Appropriation Bill, FY2022

Department of Environment and Natural Resources	802	Programs—Operations: Natural resources enforcement and regulation Natural resources conservation and development Environment and natural resources resiliency	1,591 11,408 75
Department of Health	958	Programs—Operations: Health policy and standard development Health systems strengthening Public health program Epidemiology and surveillance Health emergency management Health facility operation Health regulation Social health protection	220 41,823 47,861 874 814 56,388 1,004 21,890

Source: Government of the Philippines (2022), [General Appropriations Act, \(No. 11639\)](#), January 2022

III.4.8 SUPPLEMENTARY BUDGET

During the fiscal year, when needed, the government develops a revised budget that reflects changes in economic assumptions, legislative changes, and technical changes or corrections and submits it to the legislature for approval. This is part of a formal process. Some countries, such as the United States of America, require Congressional and Presidential approval of supplemental appropriations.

Other countries have legislation that allows MDAs to make changes to their budgets without legislative approval as long as the changes are within specified parameters. In many cases, this allows MDAs to transfer limited funds between budget lines, so long as they do not exceed their total budget. These are often referred to as virements. In South Sudan, MDAs are allowed to transfer funds up to 10 percent of the budgeted amount from one line item to another within a chapter (where chapters are salaries and allowances, operating expenses, and capital expenses) simply by notifying the Ministry of Finance and Economic Planning. In Nepal, MDAs are allowed to transfer funds between line items up to 25 percent within a program, but cannot move funds out of salaries, capital subsidies, furniture, transport means, machinery, or tools. It is important to note that virements, unless approved by legislative or other elective bodies, tend to reduce accountability and fiscal discipline.

Even where MDAs are allowed to make such changes, it is good practice to secure a posteriori legislative consent to these changes, either through special processes or through a budget adjustment. MDAs or the MOF may present a summary of the change justifications to a specific sub-committee of the legislature (usually composed of members of financial and/or fiscal committees) or through incorporation in the supplemental budget. To avoid conflicts between the legislature and executive branches, most countries' laws prohibit retroactive changes to expenditures that have already been legally made. In these countries, a supplementary budget is required for any changes beyond the legally allowed parameters and to provide additional funds for new programs and higher expenditures than expected for well-justified reasons (e.g. an economic down-turn requires larger unemployment benefits than originally budgeted), inflation adjustments, or to cover shortfalls in user fees or other non-appropriated revenues collected or expended by individual MDAs.

The central budget authority typically issues formal guidance on how to request supplementary funding and/or changes to an MDA budget as well as a calendar for development, submission, negotiation and consolidation of these requests. Such supplementary budget circulars generally are similar to their

annual budget predecessors. The supplementary budget is then submitted to the legislature for formal approval. Most countries pass at least one supplementary budget per year and some (such as Sweden) have more than one supplementary budget per year.

III.4.9 TRANSPARENCY IN BUDGET PREPARATION

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

One key element of budget transparency is the nature of the fiscal information that is released. Ideally a country will make several documents related to the budget publicly available—notably:

- pre-budget statement;
- executive budget proposal;
- enacted budget;
- revised or supplemental budgets;
- citizen’s budget;
- in-year, mid-year and year end reports; and
- audit report.¹¹

Budget information in all these documents should be comprehensive (include the macro-fiscal framework, spending for all MDAs, social spending, capital projects and where appropriate SOEs, detailed revenue estimates by revenue type, information on assets and liabilities), include a medium-term perspective, describe major policy priorities and assumptions, and indicate which spending lines are associated with earmarks/mandatory programs and which represent discretionary spending.¹²

A second key element of budget transparency is the timeliness of that information. In line with Global Initiative on Fiscal Transparency Principles, public authorities should, “allow sufficient time in the budget and policy cycles for the public to provide inputs in each phase; engage early while a range of options is still open; and, where desirable, allow for more than one round of engagement.” Timeliness is critical to enable effective citizen input on budget priorities and to improve the salience of budget reporting as an accountability tool.

A third key element of budget transparency is the accessibility of budget information. In many countries, budget documentation is extremely long and written in dense technical language. This can make it difficult for some key stakeholders to effectively analyze the budget. A citizen budget or other similar communications tools (see box below) are a useful option to bring citizens closer to the budget. For analysts and interested parties examining the full budget, it is important that the budget presentation is clear and consistent, that numerical data is machine readable, and that the presentation is comparable between budget authorization and reporting documents. Further, all budget documentation should be

¹¹ For more information on good practice for each of these key budget documents, please see section 3 of the [Open Budget Survey Guide and Questionnaire](#)

¹² “[Best Practices for Budget Transparency](#),” OECD: 2002.

made available to the public both in hard copy and online on well known platforms (e.g., government gazette, Ministry of Finance website), and in all official languages spoken in the country.

Exhibit 20: Citizens Budgets

Citizens Budgets present key public finance information written in accessible language and incorporating visuals to help the average citizen understand what the government is spending public funds on, and how those funds are being managed. It is most common for countries to produce Citizens Budget for the Executive Budget Proposal and the Enacted Budget, but each key document in the budget cycle can and should be presented in a way that the public can understand.

The specific content included in a Citizen Budget varies from country to country, but ideally they should include information about:

- Economic assumptions underlying the budget (e.g., assumptions regarding economic growth and inflation, whether the budget will run a surplus or deficit). See page 3 of Mexico's 2019 Citizens Budget.
- Revenue policy and projections (i.e., description of major taxes and revenues sources and their projected amounts). See pages 2 and 3 of South Africa's 2019 Citizens Budget.
- Spending allocations (i.e., outlines what the government is spending its money on, especially allocations between sectors, big new projects, and new policy priorities) See page 7 of Bulgaria's 2019 Citizens Budget and pages 16 to 38 of the Philippines' 2018 Citizens Budget.
- Contact information (i.e., an email, phone number and office for who to contact for further information). See page 12 of Tunisia's 2018 Citizens Budget.

CSOs can produce useful analysis of the budget, but Citizens Budgets should ideally be produced and disseminated by governments to reinforce the government's commitment to fiscal transparency and set the foundation for more meaningful citizen engagement with the budget. Citizens Budgets should not be seen as a substitute for more detailed budget documents, which should also be publicly disclosed, but are important for citizens and civil society to have the information needed to hold the government accountable for how it uses public resources.

Adapted from: <https://internationalbudget.org/publications/citizens-budgets/>

A fourth element is the transparency and inclusiveness of the budget process itself. Civil society and citizens should have meaningful opportunities to express their needs and preferences regarding the budget during the budget preparation process, both during the preparation of the executive budget and when the budget is being considered and finalized in the legislature. This engagement should enable feedback on any element of the budget, including the following outlined in the Open Budget Survey:

- Macroeconomic issues;
- Revenue forecasts, policies, and administration;
- Social spending policies;
- Deficit and debt levels;
- Public investment projects;

- Public services.¹³

These opportunities should be done in a timely manner to enable a meaningful dialogue and should be designed to enable participation from vulnerable and under-represented segments of the population. Line ministries may have their own mechanisms to engage citizens and civil society stakeholders within their own sectors, but it is also important for these stakeholders to be able to weigh in on the executive budget as a whole after the completion of budget negotiations and prior to its submission to the legislature. Similarly, civil society or media actors may engage with sectoral committees in the legislature on budget priorities, but should also have the opportunity to observe and engage during budget hearings.

III.4.10 RESPONSIBLE PARTIES

Countries may assign responsibilities for budget preparation across one or more agencies, ministries, or other government units. The specific units often vary, but the responsibilities are vital to a properly functioning PFM budget process. These responsibilities include:

- Developing and communicating macro-fiscal frameworks and MTEF. This task is generally assigned to a macroeconomic unit within the MOF or Ministries of Economy or Planning.
- Assisting the senior government official responsible for submitting the budget to the legislature. In the U.S, the President submits the budget to Congress and OMB prepares the budget submissions. OMB evaluates the effectiveness of agency programs, policies, and procedures, assesses competing funding demands among agencies, and sets funding priorities. OMB also ensures that agency reports, rules, testimony, and proposed legislation are consistent with the budget and with policies of the executive branch. In most developing countries, this role is played by the MOF or Ministry of Planning and is the core of the budget preparation process. Additional assistance is provided at the MDA level by staff and management responsible for budget preparation.
- Assisting the legislature during budget enactment. In the U.S., CBO was created by the Congressional Budget and Impoundment Control Act of 1974. CBO's mission is to provide Congress with objective, timely, non-partisan analyses for economic and budget decisions and the information required for budget enactment. CBO prepares analyses and estimates on the budget and the economy and presents options and alternatives for Congress but does not make policy recommendations. Most developing countries do not have this type of institutional support for the legislature and rely on analyses from the Ministry of Finance or Ministry of Planning and parliamentary staff and committees to provide this type of support.

In many countries, all responsibilities above fall within a single government agency, typically the Budget Department within the MOF. This agency also often monitors budget execution and adherence. One disadvantage of this arrangement is that the need to keep up with the significant amount of processing required to monitor the budget may take attention away from policy, priority, and performance analysis.

¹³ IBP (2021), [Open Budget Survey Guide and Questionnaire](#), International Budget Partnership, 2021

III.5 SPECIAL AND CROSS-CUTTING ISSUES IN BUDGET PREPARATION

U.S. President Joe Biden has been quoted as saying, “Don’t tell me what you value, show me your budget, and I’ll tell you what you value.”¹⁴ This quote captures the power of a government’s fiscal and budget policy in advancing a country’s broader goals and values. The process of translating values into budgets is not straight-forward, and the interests of those with disproportionate political and economic power may influence the allocation of public resources in a way that contradicts these values.

As such, budgeting systems have adopted and adapted specialized approaches to consider special needs and issues that have historically been overlooked during budget planning and preparation - for example special consideration for the needs of women and socially excluded groups. In some cases, budgetary resources are predominantly allocated based on the preferences of those in the capital city or with strong connections to those in political power. Use of grassroots participatory budgeting techniques may be a means to shift the resources towards those who might historically not have been able to have their voices heard in the budget process. Moreover, budget planning can sometimes be myopic considering the narrow and predictable needs that are anticipated for a given fiscal year. They may thereby be blind to the implications of longer term trends and challenges such as climate change.

The following subsections provide information on approaches to address these gaps in the budget process and key resources to learn more.

III.5.1 GENDER RESPONSIVE BUDGETING

Public revenue and spending decisions can often have different impacts on different segments of society. In particular government’s revenue and spending policies can impact women and men differently. For example, decisions on how income is treated under tax laws for married couples can have an impact on women’s labor force participation.¹⁵ Similarly, decisions on where and how to make investments in public transportation result in systems that are less well suited to meet women’s transportation needs.¹⁶

Due to the gendered nature of budget decisions, countries have increasingly begun to incorporate gender budgeting practices into their budget preparation processes. [Gender-Responsive Budgeting \(GRB\)](#) takes into account the various needs of a diverse population by using an intersectional gender lens to respond to the different experiences of women, men, and gender-diverse groups. It analyzes public spending to identify the impact of government revenue and expenditures on women and men, boys and girls, and gender-diverse groups. It aims to identify the gaps between policy statements and actual resources committed to their implementation.¹⁷

In addition to including an analysis of fiscal policies as to their differential impacts on women and men, as well as gender-diverse groups, it can involve considering other cross sectional groups and use of affirmative approaches to enhance the ability of the public finance system to support more gender

¹⁴ President Biden, [Twitter](#), Official White House Twitter Account, 3:45 PM · Mar 28, 2022

¹⁵ La Lumia, “[Tax policies to encourage women’s labor force participation](#).” Brookings, the Hamilton Project, 19 October, 2017.

¹⁶ Legocvini, Arianna et al “[All too often in transport, women are an afterthought](#),” World Bank Blogs, 8 March 2022.

¹⁷ “USAID (2016), “[Glossary of Key Terms](#)”, Gender Integration in Democracy, Human Rights, and Governance (DRG), US Agency for International Development

equitable outcomes. Gender budgeting does not require the adoption of a specific tool or technique, but instead requires the application of a gender lens to fiscal decision making. For example, gender budgeting might require line ministries to consider and budget for measures that enhance gender equity in access to services - for example health and education.

Gender budgeting might also require that key performance indicators used for performance based budgeting be sex disaggregated where possible to enable better tracking of goals. It can be further disaggregated by other factors intersecting with sex and gender, such as ethnicity and age as well. Recent work by the [IMF \(2016\)](#) and the [OECD](#) provides some practical examples of the application of GRB in different contexts.

Implementing GRB generally requires the involvement of the public officials engaged in budgeting planning and preparation as well as civil society and citizen groups involved in women's rights advocacy and monitoring. Additionally, analysis conducted as a result of GRB tends to highlight the ways in which women contribute to society and the economy with their unpaid labor, and the specific needs of socially disadvantaged groups, thus promoting social equality.

Exhibit 21: Gender Budgeting in Indonesia

Indonesia has worked for more than two decades to integrate and mainstream gender issues within their budget. Many of the early actions focused on adjustments of the legal framework. For example, in 2000, the government issued a presidential instruction on gender mainstreaming in planning and development for national and subnational governments. This was followed by issues of a decree requiring the development of an annual action plan for gender based budgeting and amendment of the laws and requirements governing the budget preparation process to include gender mainstreaming at the national (2003) and local levels (2008). Formal implementation of GRB began in earnest in 2009 through a pilot exercise in seven government agencies.

These agencies prepared Gender Budget Statements covering:

1. Outcomes and outputs of the largest-sub-programs and their implications for gender equality;
2. Outcomes and outputs which specifically target women and girls;
3. Outcomes and outputs which will benefit both men and women and promote gender equality;
4. Outcomes and outputs which will strengthen gender mainstreaming institutions (gender focal points, working groups etc.).

The pilot was subsequently expanded and GRB has been implemented in 36 MDAs and across all 34 of Indonesia's provinces. A 2021 analysis by the IMF found that while individual MDAs do consider gender-based targets and align fiscal policy with those goals, they are not yet taking an integrated approach to GB across the budget cycle and have not yet produced a holistic Gender Budget Statement at the national level. Further, the annual budget circular does not yet include a requirement to integrate a gender perspective into the resource allocation process and ex-ante and ex-post gender impact analysis is not performed. Additionally, the Government does not monitor gender responsive budget execution or use audits to facilitate accountability for gender goals.

USAID has been providing support to the Ministry of Development and Planning (Bappenas) to assess gaps in GRB implementation and suggest next steps. A report commissioned through USAID's Economic Growth Support Activity (EGSA) found that although Indonesia has a strong legal and regulatory framework to support gender equality, MDAs still lacked the skills, disaggregated data, and monitoring

and evaluation systems to fully implement GRB. In light of these findings, EGSA's recommendations identified improvement opportunities in all areas of the GRB cycle: from legislation, budgeting, and planning to monitoring and evaluation. These recommendations aimed to improve gender responsiveness in public policies at the national level and to develop practical tools for their implementation. EGSA also developed a specific tool for monitoring and evaluating the application of gender perspectives in government programs and projects.

Sources: IMF (2021), Gender Budgeting in G20 Countries, WPI/21/269, International Monetary Fund, November 2021, Firtica, Nia and Dr. Renata Simatupang (2022) Improving National Gender Responsive Planning and Budgeting for a Better Tomorrow for Indonesian Women, DevTech, May 3, 2022.

III.5.2 PARTICIPATORY APPROACHES IN BUDGETING

Participatory Budgeting (PB) is an innovative tool to democratize the budgeting process that was first practiced in the 1990s in Brazil following a pivotal democratic election. PB may be defined as a process which directly involves local people in making decisions on the spending priorities for a defined public budget. This means engaging residents and community groups representative of all parts of the community to discuss spending priorities, make spending proposals and vote on them, as well as giving local people a role in the scrutiny and monitoring of the process.”¹⁸ In many cases, PB focuses on spending of public investment funds, empowering citizens to vote to decide which projects are funded. While most efforts to conduct PB are at the local or municipal levels, in [2017 Portugal became the first country to pilot PB at a national level](#).

In North Macedonia, USAID worked through a local organization, the Fiscal Accountability, Sustainability, and Transparency Network (FISCAST), to launch PB with eight municipal governments. Through a series of townhall meetings, public lectures, regional forums and social media outreach, FISCAST reached over 500,000 people, sourcing citizen-proposed projects and ideas that were incorporated into municipal budgets. Over 99 citizen-proposed projects made their way into the 2020 municipal budgets, including: construction and renovation of local streets; improving waste disposal; helping the homeless, impoverished, and minority populations; building a kindergarten and sports facilities; and improving the city's greenery, among others. This effort also reinforced trust between citizens and their local representatives, reversing a perception that municipal budgets are made behind closed doors and not based on citizen needs.¹⁹

When done well, PB brings government decision making closer to citizens -- thereby enabling the government to be more responsive to citizen needs. However, like any deliberative process, PB needs to explicitly consider how to engage and include the participation of women, youth, people with disabilities and other groups who might be socially disadvantaged to ensure their voices and needs are

¹⁸ Department for Communities and Local Government (2011) Communities in the driving seat: a study of Participatory Budgeting in England Final report. Department for Communities and Local Government, London.

¹⁹ For more see USAID (2020), Engaging the Community in Planning for the Future, USAID/Macedonia, October 20, 2020

heard in the process. Without such considerations, PB may be captured by powerful actors or not receive the resources required to represent a meaningful response to citizen demands.

III.5.3 CLIMATE ADAPTIVE OR GREEN BUDGETING

Budget decisions can have an important environmental impact. For example, the structure of the tax code may either incentivize or disincentivize investments by the private sector that would increase carbon emissions. Similarly, the choices the government makes in how it spends public funds also has an environmental impact—from what infrastructure projects are funded (roads vs. public transit) down to the energy efficiency of the lightbulbs in public facilities.

By implementing climate adaptive or “green” budgeting, governments have a better understanding of the climate implications of their revenue mobilization and spending decisions. While Climate Adaptive Budgeting may take on a different form in different contexts it will generally require approaches to:

- Set whole-of-government climate related goals and alternative costed strategies to achieve those goals
- Integrate the costs of climate mitigation and adaptation into the macro-model, as well as the macro risks from climate change from the status quo
- Conduct regular risk analysis of the macroeconomic framework including on climate risks
- “Tag” budget lines according to their climate impact (green for low impact, brown for high)
- Link performance frameworks to climate goals (including under performance budgeting)
- Introduce ex ante and ex post environmental impact assessments for major spending programs
- Adapt budgetary and financial reporting to include information on climate goals²⁰

Implementation of these approaches may face resistance from a well-organized opposition that is benefiting from the status quo. As a result, experience introducing similar frameworks in [OECD](#) countries has shown the importance to pair reforms with the establishment of independent advisory groups that bring together reform minded experts and activists from the public and private sectors, along with representatives from academia and civil society. While initial efforts in this area have been largely concentrated in high income countries, middle- income countries like South Africa have started to introduce elements of this framework with a focus on infrastructure projects.

III.6 COMMON CHALLENGES

Common challenges during budget planning and preparation include:

- Lack of capacity in the government agency responsible for overseeing the budget planning and preparation process and in individual government MDAs
- Short budget calendar or non-adherence to the budget calendar
- Lack of budget comprehensiveness

²⁰ Adapted from: <https://www.oecd.org/gov/budgeting/green-budgeting-towards-common-principles.pdf>

III.6.1 GAPS IN CAPACITY

One major challenge in implementing a proper budget planning and preparation process is the shortage of adequate staffing, skills, processes, and systems, both within the central budgetary authority and the MDAs requesting funds. For example, when one agency is responsible for both producing the fiscal outlook and compiling the detailed budget requests, there is a risk of too much focus on budget preparation relative to analysis of the macro-fiscal framework. In some countries, the central budgetary authority has a strong focus on accounting and limited capacity for economic or policy analysis needed to introduce more advanced budget preparation reforms like the MTEF or program budgeting. Further, many countries have a very limited pool of skilled economists, and the government faces challenges to attract such candidates given higher compensation offered by the private sector and donors. Within MDAs, there is often significant variability in staff capacity to prepare budget requests. Some staff might not understand the concept of a program, the relationship between their operations and government priorities, and performance-based budgeting. If the legislature receives limited policy analysis support, it may hinder its ability to allocate resources in accordance with government policies.

Additional capacity restrictions may also be imposed by organizational or operational concerns inherent to the PFM system itself. In PFM systems where either an adversarial or intentionally distant relationship exists between the central budgetary authority and MDAs, MDAs may not have an incentive to invest in the capacities needed for an effective budget process. By the same token, in systems where the primary MOF budget contacts with MDA are not sufficiently familiar with the programs, activities, budgets and operations of their assigned MDA or are reluctant to engage directly with MDA colleagues, there is an important risk of errors that may make the budget difficult for decision-makers to assess or for the MDA to implement.

Further, lack of technology exacerbates capacity gaps because of the significant amount of manual work that MDAs must perform while developing budget requests. Without a centralized FMIS that includes a budget preparation function, the central budget agency may have to handle significant format variations in the budget requests even if there is a clear budget circular. Manual processing may also divert attention from discussions of national priorities. Technology gaps and manual processing also contribute to time challenges in preparation.

III.6.2 INSUFFICIENT TIME FOR PREPARATION

In many countries, capacity challenges are exacerbated by a short budget preparation calendar or lack of adherence to the legally mandated budget calendar. Even when the budget calendar is appropriate, it is not necessarily followed at the central and/or sub-national levels. Or the budget authority may be late in releasing a budget circular, thereby truncating the budget preparation timeline. Under a short timeframe MDAs may be forced to reduce the involvement of mid-level managers in the budget process, focus on top-level budget ceilings, or fail to justify their priorities well in the budget request. Limited timelines can also reduce or eliminate the time for citizen input into budget processes. Additionally, in situations where executive and legislative disagreements on substance can impact processes, these can introduce both major delays and substantial policy and budgetary disagreements.

III.6.3 BUDGET COVERAGE AND OFF-BUDGET OPERATIONS

Many countries place certain government agencies, programs, or operations outside of the central budget and free them from government salary scales and personnel rules. This may be done to address staff capacity constraints in high priority programs; to reduce the visibility of operations considered as

unrelated to the primary programs of an entity, or for many other reasons. This approach has the drawback of reducing the comprehensiveness and transparency of the national budget, and the ability of the government to manage its money and maintain accountability. There may be a temporary and limited justification for off-budget activity in failed or post-conflict states, and this is often the subject of international financial institution and/or donor analysis and agreement with partner governments. However, good practice calls for countries to transition away from these practices as soon as practicable.

Off-budget operations may fall into a number of categories. Examples may include power, telecommunications or other utilities; commercial or profit-making enterprises; entities whose operations are funded wholly or in part from specific revenues generated as a result of their activities; or even significant MDAs that are separated from central government operations in order to maintain the independence of their operations, such as a central bank. It is advisable, once it has been determined that there are off-budget operations, to discuss this with the responsible parties in partner country governments, local offices of international financial institutions, CSOs, and other donors to determine their provenance and justifications for those operations. Programming to assist in eliminating off-budget entities may include privatization; incorporation of organizations, staff and budgets into public budgets; or the elimination of those activities and/or functions. State owned enterprises (SOEs, also known as parastatals) represent one category entity that may continue to be treated differently than MDAs in the budgeting process. Exhibit 22 below provides a more detailed discussion of the particular challenges associated with inclusion of SOEs in government budgets.

Exhibit 22: Treatment of State-Owned Enterprises (SOEs) in the Public Budget

A state-owned enterprise is an entity in which the national, provincial, or local government has a controlling or minority ownership interest that allows it to exercise full or partial management control. SOEs have their own revenues and might or might not receive appropriated funds from the consolidated budget. An SOE will generally have more independence and flexibility in budget preparation and execution than an MDA, as long as certain conditions are met and controls in place to minimize the financial burden on the government. In general, the more commercial the SOE, the more flexibility it will have. If an SOE is producing a good or service that is or could be profitable and there is no market failure or special public purpose served, then leading practice suggests that this undertaking should be a private sector business. Many SOEs do not operate in a competitive environment due to policy restrictions that have unfavorable effects. Also, SOEs are sometimes unprofitable due to inefficiency, but could be profitable if privatized.

SOEs can be divided into three categories:

1. Departmental (an SOE legally designated as wholly owned by the government; e.g. post offices and state-owned railroads);
2. Statutory Corporation (an SOE created by legislation and controlled by government but with additional ownership by others; e.g. public airlines or banks); and
3. Joint Stock Company with shares owned by the state and non-state entities (e.g., many utilities).

The classification of the SOE will affect how it is included in the budget process and the extent of the management controls exercised by the government. While the approach varies across countries, a departmental SOE will generally be included in the budget and have less autonomy than a joint stock company. A departmental SOE may receive a direct budget subsidy from the government based on a

budget developed and negotiated with the central budget office and approved by the legislature. In exchange for the subsidy, the SOE may receive direct policy targets from the government. A statutory corporation may have its budget split between budget-funded and enterprise-funded expenditures and revenues, partaking of the characteristics of both other SOE types in terms of government controls, and usually will have a board of directors that have significant independence in policy and operations. A joint stock company generally operates entirely from its own revenues without a direct subsidy. Governments may provide a guarantee for loans incurred for any type of SOE.

SOEs may be subject to a political burden to hire redundant or inefficient labor and provide social services. They may be allowed to operate within soft budget constraints, leading to inefficiencies, low productivity, and financial losses. Over the last two decades, many countries have implemented reforms that imposed accounting and financial reporting standards on SOE and forced them to face hard budget constraints.

IV. BUDGET EXECUTION

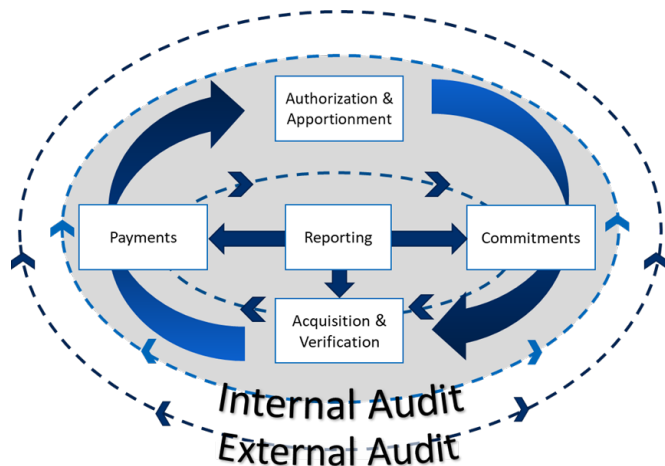
“Top Three” Reference Materials: Budget Execution

1. [Expenditure Control: Key Features, Stages, and Actors, IMF Technical Notes and Manuals: 2016](#)
2. [Government Cash Management: Its Interaction with Other Financial Policies. IMF Technical Notes and Manuals: 2010](#)
3. [Guidelines for Public Expenditure Management, International Monetary Fund: 1999](#)

Budgets are only well intentioned plans without the resources and systems to implement the budget. Budget execution is the stage in the PFM cycle when the government procures and/or pays for the personnel, goods, services, and infrastructure required to achieve the programmatic objectives outlined in strategic planning documents and the annual budget. Budget execution follows budget preparation and begins when the legislative body approves the annual budget establishing each MDA’s budget for the year. Budget execution includes authorization and apportionment, commitment of funds, acquisition or procurement and verification, and payments. It must also include robust monitoring and reporting processes to ensure accountability and transparency.

Exhibit 23 demonstrates how reporting occurs throughout budget execution and how internal and external audit processes should encompass the process. Outside stakeholders can also be extremely useful in tracking progress in budget execution, including by serving as a watchdog for wasteful or inefficient spending. This chapter defines the purpose and objectives of the budget execution process, describes roles and responsibilities of government entities in budget execution, and outlines common weaknesses and leading practices.

Exhibit 23: Critical Dimensions of Performance of an Open and Orderly PFM System



IV.1 BUDGET AUTHORIZATION AND APPORTIONMENT

Once an annual budget is approved by the legislature, the MOF will authorize MDAs to begin executing their budgets. Rather than providing MDAs with 100% of their budget at the beginning of the budget year, the MOF typically apportions the funds into monthly or quarterly allocations. These budget allocations break down an annual appropriation into smaller amounts to help control expenditures and ensure the MDA has adequate resources for the entire year.

The MOF may divide a MDA's annual appropriation into 12 equal monthly allocations or four equal quarterly allocations. Alternatively, in some countries, the MOF requires budget organizations to develop a monthly or quarterly spending plan that identifies expected cash needs for the year. These spending plans also help the MOF plan for the amount of cash to have on hand each month or quarter to reflect variations in spending patterns throughout the year. More specifically, MOF can compare projected revenue plans against the consolidated monthly or quarterly spending plans and evaluate any disparities to determine short-term borrowing needs (for more see [Section VI](#) Treasury Operations and Cash Management). The spending plans also allow budget officers within the MOF and MDAs to monitor spending patterns and identify any over- or under-spending, which is crucial to ensuring expenditures remain within budget parameters. In many countries, unspent funds from one year cannot be carried forward to the next fiscal year, and these controls reduce that possibility.

IV.2 PROCUREMENT AND VERIFICATION

Public acquisition or procurement refers to MDAs' use of public funds to purchase goods, services, or works during budget execution. The quality of procurement has a major effect on the efficiency and effectiveness of public entities. The World Bank estimates that approximately 30 to 50 percent of a country's total government expenditures flow through public procurement systems. A good procurement process provides "value for money." Value for money means that policy and service delivery goals can be achieved at required quality standards (effectiveness) at the minimum practicable cost, including staff costs. To achieve value for money, public procurement systems should be based on open competition, transparency, and accountability while minimizing fraud, waste, and corruption.

IV.2.1 PROCUREMENT SYSTEMS

There are two structural approaches to procurement implementation- centralized and 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 level MDAs as well. The centralized procurement unit may be an independent body, be based in the MOF, or based in another ministry such as Public Administration or Government Services.

Under a centralized procurement system, MDAs may still have autonomy to purchase some small items through direct shopping under a threshold determined by law. In a **decentralized procurement system**, MDAs procure their own goods and services.

Exhibit 24: Procurement Approaches

	DECENTRALIZED	CENTRALIZED
PROS	<ul style="list-style-type: none"> • Local procurement as and when required • No heavy initial investment • Orders placed quickly • Potential for enhanced local visibility to reduce corruption potentials 	<ul style="list-style-type: none"> • Bulk procurement • Reduces transport cost • No duplication of efforts • Uniformity of procurement policies • Minimizes investment on inventory • May lead to less corruption if done properly
CONS	<ul style="list-style-type: none"> • No economy of scale • Lack of specialized knowledge • Insufficient/excessive purchases • Absence of effective central control/more areas for corruption to take place 	<ul style="list-style-type: none"> • High initial investment • Delay in receipt of goods by departments • More advance planning required • Entities may be located in different regions • Often size of errors or corruption larger

Many countries also have specialized units or independent agencies with a role in procurement regulation and oversight. National regulations may dictate that procurements over a certain monetary value require approval by the MDA and someone from the centralized procurement regulator. Regardless of arrangements, it is important for a government to maintain appropriate national level procurement regulations, including a public procurement law, and for budget authorities to maintain their own policies and procedures that incorporate national legislation but provide more detailed guidance to staff on their roles and responsibilities in the procurement process.

Exhibit 25: Seven Step Procurement Process

Regardless of the institutional arrangements, major procurements generally follow a seven-step process:

1. Procurement planning
2. Requisition request
3. Bid solicitation
4. Bid evaluation
5. Contract negotiation and signature
6. Contract management
7. Verification

IV.2.2 PROCUREMENT PLANNING

Procurement planning is an essential part of the overall procurement process. It generally begins as a part of the budget preparation process, enabling the MDA to understand the set of goods, services and capital needed to deliver on their plans, quality and cost considerations. This leads to more accurate budget estimates. Procurement planning also helps MDAs to determine the appropriate mechanisms to procure the needed items and the timelines for procurement to ensure they can be delivered within the needed time frame. During procurement planning, the MDA will define its overall procurement requirements for the entire fiscal year (and sometimes for a 2-4 year rolling period). Individual items on the procurement plan will include basic information on costs, requirements and timing based on inputs

from the requesting unit and market analysis by the procurement unit. This procurement plan should be updated based on the approved budget to enable accurate and timely budget implementation, but may be updated on a quarterly basis, and is often an important input to cash planning.

IV.2.3 REQUISITION REQUEST

The procurement process for an individual procurement action begins with a requisition request. A user department completes a requisition form and submits it to the procurement unit. The requisition form should state the specifications of the goods or services and the quantity required. It is important that MDA technical staff be involved in the drafting of specifications and quantities to make sure they meet service delivery needs and standards, and to avoid situations where a procurement process will need to be re-started due to poorly defined specifications. The quality of the request will affect the quality of the bids received. For example, poorly drafted specifications for a road may lead to the road or shoulders being too narrow for cars and trucks to safely navigate the roadways. Alternatively, a poorly specified requisition of school desks could result in the wrong height of desks being purchased for a new high school facility.

It is important that MDAs have appropriate controls in place to make sure that requisitions are in line with available resources and the planned expenditures for the approved budget. This may require dual clearances, for example, by the MDA’s finance office and the requisitioning unit head prior to advancing to the next step in the procurement process. Good practice also dictates that a requisition request should be signed off by the head of the department or agency when it is above a certain monetary value. In some cases a central purchasing agency or MOF may also need to approve.

IV.2.4 BID SOLICITATION

Upon receipt of the requisition request, the procurement unit will determine the type of procurement method to use based on regulatory requirements and the perceived value for money. Typically, procurement legislation establishes certain thresholds above which procurement approaches should be used. Rules may differ based on the type and monetary value of the procurement. For larger bids (especially for vehicles and construction), there may be a requirement to use open competition. Under open competition, bids are solicited through an open tender and advertised in websites and newspapers. A country may have different rules for domestic and international procurements. Common time frames are 45 days for international competitive bidding and 15–30 days for national procurement. For smaller procurements, the law may allow requests for direct quotations from a minimum number of companies—typically at least three. For the smallest procurements—for example, coffee or office supplies—MDAs may be permitted to just shop and pay through petty cash or an imprest fund. Exhibit 26 summarizes common types of bid solicitations.

Exhibit 26: Types of Bid Solicitations

BID TYPE	DESCRIPTION
International Competitive Bidding (ICB)	The most competitive method; it entails open advertising both internationally and domestically. All interested firms are invited to submit proposals.
Limited International Bidding (LIB)	Used when a limited number of suppliers are available to deliver highly specialized goods. These solicitations are made by inviting competitive bids from a limited number of providers, often international firms with the required qualifications.

BID TYPE	DESCRIPTION
National Competitive Bidding (NCB)	Open to national as well as international suppliers, although only national advertising is required. This should be used when it is not expected that international firms will be interested because of 1) small contract values, 2) work spread out geographically or over time, 3) labor intensive, and/or d) goods or services are available locally at competitive prices. The most common bidding type.
Shopping	Shopping may be used for small purchases that can be obtained locally by having at least three suppliers submit quotes for comparison. This approach should be used for goods that are readily available off the shelf or standard specification commodities.
Direct Contracting	Direct contracting should only be used in exceptional circumstances, such as standardization of IT equipment, responses to natural disasters, or in cases where there is only one contractor that can carry out the work or provide certain goods. Sometimes allowed as “EMERGENCY CONTRACTING” and often problematic.

IV.2.5 BID EVALUATION

For ICB, LIB, and NCB bids, evaluation and selection of a successful bidder should be done by a Tender Committee. Selection of Tender Committee Members is usually done by the head of the requisitioning unit in the case of smaller procurements, or the head of an MDA or a central procurement agency in the case of large procurements. Some MDAs may form standing tender committees that review all bids above a certain threshold. There should be clearly defined rules about the length of assignment and the number of terms allowed for standing tender committee members.

The composition of the Tender Committee for a particular solicitation may vary based on the nature of the good or service being procured to ensure that the Committee has the necessary technical expertise. The Tender Committee will evaluate bids based on the specifications provided by the requester and value for money principles, including quantity, quality, and cost. The Tender Committee should also take into account past performance of the bidder based on records maintained by the MDA or a centralized procurement database. A record should be maintained on the evaluation process and the scores or other rating system used to evaluate each bidder and the evaluation should be directly tied to the requirements, and any rating criteria, specified in the solicitation.

Common evaluation methods used by Tender Committees to evaluate proposals for goods and services are covered in Exhibit 27 and Exhibit 28.

Exhibit 27: Types of Bid Evaluation Methods for Goods

BID EVALUATION METHOD	DESCRIPTION
Lowest Evaluated Bid	Bids are first evaluated based on a pass/fail basis to determine if they meet minimum criteria. The winner is selected based on lowest cost from the pass pool.
Scoring System	Under this system, the procuring entity establishes a scoring system based on the various selection criteria including cost, past performance of the provider, and technical specifications.
Sole Source Selection	In some instances, there may be a justification for a sole source selection because only one vendor is able to provide the goods or services that meet the exact specifications required. An example may be in the IT sector where a good or service is required that is compatible with the overall IT environment.

Exhibit 28: Types of Bid Evaluation Methods for Services/Works

BID EVALUATION METHOD	DESCRIPTION
Quality- and Cost-Based Selection	This method is similar to the lowest evaluated cost method for goods. It uses a “two-envelope system” in which the financial proposal and technical proposal are separated. The technical proposals are considered independently without financial considerations. The cost proposal is only considered for the highest technically rated bids, based on a weighting procedure.
Quality-Based Selection	This method is similar to quality- and cost based selection with a higher weight given to the technical proposal rather than the financial proposal. (for example, 95% for the technical proposal and 5% for the financial proposal).
Selection Under a Fixed Budget	The budget is advertised in the Request for Expressions of Interest and the same system is used for the quality- and cost-based selection procedures.
Least Cost Selection	This approach entails a two-envelope system as in the quality and cost based selection. Once the technical proposals have been evaluated and ranked, the financial proposals of the firms that meet the minimum qualifying marks will be opened. The lowest priced proposal will be accepted regardless of the technical ranking.
Selection Based on Consultants’ Qualifications	A pre-specified number of consulting firms are shortlisted and ranked based on specific criteria and then the highest ranked firm (only the single highest rated firm) is invited to submit a combined financial/technical proposal.
Single-Source (or Sole-Source) Selection	This method should only be used under exceptional circumstances, e.g., to follow-up on a previous competitively selected or if there is only one provider of essential goods or exceptional capacity for service provision. This approach is often overused and increases the risk of politicized selection, waste, fraud, and abuse.

IV.2.6 PROCUREMENT APPEALS AND PROTESTS

The Government should inform all bidders as to whether they were successful or not. Unsuccessful bidders should have a right to appeal. This right to appeal should be clearly established within the procurement legal framework and should allow bidders to challenge procurement decisions if they believe that a procurement decision was not made in accordance with the terms outlined in the bidding documents or if they suspect non-compliance with another aspect of the procurement legal framework.

In most countries, the procuring entity is the first step in an appeal process, though in some countries appeals and protests move directly to an independent procurement appeals body. The Tender Committee or another specialized group will review its bid evaluation process to confirm or revise its award decision. The outcome of the review process will be documented and sent to bidders in a written communication. In some cases such decisions may be posted on public websites.

If the bidder is not satisfied by the outcome of the review conducted by the procuring entity, or if the procuring entity does not respond to the appeal within legally designated deadlines, the bidder who lodged the appeal typically has a right to bring their complaint in front of a national procurement appeals body. This appeals body may be within the central procurement agency or the judicial branch, but will ideally exercise significant autonomy in its operations. Ideally the complaints resolutions function should be separate from procurement operations if the appeals body sits within a central procurement agency.

Award challenge decisions should be made public after giving relevant parties the opportunity to remove confidential and proprietary information. This helps firms engaged in the public procurement system to better understand how decisions are reached and understand the consistency and fairness of the process.

IV.2.7 CONTRACT NEGOTIATION AND SIGNATURE

The procurement unit will negotiate the terms of the contract with the first-choice bidder. Material contract terms should have been included in the request for proposals, including specifications and delivery dates, but there may be some small items to negotiate including requests for changes in the specifications or schedule. 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. The contract should also include milestones, a payment schedule, and reporting requirements. Typically, there will be dual signatures on a contract or purchase order, including the head of procurement and the director of finance or their legal designees. A clearly defined mechanism for dispute resolution should be stated in both the contract and the MDA's procedures. It should designate the process of appeals in the event that an agreement cannot be reached between the MDA and contractor.

IV.2.8 CONTRACT MANAGEMENT

Following contract award, the MDA will shift to the contract management phase. This phase includes 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. Contract management may also include undertaking modifications to contracts as warranted and within legal limits, although this is often assigned to staff not directly engaged in day-to-day or routine contract management. Ideally, a trained contract manager should be assigned with a responsibility to oversee a contract, and that contract manager should be free of conflicts of interest.

For larger or longer contracts (such as public works), the MDA will need to devote significant resources to contract management. Monitoring whether vendors have met contract performance requirements may involve the services of specialized staff such as engineers in the case of public works programs. MDAs may also engage citizens as a part of the contract management process. For example, in Peru introduction of citizen oversight of construction projects was shown to significantly improve projects' cost effectiveness.²¹ This approach is known as third party monitoring.

There should be written rules, regulations, policies, and procedures governing contract management processes and they should be quoted or referenced in the contracts. All reports and other documents associated with all phases of contract management and verification should be signed by both the individuals performing the action and of the official with ultimate responsibility. All contract records should be retained for periods set by law to facilitate transparency and ensure their availability for any future disputes. Some e-procurement systems may include a contract management module that enables tracking of completion of milestones, oversight activities, and any associated contract modifications with justification. Strong contract records management facilitates more effective management decision making as well as internal and external audit and review of contract implementation.

IV.2.9 VERIFICATION

After the goods and services have been received, procurement staff must verify receipt or completion according to the contract specifications. Received goods should be inspected immediately for any damage. If a more in-depth inspection is needed, it should happen within 1- 2 days of delivery. Some

²¹ IADB (2020). [Digital Government and Corruption: The Impact of Citizen Oversight and Infobras on the Efficiency of the Execution of Public Works in Peru](#)

goods or services may require testing to determine that they perform at a satisfactory level; examples include clinical or research products, software, and capital equipment. During the inspection, the supplier's packing list or submission memo itemizing the contents should be compared to the original purchase order and invoice to determine if there are any discrepancies. Good practice is that the items are verified by representatives from both the user department and procurement unit and that both parties sign off on the appropriate proof of delivery documents. All relevant documents (such as the purchase order, packing list, invoice, and proof of delivery) should be kept in the procurement file. These documents should be subject to performance audits by an internal auditor.

The government or MDA should have policies and procedures to deal with incorrect, inadequate, or partial deliveries, as well as over fulfillment of orders. If deliveries are incorrect (wrong products) or inadequate (the item is out of date, damaged, or below expected quality), the supplier should be notified immediately and required to provide the goods or services stated in the contract. Payment should be withheld until receipt of the proper quantity and quality of goods and services. As an additional safeguard against inadequate vendor performance, it is a common practice to withhold all or part of the total payment until final acceptance and verification. When a partial delivery is received, the supplier should be notified immediately and arrangements negotiated to pay for only the items received or, preferably, the withholding of any payment until receipt of the full order. For over-fulfillments, the supplier should be notified immediately, and arrangements made to either return the items or credit the buyer on the current or a future payment. Adequate verification requires that the individuals who perform the function and responsible management take personal responsibility for the verification by providing signatures.

IV.2.10 PROJECT CLOSE-OUT

After all goods or services under the contract have been received and payment made, the procurement unit should close out a contract. Close-out involves making sure that the procurement file is up-to-date and comprehensive, including 1) procurement plans and/or a requisition request, 2) bid documents, 3) bid opening records/minutes, 4) notice of bidding/advertisement, 5) bid evaluation reports, 6) negotiation communications, 7) contract, 8) notification of successful and unsuccessful bidders, 9) report on the supervision/inspection of works, 10) request for quotations, and 11) payments made against the contract. Assets procured should be formally transferred to the organization that will manage them.

IV.2.11 E-PROCUREMENT

Increasingly, e-Procurement reforms are making procurement more transparent, aligning processes with separation of duties and other internal controls, and facilitating more effective, risk based audit of procurement activities. E-Procurement works across the whole procurement lifecycle. MDAs can prepare procurement plans and issue requests for proposals/quotations.

Potential vendors can download procurement notices and tender documents; submit questions and proposals, complaints and appeals through the website. E-procurement systems can improve government performance by allowing requisitions to be routed to the appropriate individuals for approval. Other advantages of E-procurement systems include time and cost savings for applicants and agencies and improved transparency. Because procurement requests posted on the web can be accessed anywhere, the number of potential bidders may increase, including regional and international bidders. Modifications of E-Procurement may be needed in countries where the government's IT-infrastructure is weak, or the majority of potential bidders do not have regular access to the internet or computers.

Exhibit 29 provides a summary of USAID’s work on procurement in collaboration with counterparts in Ukraine. A [2022 World Bank Report](#) is also a useful resource for options and good practices for countries considering introducing a new eProcurement system or improving existing ones.

Exhibit 29: USAID Support for an E-Procurement System in Ukraine

Procurement reform efforts in Ukraine were initiated in 2014 by a group of anti-corruption activists that focused on developing an electronic procurement platform for all Ukrainian public procurement. This effort was motivated out of widespread protests in 2013. In February 2015, the Government of Ukraine worked in cooperation with civil society to launch and pilot the ProZorro platform, which was launched and started piloting electronic bidding in February 2015. USAID supported the expansion of this pilot through improvements to the system, staff training and process re-engineering, and needed legal and regulatory reforms. USAID also supported the development of DOZORRO, an independent civil society watchdog network that has leveraged e-Procurement to identify more than 12,000 high-risk tenders as of 2018, leading to the cancellation of nearly 1,700 “red-flag” tenders. The Open Government Partnership highlighted DOZORRO in 2018 as one of the top 12 Star Reforms. The government reports e-procurement, through greater efficiency and reduced corruption, has saved more than \$2.5 billion over its first 3 years of operation.

IV.2.12 COMMON CHALLENGES AND APPROACHES

Public procurement is one of the most complex and wide-reaching elements of the PFM system. Public procurement represents about 13 percent of GDP on average in low- and middle-income countries and typically comprises about 30 percent of government spending.²² Moreover, public procurement systems must be able to procure a wide variety of goods, services and works - ranging from stationary supplies to complex multi-year public works. Because of this complexity and the large amount of public funds in government procurement, it is one of the most challenging areas for reform.

CORRUPTION represents one of the largest obstacles to a strong procurement system, and there may be a lack of political will to rectify the situation. Private and public sector actors who benefit from flawed systems have an interest in maintaining the status quo. To address risks of collusion and corruption, public procurement systems should be designed to require multiple competitive bids and contain internal controls. Procedures and controls must be enforced to reduce the risk of corruption and collusion between government employees and vendors (e.g., bid rigging, kickback schemes, self-dealing, conflict of interest), otherwise efficiency and effectiveness will be jeopardized. Different individuals should be responsible for determining the need for goods/services and defining the specifications, soliciting bids, evaluating and selecting bids, signing purchase orders and contracts, and verifying receipt. Procurement files should be comprehensive, organized, and secure to allow auditors to perform finance or performance audits.

LACK OF TRANSPARENCY IN PROCUREMENT. It is critical to build in transparency throughout the entire public procurement cycle to reduce risks of fraud and mismanagement of public funds, to

²²Bosio, Erica and Simeon Djankov (2020) “[How large is public procurement?](#)” Let’s Talk Development, World Bank, February 5, 2020; ITCILO (2021) [10 Surprising Facts on Public Procurement](#). ILO Center for International Training, August 2, 2021.

increase competitiveness by leveling the playing field among potential bidders, and to enable new bidders to engage in public procurement markets. There are many aspects of the procurement process that require transparency, including:

- Publishing procurement laws and policies;
- Posting of up to date procurement plans in advance;
- Advertising tender notices with sufficient lead time;
- Disclosing evaluation criteria in solicitation documents;
- Publishing contract awards and prices paid;
- Maintaining appropriate and timely complaint/protest/dispute mechanisms;
- Requiring financial and conflict of interest disclosure for public procurement officials;
- Implementing beneficial ownership disclosure requirements for registered bidders; and
- Publishing supplier sanction lists.²³

These approaches, among others, will help to reduce the risks of corruption and improve the competitiveness of the public procurement marketplace.

WEAK AUDIT, OVERSIGHT, AND ENFORCEMENT. Many countries suffer from inconsistent oversight and weak enforcement of the prevailing rules. The supreme audit institution (SAI) or procurement regulatory agency should conduct compliance and performance audits on MDAs to ensure they are interpreting regulations correctly and maintain a list of debarred vendors. Unfortunately, SAIs and procurement regulatory agencies often suffer from underfunding, low staffing levels, and challenges to their independence. As a result, these agencies often are not able to conduct the frequency or quality of audits required to identify challenges in the procurement system. Moreover, many SAIs do not yet use risk-based audit planning approaches - meaning that audit activities could be better targeted toward procurement activities at higher risk for fraud or mis-management. Exhibit 30 discusses how introduction of “red flags”; to focus audits on high-risk activities can improve audit oversight of procurement activities.

Exhibit 30: Use of Red Flags to Improve Oversight and Audit of Procurement

Procurement risk “red flags,” are specific features of procurement transactions that might be associated with corrupt practices. “Red flags” may relate to any phase of the procurement process and should be regularly updated to evolve as corrupt market practices change. “Red flags” might trigger enhanced internal control processes or an internal or external audit. Some examples of “red flags” include:

Planning:

- Key planning documents are not provided

Tender:

- Non-public bid opening
- Short time allotted for advertisement of bidding opportunities and for submission of bids
- Tender value is higher or lower than the average cost for this item category

²³ Adapted from: Transparency and public procurement

Award:

- High number of contract awards to one bidder
- Business similarities between suppliers (e.g., common addresses, personnel, phone numbers, etc.)
- Supplier address is same as selecting official's

Contract:

- Large difference between contract award and final contract amount
- Contract is not public

Implementation:

- Approval of frequent or unnecessary change orders to change contract price or adjust terms
- Total payments to a contractor exceed total contract or purchase order amounts

Source: [Red flags for integrity: Giving the green light to open data solutions](#), Open Contracting Partnership

In terms of enforcement, procurement fraud and financial crime cases are generally complex, involve multiple participants and may be complicated by schemes in which participants disguise corrupt actions within seemingly normal business procedures. Where systems are not automated (and sometimes where they are) finding sufficient evidence to prosecute can be difficult.²⁴ Moreover, the repercussions of prosecuting politically well-connected individuals who engage in misconduct creates dis-incentives for some prosecutors to take up procurement corruption cases.

LACK OF AN EFFECTIVE LEGAL AND INSTITUTIONAL FRAMEWORK. An effective framework for procurement should be comprehensive, applying to all MDAs and categories of goods, and set clear roles for oversight and a complaints mechanism. Moreover, it provides guidance on tender documents, the bidding process and evaluation criteria in order to encourage transparency and competition - and limit opportunities for work-arounds. Where the legal and regulatory framework is unclear, conflicting or has gaps, staff and bidders may struggle to appropriately follow or administer the procurement rules. Even where there is a strong legal framework, it should be translated into clear and user-friendly guidelines and templates so that MDA procurement staff and potential bidders are able to easily comply.

SHORTAGE OF QUALIFIED PROCUREMENT PERSONNEL. A well-functioning public procurement system must have sufficient procurement staff with knowledge of rules, regulations and tender requirements. Procurement officers must juggle complex procedural and technical requirements, promote competition, minimize bureaucracy, and deliver the goods and services needed with high value for money. On top of these responsibilities, they must resist political pressures from those higher within the bureaucracy and behave in an ethical manner, despite the temptation to accept bribes. In some sectors this is an even greater challenge, such as for public works, as specialized engineering knowledge may be required. These skills are often under high demand from the private sector as well. This comes in the context that these jobs are often viewed as administrative in nature. Procurement systems work more effectively when the government professionalizes procurement by establishing structures for accreditation and a career track for procurement officials.

²⁴ Nowrousian, B. (2019), "[Combating public procurement criminality or simple rules for complex cases](#)", Journal of Financial Crime, Vol. 26 No. 1, pp. 203-210.

MISMANAGEMENT OF CONTRACTS. When MDAs lack appropriate skills, policies, and procedures for contract management this can result in poor oversight, deliverable delays, and delays in payment to vendors. This may also contribute to corruption risks in the implementation of contracts, including through the execution of unjustified contract modifications or work order changes to increase the ceiling price of contracts. It may also result in contract managers signing off on a work product that does not meet quality or quantity standards set in the contract. Developing formal roles and requirements for individuals to serve as contract managers, as well as training and guidelines to support these individuals is a good first step to address these challenges. Additionally, contract management may be integrated within an e-Procurement system to improve file management on contracts and to improve the ability of auditors to identify where actual deliverables or payments may be out of line with the requirements set within the contract.

IV.3 COMMITMENT OF FUNDS

The precise definition of a ‘commitment’ varies according to country and the accounting standards being used. Generally, a commitment means an obligation to make a future payment subject to the fulfillment of certain conditions, for example, when a purchase order is made, or a contract is signed. In the USAID system, commitments in this sense are “obligations.” Both terms imply that goods or services will be delivered and that there will be a bill received later on.

There are two main types of commitments:²⁵

Specific commitments are those that require a single payment or a series of payments over a determinate period of time. These include contracts for goods and services and occur when a formal action is taken by a MDA such as placing an order for supply of goods and services, issuing a local purchase order, or awarding a contract to a supplier.

Continuing commitments are those that require a series of payments or settlement actions over an indeterminate period of time. This does not necessarily involve a specific contract. This kind of commitment includes wages, utilities, scholarships, entitlement payments, and other similar arrangements.

When executing an annual budget, a typical MDA will incur both specific and continuing commitments. For example, a Ministry of Health may place an order for essential medicines for which it will pay a pharmaceutical vendor a one-time payment (specific commitment). These drugs will then be distributed by a district health worker who is paid an annual salary (continuing commitment).

In general, properly managed specific commitments are similar to obligations under the USAID accounting system. That is, funds are obligated, or set aside, when contracts are signed. USAID also requires, under the accounting system, an administrative reservation of funds in anticipation of an obligation. At times in practice, commitments in developing countries are set aside in their entirety once the contract or agreement has been executed. This contrasts with USAID obligations that are made for a set time period of funding.

Different categories of commitments can have different cash requirements for payments. For example, salaries, wages, and allowances are commitments MDAs will generally have to honor based on a

²⁵ Dimitar Radev and Pokar Khemani, [Commitment Controls](#), IMF Technical Notes and Manuals: 2009

contractual agreement between the employer and employee. At any point in time, MOF and MDA staff should know what these costs will be per month/year into the foreseeable future. Capital projects are probably the most difficult to forecast in terms of both commitments and the associated payments. While most project contracts have specific outputs and payment terms, the implementation of such contracts are complex and usually cover more than one year.

Because delays can occur in construction and delivery, updated forecasts on the progress of work and requirement of funds are regularly needed. Other commitment categories include programmatic supply costs; financing costs (debt or loan costs); and other recurrent expenditures (telephone services, office supplies).²⁶

Commitment of resources is a critical stage in the budget process and controlling those commitments is essential for controlling expenditures. To avoid the accumulation of arrears, governments must enact commitment controls. The International Monetary Fund (IMF) notes, “The key objective of commitment control[s] is to manage the initial incurrence of obligations, rather than subsequent cash payments, in order to enforce expenditure ceilings and avoid expenditure arrears.”²⁷ This means, for example, that a commitment control would require a government to check to make sure they will have budgetary resources available to pay a vendor before issuing that vendor a purchase order.

Developing country governments often lack an effective system for tracking committed funds. The inability to set aside or “ring fence” funds for certain obligations from the general pool of funds can result in the same funds being committed for multiple purposes. Key commitment controls include:

- A budget based on realistic revenue and expenditure projections;
- Requirements for the MDA and/or the MOF to verify by signature that funds are available and budgeted for expenditure;
- Designation of specific senior officers (e.g., heads of departments) who can authorize the purchase of goods and services (i.e., initiate a purchase order) based on line items in the submitted/approved budget; and
- A computerized FMIS with a well-designed commitment control system as well as requirements that accurate and timely recording of all commitments and expenditures be made by MDAs with punitive measures for noncompliance (see [Subsection VII.3](#) on Financial Management Information Systems).

Institutional design and operational arrangements for commitment controls vary by country and, as with procurement, can broadly be classified as either centralized or decentralized. A centralized system requires MDAs to make all commitments/purchase orders through the MOF/Treasury. MOF/Treasury then verifies that the funds and budget are available to cover the commitment, as well as verifying receipt of the goods or services before payment is provided. Decentralized commitment controls require MDAs to manage these responsibilities (ideally with senior officers signing off on verifications and payments). Centralized systems allow for greater centralized cost control and expenditure monitoring and may result in longer approval times. Decentralized systems tend to be more flexible and

²⁶ *Ibid*

²⁷ *Ibid*

quicker to respond to the programmatic needs of MDAs, but may result in overspending if each MDA is not able to maintain its own commitment controls.

IV.4 PAYMENT PROCEDURES

After verification of receipt, an invoice can be processed for payment. The institutional structure and operational arrangements for payment procedures vary across countries but can be classified as either centralized or decentralized. With centralized payments, MDAs initiate purchase orders and usually conduct verification in-house, but payment (and sometimes verification confirmation) is made by the MOF or Treasury. In a decentralized payment system, MDAs pay vendors themselves and perform the other functions. It is important to remember that MDAs may include sub-national governments.

Under a centralized system, the MDA's finance department submits a payment request form attaching any required supporting documentation (invoice, proof of delivery, purchase order or packing list) to the payments department in the MOF. Within the MOF, the payment request undergoes the following steps: confirmation that budget funds are available, input to the FMIS (if applicable), approval, preparation of payment instrument (check or electronic fund transfer), approval of the payment instrument, and issuance of payment. Payment is generally made directly to the vendor, although in some countries payment is released to the MDA who in turn pays the vendor. 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. This reflects the importance in all financial practices to minimize the necessity for personal contacts to remove or reduce the potential for collusion. An added benefit of making payments through the MOF is its ability to require vendors to have a tax identification number prior to payment, thus improving revenue collection.

Under a decentralized payment system, a user department will prepare the payment request and documentation that is transmitted to the MDA finance department. If the documentation is correct, it is approved and entered in the accounting system. The bill is then paid by cash, check, or electronic fund transfer from accounts assigned to the MDA much as in a centralized system.

When payments are not made on a timely basis, they become classified as payment arrears. In some cases, when an MDA or the Treasury system does not have effective commitment controls, the MDA may exceed their approved budget lines and may need to seek a budget amendment or special approval to exceed their budget line in order to pay vendors. Payment arrears are particularly detrimental to small and medium businesses that do work with the government as they have less access to working capital.

IV.5 ASSET MANAGEMENT AND INVENTORY

After goods are procured and their receipt is verified, the MDA must record non-expendable property²⁸ in a fixed asset register (FAR). A FAR lists assets owned by an MDA, usually including items such as minor capital equipment (e.g., loaders, backhoes) and consumer durables (e.g., computers, vehicles, office furniture, and laboratory equipment). These items should be labeled with a permanent ID tag and

²⁸ Specific definitions of non-expendable property may vary from country to country. In the U.S. Government it is defined as, "Property which is complete in itself, does not lose its identity or become a component part of another article when put into use; is durable, with an expected service life of two years or more; and which has a unit cost of more than \$500."

that ID number is recorded in the FAR. A FAR is usually maintained by an MDA's asset management or finance department. Entries in the FAR often require approval by two members of the finance department, an accountant and a supervisor. In some countries, the FAR is integrated into the FMIS through an asset management module, which affords greater centralized control.

Proper management of a FAR can help prevent theft and/or the misappropriation of assets. It also can be used to keep track of the value of assets and allows for computation of depreciation. Depreciation is an important component of the annual financial statements when using accrual accounting (see [Section VII](#) on Public Sector Accounting). If an asset is sold at a price higher than the original price minus depreciation, a gain may show on the financial statements. If the asset is sold at a price lower than the original price minus depreciation costs, a loss may show on the financial statements. Annual audits of the financial statements which include assets recorded in the FAR help ensure items currently owned are cataloged, correctly valued, can be located, and are operable. A well-managed FAR also allows the government to make better decisions on when to retire or dispose of certain assets, and when they should be replaced. Databases designed to track and report on the status of assets are of material value in managing the FAR.

Some government MDAs also manage active inventories of goods, such as pharmaceuticals, and therefore may require an automated asset and inventory management system. Such systems help track shipment arrivals, warehouse placement, units sold or distributed, current stock levels, and provide information on when to replenish or replace dated inventory.

A key challenge in asset management is the volume of data to be organized. It is often best to initially develop FAR in the central ministries (e.g., MOF) and subsequently implement them at sub-national levels of the government. Another key challenge involves tracking assets that move or are transported between locations. The greatest challenge is the fact that each fixed asset has its own depreciation schedule and life cycle, vastly increasing the amount of data to be retained. Cataloging and tracking this information will help understand an MDA's financial position and its future obligations for replacing assets.

IV.6 PAYROLL

The payment of salaries and wages to public employees is often the largest expenditure category for any government. Due to the political nature of public sector wages (and wage negotiations), it is usually considered a protected expenditure. Due to its volume and complexity, effective government payroll management is needed to mitigate misappropriation and corruption.

Government payroll is based on a personnel database that lists all staff that are to be paid each month and their position. People in the database should be verifiable against the positions included in an approved establishment list—the approved list of budgeted positions. In many countries, these data sets are not directly linked to payroll systems and are often not updated systematically to reflect new hires, terminations, retirements, and transfers. A consequence of such fragmentation of the databases is often the creation and perpetuation of so-called “ghost employees” who have been terminated, left the institution, or are perpetually absent; yet apparently continue to receive payment through the payroll system. Another potential consequence is multiple entries of a single civil servant, allowing that person to receive multiple payments.

A driver of fragmentation in the payroll system is poor coordination between the entity responsible for paying salaries based on the personnel database (MOF, Ministry of Labor, Ministry of Public Administration, etc.) and individual MDAs who make personnel decisions (i.e., staff hiring and termination). When MDAs do not regularly update their staff lists/databases, wherever these are housed, then the paying organization may continue to make erroneous payments.

A regular and comprehensive government employee census is needed to increase reliability of the payroll system. In some countries MDAs hold an annual staff census, and only employees who are physically present continue to receive paychecks. Some countries require staff to physically present themselves each pay period to receive payment, while others have introduced biometric controls such as fingerprint verification before payment is made. Other payroll challenges include:

- **Time and Absence Control:** This area includes the procedures for submitting and certifying timesheets and authorizing overtime. Controls should be in place to discourage absenteeism and falsification of timesheets. Requiring timesheets and the working of overtime to be authorized by a senior officer can mitigate those risks. Biometric access controls can also be used to record employee time and attendance, while automated systems can improve record retention and verification.
- **Payroll Preparation:** Controls should be in place to mitigate payroll errors, such as requiring that the payroll is checked by two senior officers and that segregation of duties are in place, so that final approval of payment is provided by a person independent of those who prepare the payroll.
- **Payment Controls:** Controls should be in place to ensure employees are properly identified before payment, such as requiring signatures (or verifiable identification) prior to receiving paychecks.

Internal controls and audits are the cornerstone of any payroll management system. Authority to change records and the payroll should be restricted and should provide an audit trail. The combination of these controls aim to mitigate against the risk of ghost workers or absenteeism. In some cases, it may be necessary to conduct a full census of ghost workers when there is a high volume of ghost workers or limited capacity to implement systematic and regular controls.

In some countries, payroll is integrated into the FMIS through a payroll module. This allows for better tracking of salary and allowance expenditures. As funds are released through the FMIS, budget aggregates are updated and reflect new balances. The use of FMIS for payroll also eases the use of electronic fund transfers rather than cash payments. This practice is recommended because it provides a somewhat less expensive and more verifiable system.

IV.7 COMMON CHALLENGES IN BUDGET EXECUTION

This section highlights the various challenges governments face when implementing the steps involved in the budget execution process. These include:

- Organizational and institutional challenges
- Corruption, waste, fraud, and abuse challenges
- Administrative process and policy challenges

More details on each of these categories of challenges is provided below.

IV.7.1 ORGANIZATIONAL AND INSTITUTIONAL CHALLENGES

One of the key challenges facing developing countries' PFM systems is establishing appropriate institutional arrangements to enable efficient and effective budget execution. Most importantly, many countries struggle with determining how responsibilities should be shared between the MOF and MDAs (centralized vs. decentralized systems). The MOF has a crucial role in budget execution and its role and level of control can be quite diverse depending on the country context. In more centralized systems, power is concentrated at the MOF (and central procurement unit) who manage procurements, commitments, and payments on behalf of MDAs.

One of the key advantages of a centralized system is greater cost control; however this comes at the expense of less flexibility and longer approval times for MDAs. Ideally, the MOF should be responsible for tax and expenditure policies and leave decision-making to MDAs. How governments arrange their systems on the continuum from centralized to decentralized arrangements should depend largely on the level of maturity of their PFM systems. From a PFM perspective, it may be appropriate for less-developed country systems to be more centralized and for systems to become more decentralized as they develop. However, consideration of political economy, conflict mitigation, diplomatic, and governance issues may necessitate enhanced levels of devolution, deconcentration, or decentralization on an accelerated timetable.

IV.7.2 CORRUPTION, WASTE, FRAUD, AND ABUSE CHALLENGES

Anti-corruption monitoring and whistle-blowing mechanisms are important to safeguard the integrity of government financial operations, and challenges can arise when anti-corruption efforts are weak or not coordinated enough to ensure that complaints are heard and handled by the proper authorities. Challenges to anti-corruption efforts can occur when there are too many entities to report complaints to, resulting in complaints that are lost or never reach the intended authorities, or if anti-corruption efforts are not seen as confidential or autonomous. If anti-corruption agencies are not respected or deemed effective, there may be a tendency in some countries to be unwilling to share information across government agencies so internally MDAs may add internal controls of their own to handle corruption whose effectiveness may vary.

IV.7.3 ADMINISTRATIVE PROCESS AND POLICY CHALLENGES

If methods like those referenced in the Guide are put in place, so that additional procedures and controls are added, the traditional budget execution process can become so cumbersome that MDAs start consistently bypassing traditional expenditure channels to speed up processes. Many MOFs recognize this as a challenge and tolerate bypassing processes by using 'accelerated or exceptional procedures' for politically sensitive expenditures. A natural tendency is then for accelerated or exceptional procedures to be used on a routine basis. That nullifies the effectiveness of the normal management systems and eliminates any necessity for occasional usage.

IV.8 IMPLEMENTING REFORM

Budget execution consists of five essential phases: authorization and apportionment, commitments, acquisition and verification, payments, and reporting. Effective budget execution assumes the establishment of controls so that funds are not misused and ensures that the budget is implemented as legally authorized to prevent abuse and corruption. Although any PFM reform package must be tailored

to the specific needs of the given country, there are several key international leading practices which are necessary for a properly functioning PFM system. The four key good governance practices for budget execution, according to the IMF²⁹ are:

- Every action is transparent;
- Every participant is held accountable;
- Every action is properly documented and reported; and
- Every action is subject to an independent, professional, and unbiased audit and review

A sound legal and political environment is necessary to support budget execution and accountability of activities. Strong legislation and well-documented policies can help remedy the challenges mentioned above, however, an equally strong tone-at-the-top and commitment by top management is necessary to enforce the adoption of sound and executed internal controls, prevent the proliferation of using exceptional procedures, register commitments on a timely basis, prevent arrears and perform routine bank reconciliations. The accounting system should be comprehensive and cover all MDAs. Finally, regulations should allow MDAs to carry over committed funds to the next budget year when justified.

The MOF must have authority and the will to rigorously ensure compliance with all legislation and regulations, and be transparent in disclosing information to all interested parties and stakeholders, including updates to laws or reporting practices. It should not continue to allow the usage of exceptional procedures to bypass traditional budget execution procedures and to unnecessarily expedite transactions. Instead, standard controls should be enforced and simplified if necessary. The budget execution process should be comprehensive to capture all budgetary funds so that no extra-budgetary spending can be authorized.

Despite the often extraordinary challenges to establishing other effective oversight bodies, they greatly contribute to a functioning PFM system. Their roles and communications between them should be strengthened. This includes anti-corruption entities, any public procurement regulatory body (that disseminates standard procurement related documents and trainings for both bidders and government agencies involved in procurement), professional accountancy organizations (that support implementation of international accounting/auditing standards and provide enforcement of professional behavior of their individual members), and both internal and external audit bodies that are autonomous and well-established to follow-up on recommendations. All of these entities will strengthen the public's ability to file complaints and to understand legislation and the budget execution process. A strong internal and external audit function that is well-respected will allow for continuous process and internal controls improvements. All of these functions, as well as those within the MOF, should have appropriate segregation of duties and oversight, to allow for checks and balances throughout the budget execution process.

²⁹ [Guidelines for Public Expenditure Management](#), International Monetary Fund: 1999.

V. REVENUES

“Top Three” Reference Materials: Budget Planning and Preparation

1. [Tax Policy Reform Primer \(USAID, 2022\)](#)
2. [Tax Administration Reform Primer \(USAID, 2012\)](#).
3. [Innovations in Tax Compliance: Building Trust, Navigating Politics, and Tailoring Reform \(World Bank, 2022\)](#).

While this Guide primarily focuses on issues related to the expenditure side of the budget (the uses of public funds), it is nevertheless important to have a foundational understanding of government revenues (the sources of public funds) and their implications for public financial management and accountability.

This chapter focuses on the theory and practice of revenue policy and its administration, including the institutional arrangements for designing and implementing taxes and the common challenges countries face in mobilizing revenues to fund the budget.

V.1 WHY REVENUES MATTER FOR PFM

Government revenues are what fund government operations and ultimately the provision of public services and social benefits. There are many ways governments can generate revenues and governments choose how much, from whom, when, and how to collect revenues. In doing so, governments aim to collect a stable and adequate stream of revenues, ideally without stifling economic growth or unduly burdening any particular segment of the economy. Striking this balance requires attention to both the design of tax and non-tax revenue instruments, and the manner in which they are administered and collected from businesses and households.

In the context of the annual budget cycle, revenue forecasting is an important input into budget planning (see [Chapter III](#)) and is central to establishing the government’s “resource envelope” for the upcoming budget. Accurate revenue projections help governments prepare realistic budgets – ones that reflect expected future revenues. Moreover, knowing how much revenue should be coming into the government’s treasury at any point in time helps governments execute budgets, allowing them to match the timing of cash outflows and borrowing with cash inflows. Hence, within the PFM universe, revenues and expenditures are inextricably linked.

V.2 REVENUE POLICY

Revenue policy refers to the choices a national or subnational government makes as to what revenue instruments to levy, for what purposes, in what amounts, and on whom. It forms the basis for the laws and regulations that provide the rules of the game – especially as it relates to taxation. Tax policy in

particular addresses important questions, such as: Who should pay? At what rates? And on what base (e.g., income, consumption, property value)?

Answers to these questions determine the fairness, efficiency, and simplicity of a tax regime and its ability to generate adequate revenues for the budget. When tax policies are well-designed, translated into good legislation, and well implemented, we're likely to see strong revenues, low compliance and administrative costs, fewer economic distortions and impacts on growth. When done poorly, we see the opposite: revenue shortfalls; chronic fiscal deficits; high compliance costs; and losses in economic welfare and growth.

Of course, there is no such thing as a "best" tax for everybody. Different people want different things. But when approaching tax policy and design options, we can make better informed choices when those conversations are based on common criteria, or principles.

Specifically, in designing tax and broader revenue policy, governments should consider the following principles:

- Revenues should be **sufficient**. That is, they should reflect the planned spending by the government;
- Revenue rules should be **simple** and **transparent** so that they impose minimal costs on both payers and the government;
- Revenues should be **stable**, generating consistent and predictable levels of revenue for the government, with rules that provide sufficient certainty to payers;
- Revenue burdens should be **equitable**, with the understanding that actual burdens may differ from those suggested by law; and
- Revenue instruments should be economically **neutral** or **efficient**, meaning that they change people's behavior as little as possible.

These are common criteria advanced by practitioners for good policy design. They aim to provide the government with an adequate, stable funding stream that supports the government's long-term fiscal sustainability, minimizes the economic burden of the revenue system, and inspires trust in government as a steward of public resources.

In many instances, these tax policy principles can complement and reinforce each other. For instance, taxes that are simple and easy to administer are also often neutral to economic decision-making: they have limited impact on the behavior or decisions of firms and individuals.

But these principles can also often work at cross purposes. For example, engineering a tax to make it more equitable – even if for good reasons – has a way of reducing a tax's simplicity. For instance, using exemptions or similar tax reliefs to help the poor or disadvantaged groups can make tax laws much more difficult to administer. It can also make richer taxpayers go to great lengths to "game" the system in an effort to reduce their tax bill, thereby undermining the equity goals that the exemption may have been introduced to achieve.

Indeed, it is quite often the case that taxes – which in most jurisdictions represent the primary source of revenue for the central governments of most countries – do not perform well against these time-honored policy principles. As the following comparison illustrates, fees respect these principles far better than do taxes, and yet fees generally account for only a small percentage of many governments'

overall revenue effort. The comparison, thus, highlights the importance and limitations of government revenue choices.

V.2.1 TAXES

Taxes are defined by the [OECD](#) as compulsory, unrequited payments to the general government sector. The fact that taxes are compulsory and not proportional to the benefits received by taxpayers has far-reaching implications. For example, since the benefits of taxes are not easy to discern, people may seek to alter their decisions (e.g., decisions about whether and how much to invest, produce, work or employ people) simply to avoid paying them.

They may also devote considerable effort to transforming the form or substance of their activities to minimize their tax bill – depriving the government and society of critically needed resources.

V.2.2 FEES

Unlike taxes, fees operate much like a market transaction. A government may charge a fee for a specific service from the person seeking it. Fees are not compulsory and, in principle, there is a direct relationship between the benefit received and the payment. This payment-benefit linkage may make people more willing to pay a fee than a tax, although there may still be resistance if people do not perceive the benefits to be commensurate with the cost they pay for the service.

Fees may be charged by any level of government. Because you cannot limit access to many of the goods and services the central government provides (e.g., national defense) to only those who pay, central governments rely more on taxes than on fees. By contrast, sub-national governments and especially local governments rely more heavily on fees as they are “closer” to their constituents and therefore can more easily determine the demand for and beneficiaries of services.

In setting fee levels, a guiding principle is that the charge cannot be greater than the cost incurred in providing the service. For equity reasons, governments may sometimes opt to set fee levels lower than the cost of providing the service; for instance, in an effort to make water or electricity provision affordable to poorer households. Beyond that, fee setting is largely a policy matter focused on who benefits from—and who pays for—the service.

Often, a central government agency (e.g., the Ministry of Finance) will issue cost specific guidelines to ministries, departments, and agencies (MDAs) to guide fee setting for the services they provide. Illustrative guidelines include: 1) setting fees at a level that fully recovers the cost to the government of providing the service; 2) varying the fee only based on changes to cost structures; and 3) reporting any such changes.

V.2.3 OTHER REVENUE INSTRUMENTS

Governments have choices in deciding the means by which to collect revenues. Licenses, for example, may be similar to fees, but have the added purpose of restricting the supply of a particular good or service (e.g., permits to fish in certain waters). Royalties are payments for the use of publicly-owned assets, and are often levied for the extraction of mineral resources. Governments may also collect rents, dividends, payments for the sale of goods or services, fines and penalties, and so on. Each of these may

perform differently against the aforementioned objectives.³⁰ For example, a driver's license fee might not be simple and transparent if there are too many classifications of types of licenses that are unclear and arbitrarily applied. Alternatively, fines or penalties might not be equitable if different individuals are charged different levels of fines or penalties under similar circumstances under the same policy framework.

V.3 REVENUE ADMINISTRATION

The revenue administration agency or department is the division of the central government tasked with collecting revenues. The responsibility of any revenue 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.

Many governments actually have more than one revenue administration agency. It is preferable that the collection of all core taxes (with the exception of taxes on international trade, which are collected by Customs³¹) be the responsibility of a single organization: the tax administration. This allows the agency to better manage compliance because it has an integrated perspective of all the accounts and activities of a single taxpayer. Often, the tax administration department is a part of the MOF or a Ministry of Revenue, and sometimes it is set up as an independent or semi-autonomous revenue authority, separate from any formal ministry structure. However it is constituted, the tax administration usually collects the bulk of the government's revenues.

Historically, tax administrators were "tax collectors" enforcing compliance by working to ensure that each taxpayer paid the amount they were obliged to pay. Today, tax administrations recognize that, with limited resources, it is not possible to effectively enforce compliance for all taxpayers. Instead, they focus on three key objectives: 1) facilitating voluntary compliance;³² 2) monitoring to detect those who do not comply voluntarily; and 3) enforcing compliance for those who do not comply voluntarily. To do so, modern tax administrations typically perform the following functions:³³

- **Maintain a register of taxpayers** — collect, record, and maintain identifying and other taxpayer information to understand taxpayers and to plan for staffing, facilities, systems, and processes, accordingly;
- **Provide services, support, and education to taxpayers** — provide, upon request or proactively, the information, forms, publications, and education that helps taxpayers comply with their tax obligations and therefore reduce the need for extensive enforcement, given limited resources;
- **Process tax declaration filings and tax payments** — collect revenue and, at the same time, information to monitor compliance;

³⁰ Revenues should be (1) sufficient; (2) simple and transparent; (3) stable, generating consistent and predictable levels of revenue; (4) equitable; (5) economically neutral or efficient.

³¹ Beyond collecting "customs duties" and other international trade taxes, Customs may also be concerned with policy concerns such as national security and public health and safety.

³² Some practitioners contend that compliance is never truly voluntary as no taxpayer pays taxes voluntarily. No matter the term, some taxpayers will pay the correct amount at the correct time without government intervention. Such compliance can be called "voluntary."

³³ 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.

- **Audit taxpayers** — monitor compliance, by selecting declarations that have been filed to audit/verify information reported and by making additional assessments that may require collection action;³⁴
- **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 with the use of enforcement measures, such as liens, levies, and seizure and sale of taxpayers' property; and
- **Investigate fraud** — pursue the most egregious attempts to deprive the government of its revenue and thereby deter future non-compliance and institute further trust in the equity of the tax system.

Several other functions provide significant support to enable the tax administration to perform its duties:

- **Information technology (IT)** supports all core functions above. IT eases the collection, processing, and maintenance of information during registration, filing, and payment for use during audit and collections; enables the management of risk during audits and collections; facilitates filing and payment by taxpayers, and facilitates the distribution of performance information throughout the tax administration;
- **Internal audit** ensures that selected regulations, operations, and administrative procedures and programs conform to specified standards and are being implemented efficiently and effectively, including the analysis and verification of accounts, financial transactions, and reports;
- **Integrity investigations** — investigations about the conduct, such as alleged or suspected corruption, of any member of the tax administration's staff; and
- **Legal services** — services provided to technical and management personnel by a cadre of attorneys of the tax administration, including legal interpretation of tax laws and regulations, and representation of the tax administration in all judicial forums, including tax appeals.

Exhibit 3 I: Guatemala's BancaSAT eTax Services

In August 2001, Guatemala initiated BancaSAT, an online tax filing and payment system supported by the World Bank and managed by the Guatemalan tax agency, Superintendencia de Administración Tributaria (SAT). In December 2002, BancaSAT accounted for 84 percent of the tax revenues of the country. The online system has significantly reduced SAT's transaction costs and improved service delivery. The system is considered largely successful and highly regarded by users, in particular because of its simplicity.

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 less formal

³⁴ Customs administrations undertake much more of a "real time" approach to monitoring compliance — auditing transactions as they happen (upon transiting a port of entry), rather than after the fact as a tax administration does.

businesses without proper books and records. Second, monitoring compliance is a constant challenge given the diverse taxpayer population, an increasingly globalized world, and the limited resources of tax administrations in many countries.

Many tax administrations address these challenges through risk-based approaches to compliance monitoring and enforcement. “Risk” is any event or circumstance that may make it difficult for the tax administration to secure compliance. The risks may be internal (derived from the way the tax administration operates), but most often they are external (derived from the behavior of taxpayers). In this respect, modern tax administrations recognize that there are varying degrees of compliance risk associated with different groups of taxpayers, and they recognize the need to vary their compliance strategies, services, and enforcement tactics accordingly.

In all cases, tax administrations are most effective when they establish productive relationships with other institutions, such as the judiciary, private-sector groups, financial institutions, domestic and international associations of accountants and attorneys, and others. For example, a tax administration may establish a working relationship with the government agency that maintains the country’s business registry to validate the information on businesses in its taxpayer register and to discover businesses that may exist in the business registry but failed to register for tax purposes. Finally, tax administrations all over the world are faced with powerful opportunities and challenges to use modern information technology in their operations.

V.4 INSTITUTIONAL ARRANGEMENTS

Governments that understand their revenues can prepare budgets that reflect revenue expectations and are therefore more realistic. These governments can also spend (or anticipate short-term borrowing) in a manner that reflects the timing of revenues and is responsive to revenue changes, whether economic or legislative. To support the budget cycle in this way, the government needs expertise to:

- Forecast revenues to develop the fiscal outlook for budget planning;
- Analyze and propose changes in legislation that change the fiscal outlook for budget planning; and
- Monitor and report during budget execution on whether revenues and expenditures are aligned to the budget.

Such expertise may reside in MOF, the revenue authority, or both. The parliament may also have its own revenue forecasting experts in order to provide an independent check on the executive. These experts should also:

- Support the MOF or the head of tax administration with daily feedback;
- Undertake research on fiscal issues;
- Propose changes to fiscal laws to the MOF or the head of the tax administration; and
- Communicate with similar experts in other government institutions, academia, the private sector, or civil society organizations to enhance effectiveness throughout the PFM system.

While this expertise is needed in any executive or legislative institution that has a central role in financial planning or operations, in many countries, such expertise is in short supply. In these countries, government institutions may focus on accounting for the money received by the government (i.e., operations), without analyzing policy. Alternatively, even where such institutions have significant policy roles, their policy focused divisions may not be well-separated from the divisions focused on operations.

Modern fiscal institutions, on the other hand, include separate policy divisions that, rather than performing day-to-day operations, focus on providing policy advice to senior government officials. Most modern ministries of finance, for example, include a separate policy division, with units responsible for macro-economic, legal, and fiscal analysis (i.e., analysis of budget, revenue, and debt). Separating the policy division from operations ensures that the Minister of Finance receives the day-to-day support that allows him or her to act as the country's chief financial officer.

A modern tax administration similarly often has a unit responsible for tax policy. This unit may be placed in a division responsible for all policy, including operational policy. Separating (as well as centralizing) operational policy from operations is, in fact, good management. Placing the tax policy unit closer to the operational policy division, again, ensures the needed level of cooperation and eases IT and legal support.

Wherever revenue policy staff is placed, several staffing and organizational considerations are similar. A mix of appointee and permanent staff is preferred. Appointees will tend to carry the government's message more consistently, while permanent staff will ensure continuity of expertise. Specialization is also needed. Revenue instruments - taxes, fees, royalties - differ and intimate familiarity with each type helps analysis. Redundancy (several staff with similar specializations) also ensures continuity. Education is preferred (e.g., degrees in economics, accounting, or law), but experience is a must, as the specific knowledge required is rarely taught in academia.

V.5 COMMON CHALLENGES IN REVENUE POLICY AND ADMINISTRATION

Common challenges in revenue policy include:³⁵

- Revenue policy decision-making is highly centralized and stakeholders outside the finance ministry have a difficult time trying to meaningfully challenge the executive. Moreover, the data needed to produce meaningful analysis of revenue policy may not be available outside of the MOF, making it difficult for other actors to provide alternative analysis on the potential impacts of tax policies.
- Those, who are often liable for the largest amounts of revenue, are also those that are wealthiest and most politically connected, and may be able to lobby for exemptions or changes to tax policy to their narrow benefit.

Challenges in the administration of revenue include:

- Some economic sectors and segments of the population are difficult to tax, for example the informal sector.
- Those who have the highest burdens also tend to have the better means to pursue complex tax avoidance strategies.
- Historical approaches towards tax collection were based on individual tax official-to-taxpayer relationships. Contemporary tax administration must recognize that efforts to tax a broad base combined with limited tax administration resources requires a very different approach, where limited resources are focused where risks to revenues are higher.

³⁵ Based on USAID (2022). [Tax Policy Reform Primer](#).

These challenges are discussed in more detail below.

V.5.1 HIGHLY CENTRALIZED POLICY-MAKING

Tax policy-making is often highly centralized with limited roles for external stakeholders. The main actors include the Treasury and MOF, the revenue authority or administration, and the legislative branch of the government. One barrier to involving others and the general public is the confidentiality surrounding data on specific taxpayers. Another is the secrecy of taxation agreements in selected sectors (mining). Still another is the need for accounting or industry specific knowledge. The necessity to present major tax reform to the legislature is an opportunity for scrutiny and debate. At this stage, the media and civil society can play a role by publicizing the issues and encouraging debate. Even then, however, a technically competent and motivated tax policy unit - a unit of the ministry of finance, revenue authority, or other - is essential to provide analytical support.

V.5.2 THE POLITICAL ECONOMY OF REVENUE REFORM

Changes to revenue policy may result in the shifting of tax burdens from one set of taxpayers to another. In other words, there are “winners” and “losers” of reform. As a result, well-designed tax reforms are often politically challenging. Powerful actors have an incentive to use their resources and influence to carve out special tax preferences that tend to make the tax system less efficient, less equitable, and less straightforward. Consequently, sound tax policy reform, including changes to the legal and regulatory structures of the tax system, requires determined leaders. Such leaders need to have a vision to improve the tax system and an ability to reach consensus across the executive and legislative branches of government.

V.5.3 DIFFICULT TO TAX SECTORS

Examples of sectors that are difficult to tax include: 1) agriculture, where there may be many small, subsistence farmers who do not have formal sales and who do not keep books and records for tax purposes; 2) finance, where it may be difficult to separate interests and fees paid for for the time value of money and the interests and fees paid for financial services; and 3) mining, where governments must simultaneously negotiate multiple revenue issues (taxes on profits, royalties for the use of assets, dividends for ownership stakes) with mining companies, which have significant expertise advantage. Difficult to tax sectors also include those that often operate solely in cash (professionals, taxis) as well as those that are too small and often too mobile to be “caught” in the formal tax net. Approaches to addressing difficult-to-tax sectors and informality are multi-pronged. They may include: 1) tax law simplification and presumptive taxation (tax policy issues) or tax form simplification to ease compliance; 2) sector specific taxes on easier to find transactions or other bases (e.g., stamp duties on financial transactions); 3) using third party data to find informality (e.g., utility registrations); 4) adjustments to tax administration processes (e.g., taking a look at those that paid taxes last year, but did not this year); 5) “beating the streets” to look for informal participants in the economy; and so on.

V.5.4 TAX AVOIDANCE

Tax avoidance should not be confused with tax evasion. For this discussion, tax avoidance means finding legal ways to reduce one’s tax liability. Tax evasion is the illegal underpayment or nonpayment of tax. Tax avoidance strategies can be complex. A multinational company with subsidiaries in several countries can determine internal pricing structures in such a way that, when subsidiaries sell goods to each other,

most profits are registered in the country with the lowest tax rate (a “transfer pricing strategy”). Besides reducing the revenue available to the government, tax avoidance strategies create equity issues, since such strategies are often available only to larger taxpayers. Addressing tax avoidance may require significant expertise and information. Counteracting transfer pricing strategies, for example, may require access to information on similar transactions in the industry so that the tax authority can make an informed decision whether there is, in fact, tax avoidance.

V.5.5 RISK BASED APPROACHES TO ADMINISTERING REVENUES

Modern tax administrations recognize that most taxpayers aim to comply with their tax obligations. Such tax administrations then focus their efforts and resources on those taxpayers that pose the greatest risk to revenues. This is, however, not an easy proposition. Some tax administrations, being used to handling few taxpayers with great care, are unwilling to handle many taxpayers with a less than heavy hand. Some tax administrations worry that the law requires them to ensure the correct amount of tax and are therefore unwilling to “trust” taxpayers. Others worry that focused efforts create perceptions of differential treatment.

V.6 REFORMING REVENUES

The following are important considerations for revenue policy and revenue administration reform.

V.6.1 THE POLICY REFORM WINDOW³⁶

Revenue policy reform is a continual process. While there are many examples of successful, large changes to policies and legislation in various countries, changes are often smaller, less visible, and more frequent.

Revenue policy reforms may either improve or worsen the simplicity, transparency, stability, equity and sufficiency of the revenue system. Taxes, specifically, are visible and impactful. Among taxpayers, there is strong interest to lobby for lower tax burdens. In particular, in the years after successful major tax policy reform, governments are prone to passing changes that slowly erode revenues over time or create inequities or inefficiencies. Even when governments intend to pursue improvements, they may not do so due to lack of capacity or because government priorities change. There is almost always a need for adjustment and calibration. Although the opportunity to pass and implement tax reform is not always present, engaging governments and other policy stakeholders to prepare for reform should always be considered. This is in part because it takes time to understand priorities, develop and analyze options, and garner political support.

There are political and economic circumstances that may help the passing and implementation of tax policy reform. Opportunities, for example, arise after changes in leadership or at times of economic or fiscal crises. Governments and donors must be prepared to take advantage of such opportunities.

³⁶ Based on [Tax Policy Reform Primer](#), USAID, 2022.

V.6.2 POLICY REFORM OBJECTIVES

Generating more revenues is only one of the objectives of revenue policy reform. Other objectives could include diversifying revenues for more stable revenue collections, a more equitable tax burden, or a better enabling environment for businesses. Often, revenue reforms pursue several objectives at the same time. Since many stakeholders have significant interests in the results of revenue policy reform and since stakeholder goals often differ, reform champions should aim to define reform objectives and obtain buy-in early.

V.6.3 ANALYTICAL SUPPORT AND COMMUNICATIONS

Revenue policy reform should be supported by expertise in economics, accounting, tax administration, and specific industries. In many countries, such expertise resides in the specialized tax policy or similar units that reside in the ministry of finance, tax authority, or legislature. A technically competent and motivated tax policy unit is essential to provide analytical support to and guide the process of tax reform. Often, the tax policy unit will also guide the design of revenue policy.

When a large tax reform proposal is on the table, it is the job of the tax policy unit to explain complex tax concepts to senior government officials, who may not be knowledgeable on the subject. It is also the job of the tax policy unit to provide the government with the material that can be communicated to external stakeholders and the general public to explain and often justify reform. The communications efforts that are required to secure buy-in for significant reform, however, are often larger than what the tax policy unit can handle. During such times, the government should look for dedicated communication expertise that can deliver consistent messages to multiple stakeholders with multiple communication channels over a long period of time.

V.6.4 ADMINISTRATION REFORM OBJECTIVES³⁷

A general objective of a revenue administration reform is to establish an effective and efficient administration that will ensure taxpayer compliance through the delivery of modern and reliable taxpayer services and targeted audit and enforcement activities. The goal is an end-state with fully automated business processes, risk-based compliance programs, and skilled and professional staff, all contributing to an environment characterized by fairness, honesty, and transparency. Many benefits are expected to accrue with the reform and modernization of tax administration, including:

- Enhanced revenue performance;
- More consistency and fairness for business and individuals;
- Reduced administrative and compliance costs – both for the government and for the taxpayers;
- Reduction in tax evasion and fraud;
- Increase in registered taxpayers;
- Improved management of tax arrears;
- Enhanced service to taxpayers; and,

³⁷ Based on Terry Murdoch, Ron McMorran, Anton Kamenov, and Johan van der Walt, [Tax Administration Reform: A Primer](#), USAID, 2012.

- Greater transparency and integrity within the administration.

Achieving these benefits is not always straightforward. The following section describes the conditions for what may be a significant, sustained, multipronged reform, including the need for a focused, piece-wise approach.

V.6.5 CONDITIONS FOR SUCCESSFUL REVENUE ADMINISTRATION REFORM

Managing the change associated with reform is a challenging task. During the transitional period, operations must continue, services to taxpayers must not decline, revenues must be protected, and enforcement obligations must be met. Success will be contingent on many factors, including political commitment and strong leadership. The following describes some of the conditions for successful reform in tax administration, based on worldwide experience:

- Sustained political commitment and support;
- Competent, committed, and dynamic leadership;
- A clear vision for the organization's future state, with well-articulated strategies and comprehensive plans to realize the vision;
- Change initiatives set out in manageable "chunks," rather than a "big bang" approach;
- Legislation that supports the reform proposals or is modified to do so;
- Adequate resources and funding;
- High level of accountability, founded on sound corporate governance and management structures and processes;
- Good project management and budgeting processes, with appropriate external oversight and supervision;
- Staff and external stakeholders' involvement, and strong communications;
- Cohesion within the administration, between those developing and implementing reform and those performing current operations;
- Steps to ensure ownership of the reform process throughout the organization; and
- Appropriate use of technical assistance.

Development partners working with tax administrations should engage with counterparts to regularly assess the extent to which these conditions are in place and develop their reform and system strengthening places in response to the prevailing context.

VI. TREASURY OPERATIONS & CASH MANAGEMENT

“Top Three” Reference Materials: Treasury Operations & Cash Management

1. [Cash Management and Commitment Control - Principles and Problems in Practice. \(The World Bank 2021\)](#)
2. [How to Build Cash Management Capacity in Fragile States and Low-Income Developing Countries. \(IMF 2022\)](#)
3. [Public Debt: A Primer for Development Practitioners. \(USAID 2022\)](#)

To implement government programs as planned in the budget documentation, the government must have cash available to pay vendors for goods and services, wages to employees, and social benefits to the public. Effective cash management entails having a strategy and processes to meet the government’s financial obligations. This means setting up efficient collections and disbursement systems, producing periodic cash flow forecasts, establishing short-term debt vehicles to fill daily deficits and short-term investment vehicles to avoid carrying idle cash balances. In other words, cash management is about having the right money in the right place at the right time to meet government obligations in the most cost-effective way.

This chapter outlines the main objectives of a cash management system, describes what a Treasury Single Account is and how it helps to improve cash management, and outlines requirements for effective debt management. The chapter ends with a discussion of common challenges in treasury operations and cash management and potential avenues for reforms in this area.

VI.1 OBJECTIVES OF CASH MANAGEMENT

The primary objective of cash management is to maintain liquidity so that the government is always in a position to meet its obligations when due. Cash management is generally the responsibility of a cash management unit or treasury department housed within the MOF. This requires effective cash flow forecasting; or managing the timing of revenues (cash inflows) so as to be able to meet obligations for expenditures (cash outflows). One of the key challenges faced by the cash management unit is designing, developing, and implementing collection systems to collect funds through various government streams. Key cash management objectives are discussed below:

- **Managing liquidity:** Government cash management deals with both collections and disbursement. It is the responsibility of the cash management unit to make sure that the government is liquid at any point in time. This means that it has to be able to make good on its commitments when payments are due by having sufficient funds in its accounts.

- **Cash flow forecasting** is the most critical function of liquidity management. Governments, especially those in developing countries often have little capacity to produce regular cash flow projections. This can lead governments to incur significant, unnecessary borrowing costs.
- **Reducing waste and borrowing costs** are key functions of a cash management unit. This includes reducing waste by managing idle cash balances through the use of cash flow forecasting and investing excess cash in short-term investments or paying off debt and reducing borrowing costs to the government by using appropriate banking services and/or limiting the need for short-term borrowing.
- **Manage bank accounts:** Managing bank accounts is a major task for government cash management units. Governments that do not use a single treasury account system (discussed below) tend to have thousands of accounts throughout the banking system. Often these accounts hold significant cash balances and are outside the control structure of the treasury. Managing these accounts includes performing assurance functions on the bank documents, authorized signers and ensuring account reconciliation to the general ledger.
- **Bank relationship management:** The cash management unit is also responsible for determining which commercial banks the government can do business with, as well as maintaining strong relationships with financial institutions to facilitate smooth collections and disbursement systems. It should have periodic meetings with the banks to get an update of markets and new services, as well as to perform periodic reviews of bank pricing.
- **Short-term debt and investment management** are also responsibilities of the cash management unit. This includes investing the government's cash in the event of a surplus and/or managing debt vehicles (e.g., loans, bonds) in the event of a deficit. Debt can also be incurred to fund capital projects and in some systems is not immediately reported as contributing to a deficit.
- **Implementing cash management systems:** There are several cash management systems (e.g. FMIS) that a government can employ depending on the financial sector's state of technology, regulations affecting cash management and the human and institutional capacity of the government.
- **Risk management:** The premier objective of a cash management unit is to safeguard the cash and investment assets of the government. It is thus managing government fiscal risks. Three primary types of these risks include: financial risk including risks posed by financial institutions, market risk such as interest rate and exchange rate risks, and operational risk that includes fraud, misuse of funds and liquidity.
- **Internal controls:** It is important for the cash management unit to maintain and enforce internal control policies and procedures specifically around account reconciliations, signature authorizations, and segregation of duties.

In many countries, the MOF will require MDAs to develop monthly (or quarterly) spending plans at the beginning of the fiscal year, which lay out their expected expenditures by month. Ideally, this plan dictates the amount of funds (apportionment) that will be transferred each month to the MDAs to cover their commitments. These spending plans should be adjusted regularly to reflect the most up to date revenue and expenditure information. If the treasury does not collect revenue that was originally forecasted, spending plans may need to be adjusted downward. If expenditures increased (e.g., construction delays), spending plans may need to be adjusted upward to seek additional funds.

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 occurs when the MOF provides MDAs with decreased apportionments than those in the approved budget or spending plans. Cash rationing can be

responsible for significant dislocations in spending priorities relative to those that were agreed to in the approved budget. Cash rationing can also result in the approved budget becoming an unreliable predictor of resource allocations to MDAs and the actual expenditures by MDAs bearing little resemblance to the budget approved by the legislature.³⁸

Exhibit 32: Key Characteristics of Good Practice in Government Cash Management

1. Centralization of government cash balances and establishment of a treasury single account (TSA)
2. Modern systems: an adequate transaction processing and accounting framework (processing government transactions with few handling steps, reliance on electronic transactions); modern banking, payment, and settlement systems
3. Ability to make accurate projections of short-term cash inflows and outflows
4. Strong institutional interaction, covering in particular:
 - Information sharing between the cash managers, revenue-collecting agencies and spending ministries (and any relevant ministry branch offices)
 - Strong coordination of cash and debt management
 - Formal agreements between the MOF and the central bank on information flows and respective responsibilities
5. Use of short-term instruments (treasury bills, term deposits, etc.) to help manage balances and timing mismatches.

Source: Mike Williams, Government Cash Management: Its Interaction with Other Financial Policies, International Monetary Fund Technical Notes and Manuals, 2010.

VI.2 TREASURY SINGLE ACCOUNT

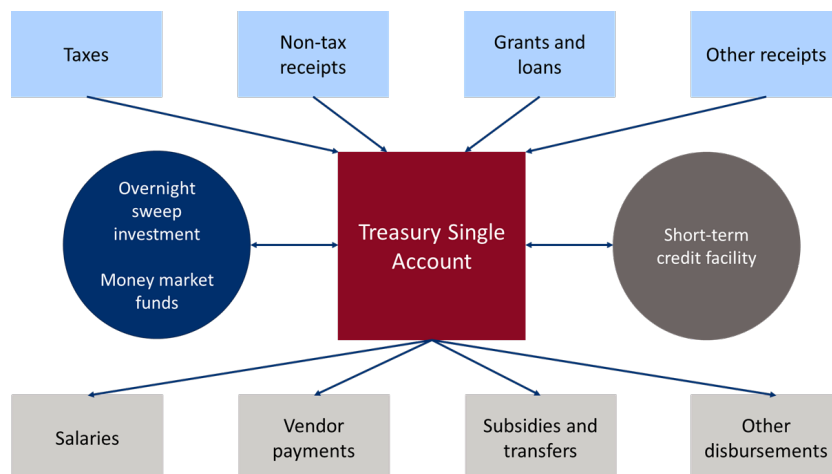
A highly useful tool for successful government cash management is a treasury single account (TSA). A TSA is a bank account or set of linked bank accounts through which the government transacts all its receipts and disbursements, and which allows the MOF to determine the government's consolidated cash position at the end of each day. According to the IMF, a TSA is one of the most important tools for reforming PFM systems in developing countries whose financial systems often rely on highly fragmented banking arrangements and services. Indeed, it is not uncommon for developing country governments to operate several thousand bank accounts, with each MDA operating several separate accounts.

Fragmented banking arrangements are suboptimal for several reasons. First, if MDAs are allowed to maintain their own bank accounts without authorization and control 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 and Treasury greater monitoring and oversight capabilities over all government cash transactions.

³⁸ Zambia: Public Expenditure Management and Financial Accountability Review, The World Bank: 2004.

Exhibit 33, which highlights the basic structure of a TSA, shows that all government receipts (e.g., tax and non-tax revenues, grants, etc.)—regardless of which entity collects those receipts—are transferred into the TSA and all disbursements (e.g., salaries, vendor payments, etc.) are made from the TSA. Ideally, all inflows into receipt accounts should be swept into the master TSA account (leaving receipt accounts with zero balance) at the end of each day. Similarly, funds from disbursement accounts should be cleared out daily leaving these accounts with a zero balance at the end of the day.

Exhibit 33: The Structure of a TSA



Once the daily collections and disbursement amounts are captured, the cash management unit determines the net cash position of the TSA. If the day’s receipts are larger than disbursements, the TSA will have surplus cash for the day and if disbursements are larger, the TSA will have a deficit. Depending on the cash position of the TSA, the cash management unit may have to borrow money from a short-term credit facility to fund the deficit or may choose to invest the surplus cash into short-term investment vehicles in order to raise investment income for the government.

Exhibit 34: Nepal’s Successful TSA Implementation

In 2011, Nepal initiated the implementation of a TSA. Within one year, the TSA had been rolled out to all central government ministries and was operational in 60 out of 75 districts. Through the District Expenditure Control System, the financial data for all MDAs in 67 of the districts is reported on a real time basis. The primary reasons for the swift and successful implementation include: political will of the MOF, strong IT skills available in Nepal, and ownership of the reform initiative by the Government of Nepal with strong collaboration with and financial support from the multi-donor trust fund. Financial staff in each of the MDAs is seconded from the MOF which helped build support for the reform. In addition, generators and solar panels were provided to district treasury offices to allow uninterrupted operations.

Implementing a TSA has several benefits for government cash management, including improved liquidity management, improved payment processing, improved revenue mobilization, and perhaps most importantly, improved internal control and accountability (see Exhibit 35).

Migrating to a TSA, however, poses several challenges for many developing countries. Many countries lack the political will to invest the energy and resources required to make the transition from existing systems to a TSA. The task of identifying, reconciling, and closing of often several thousand bank

accounts appears daunting to governments. MDAs may also view the establishment of a TSA as an expansion of central government control over government activities. Many developing countries also lack staff adequately trained to conduct active cash management as required by a TSA. Perhaps most importantly, many countries lack efficient and well functioning financial sectors and technological infrastructure. The lack of an adequate banking environment may be denoted by insufficient banking coverage across the country, particularly in more remote areas, in which banks may not have the systems in place to share information with the MOF (e.g., information on revenue collection), and/or banks may only provide limited banking services. As with any PFM reform, implementing a TSA should happen in stages according to the “as is” state of a government’s current cash management system. 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 and reporting (e.g., FMIS) and payment systems facilitates the establishment of a TSA.

Exhibit 35: Benefits of a TSA

BENEFIT AREA	SPECIFIC BENEFITS
Improved Liquidity Management	<ol style="list-style-type: none"> 1. Effective control over aggregate cash balance 2. Improved cash visibility 3. Efficient and timely collection and disbursement processes 4. Improved debt management (realistic cash flow projection) 5. Significant cost reduction (transaction processing and interest costs)
Improved Payments Processing	<ol style="list-style-type: none"> 1. Single disbursement account (centralized TSA) 2. Low cost transactions 3. Facilitates payment automation through interfaces to operating systems 4. Allows utilization of modern payment services such as pre-paid cards, electronic funds transfer and direct deposits 5. Controlled disbursement accounts
Improved Revenue Mobilization	<ol style="list-style-type: none"> 1. Effective control over aggregate cash balance 2. Improved cash visibility 3. Efficient and timely collection and disbursement processes 4. Improved debt management (realistic cash flow projection) 5. Significant cost reduction (transaction processing and interest costs)
Improved Internal Control	<ol style="list-style-type: none"> 1. Simplifies the government cash flow to only a few bank accounts, which means fewer bank reconciliations 2. Limits other agencies from opening bank accounts 3. Few individuals have access to checks, wires and other payment instruments 4. Clear segregation of duties
Improved Accounting Processes	<ol style="list-style-type: none"> 1. Automation of payments allows real-time recording of cash transactions 2. Allows automated daily reconciliation 3. Provides easily accessed audit trails 4. Increases reliability of accounting data

VI.3 DEBT MANAGEMENT

When a government’s revenues do not provide adequate funds to meet its current or planned financial obligations, it may need to incur debt. Debt can take many forms, including short-term debt—for example, an overnight loan from the short-term credit facility—or longer-term debt, such as loans to fund capital projects. The type of debt instrument a government uses will be dictated by the timeframe and specific purpose for which the debt is incurred. A country may also face limitations in the debt instruments available to them based on the depth and sophistication of their domestic debt market as well as their credit ratings and access to international markets. The most common types of debt instruments are loans taken out from capital markets or international financial institutions (IFIs) such as the IMF, and treasury bills and treasury bonds issued by the government itself.

The primary task of a government debt manager is to incur debt at the lowest possible borrowing cost. For many transitional economies, loans at concessional interest rates from IFIs are the primary sources of debt. Both advanced and developing countries seek funds from domestic and international capital markets. For many developing countries, domestic capital markets and banking systems are underdeveloped and therefore may not be a good source of financing.

Although it is expected that governments will take on debt to make investments or fund short-term deficits, prudent debt management is essential for reducing risks and managing costs over the medium and long term. The risks of excessive debt accumulation include:

- Debt will become too large to repay;
- Debt restructuring will be unsustainable in the long-term (i.e., low costs in the short-term but much higher debt service costs in the future); and/or
- Exogenous shocks will result in reversals of capital flows, cause currencies to fluctuate, or foreign assistance levels to drop.

For some countries, unsustainably high and/or poorly-structured debt (in terms of maturity, currency, or repayment terms) have been important factors in inducing or aggravating economic crises.³⁹ For example, if the maturity structure (i.e. length of loan/bond repayment) of the debt vehicle is inadequate, or if the interest rate terms are unfavorable, then the likelihood for default is heightened. Similarly, if a government seeks a loan denominated in another country's currency (external debt)—such as if the Tanzanian government took out a loan from a Zambian commercial bank—and if the borrowing currency (e.g., Zambian Kwacha) were to appreciate (or depreciate), this could significantly affect the terms of the loan and its servicing costs.

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. A 2006 report by the World Bank's Independent Evaluation Group noted that although countries had been given debt relief under the Heavily Indebted Poor Countries (HIPC) and Multilateral Debt Relief Initiative (MDRI), most of them still had weak debt management practices and functions.⁴⁰ A World Bank paper notes:

“In most low income countries, the government debt portfolio typically comprises the largest financial portfolio; on average, public debt accounts for over 60 percent of GDP. If not properly managed, the structure of the debt portfolio may evolve in ways that could generate substantial risks to government balance sheets and affect the countries’ financial stability. Further, the economies of lower-income countries are less diversified than those at higher income levels: export bases are narrower, exposure to recurrent commodity price shocks is higher, and reliance on limited and unpredictable aid flows for budget support is often heavier. All these factors make lower-income countries highly vulnerable to exogenous shocks that can significantly, and rapidly, worsen debt dynamics....The challenges faced by these countries highlight the need to identify and address weaknesses in debt management capacity.”⁴¹

³⁹ Independent Evaluation Group Report on the HIPC Initiative, The World Bank: 2006.

⁴⁰ *Ibid*

⁴¹ Abha Prashad and Malvina Pollock, “Measuring Debt Performance: Key Findings from the Debt Management Performance Assessment (DeMPA),” The World Bank: 2011.

Leading practices in public debt management suggest a number of important reforms for developing countries, including developing a proper legal framework to support debt management, and centralizing debt management activities at the central level into one entity.

This means that MDAs should not be able to incur debt themselves, and that any debt required to fund short-term deficits or capital projects should be managed centrally by the MOF. Historically, in many developing countries, MDAs have been able to incur or issue their own debt which led to unsustainable debt levels. While sub-national governments are legally distinct from central governments under federal systems, the central governments may be held legally responsible for the repayment of debts due to the implied sovereign guarantees to lenders and possibly, because of how national legislation is written. As a result, some countries do not allow sub-national governments to borrow or put controls in place on subnational borrowing, e.g., requiring MOF approval prior to lending or limitations on the amount that can be borrowed.

Exhibit 36: Local Government Borrowing in Albania

The Law on Local Government Borrowing of February 4, 2008, allows local governments to borrow for cash flow and investment purposes. Loans can be obtained for:

- Short-term (less than one budgetary year): To finance temporary cash flow deficits when operational expenditures are higher than revenues.
- Long-term (longer than one budgetary year): To finance investment for public purposes and to cover local own or shared (with the national government) functions.

The rules that apply to short and long-term loans include:

- Short-term debt cannot exceed 10% of total actual revenues of the local government from local taxes and fees and shared taxes of the previous fiscal year.
- For long-term loans, the debt maturity cannot be longer than the useful life of the investment.
- The amount of debt service due in any year on all long-term debt cannot exceed 20% of the average total actual revenues of the local government from the equalization grants, shared taxes, and local taxes and fees of the previous fiscal years.

Additional leading practices include: appropriate sharing of information between debt managers, and fiscal and monetary authorities; transparency in debt management activities and appropriate accountability mechanisms; and the acquisition of necessary technological tools such as cash flow simulation models, means for debt recording, and reporting systems. Another essential component of prudent debt management is risk management. A country should only take on an amount of debt it will likely be able to pay based on realistic assessments of its macroeconomic health, expected growth potential, and future revenue and expenditure forecasts. Maintaining sustainable levels of debt is important for withstanding exogenous shocks.

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. This is especially true for HIPCs and less developed transitional economies. These countries are at an earlier stage in their development, and as such continuing to strengthen their budget and cash management functions are priorities and requirements to build a proper foundation for conducting debt management. For more information on Debt Management, please see [USAID's Public Debt Primer](#).

VI.4 COMMON CHALLENGES IN TREASURY OPERATIONS AND CASH MANAGEMENT

This section highlights the various challenges governments face when implementing the steps involved in the treasury management and cash management process.

VI.4.1 CASH MANAGEMENT CHALLENGES

Another key challenge is cash management, including maintaining proper communication between an MOF and MDAs on reporting monthly and quarterly cash requests, based on budget allocations. Routine reports and cash flow forecasts to monitor performance are important for reaching consistent service delivery targets and departmental or ministerial programmatic objectives. This is especially important in decentralized systems, where MDAs must track their own budget execution against planned expenditures since they cannot rely on the MOF to cover excess obligations due to execution errors.

VI.4.2 ADMINISTRATIVE PROCESS AND POLICY CHALLENGES

If methods like those referenced in the Guide are put in place, so that additional procedures and controls are added, the traditional budget execution process can become so cumbersome that MDAs start consistently bypassing traditional expenditure channels to speed up processes. Many MOFs recognize this as a challenge and tolerate bypassing processes by using ‘accelerated or exceptional procedures’ for politically sensitive expenditures. A natural tendency is then for accelerated or exceptional procedures to be used on a routine basis. That nullifies the effectiveness of the normal management systems and eliminates any necessity for occasional usage. Using these exceptional procedures that bypass standard controls make it more difficult to reconcile bank statements with budget accounts, and to obtain reliable information on cash expenditures. For example, if purchasing on credit when authorization has not yet been approved can occur it is difficult to understand whether appropriations have been surpassed; and thus if there is cash available to pay for purchases after goods or services have been received and rendered. In cases like this, it is difficult to reconcile bank statements on cash expenditures with budget accounts, or to manage the financial position of the Government.

VI.4.3 ACCOUNTING PROCEDURE CHALLENGES

Another common challenge is delays in recording transactions, disbursing funds, or collecting arrears. Many countries have trouble maintaining their accounting system and hiring and retaining qualified staff. Delays can lead to errors in recording transactions and reporting, or errors in registering transactions which can inflate or deflate budget availability. Delays could also occur because of monthly or quarterly financing constraints, forcing a MOF to slow down the payment process, either by delaying the issue of payment orders, or the cashing of checks because of limitations in the availability of funds. If a government delays disbursement of funds to later in the calendar year but does not allow carrying-over funds across fiscal years, then problems can occur in spending committed funds before the end of the fiscal year. This may lead to wasteful or misallocated spending. If funds are disbursed late, and were not spent toward originally planned purposes, then an excess of funds prior to a cut-off date may exacerbate unnecessary or unplanned spending, or even lower rates of budget expenditure execution.

At a more macro level, it can be seen that many of the challenges in the budget execution process are interconnected. For example, the development of a commitment control system needs to be supported

by measures in other areas, particularly on improving the budget formulation process and the introduction of an FMIS system with adequate procedures and enforcement. Similarly, effective cash management, including the avoidance of arrears or debt requires properly functioning commitment controls.

VI.5 IMPLEMENTING REFORM

Regarding leading international practices in cash management, the adoption of a treasury single account (TSA) is essential to reform. MOFs should be the only entity with the mandate to open and close bank accounts. This does not preclude MDAs from having bank accounts, but it does mean that the MOF must have access to these accounts and that the accounts are incorporated into the TSA, including overnight sweeps of funds. There should be a manageable number of bank accounts, and only enough to allow the MOF to effectively conduct treasury operations.

In order to successfully implement a TSA, a well-developed banking system must exist. The retail banking network must cover all possible MDAs and must be able to provide modern services including zero balance accounts; online reporting, transaction processing and account reconciliation services; and direct deposits to bank accounts across a country. The payment process should be accurate and timely in capturing data flow and flow of funds. Accurate and timely data entered for every transaction is essential to transparency and legitimacy of financial data, especially to budgetary decision-making.

Communication across MDAs and oversight bodies is essential to transparency and understanding real-time cash management issues. Timely and standardized monthly and quarterly reporting across government entities should be adopted. A FMIS can be implemented to enable standardized reporting formats in accordance with international reporting standards. This means reports should be comprehensive, easy to understand, and timely enough so that management can use reports to change programmatic objectives and activities based on current financial information.

VII. PUBLIC SECTOR ACCOUNTING AND REPORTING

“Top Three” Reference Materials: Public Sector Accounting

1. [Chart of Accounts: A Critical Element of the Public Financial Management Framework, International Monetary Fund: 2011](#)
2. [Strengthening PFM in Post-Conflict Countries, World Bank: 2011](#)
3. [International Public Sector Accounting Standards Board: Handbook of International Public Sector Accounting Pronouncements: 2022](#)

Accounting is the process of recording, classifying, and summarizing the financial transactions of an organization. This data is then summarized in financial reports and used to prepare financial statements that are useful for review, audit, and decision-making purposes. These documents are generally intended to be reliable indications of the financial status of the organization’s accounts and may comply with laws and internationally accepted accounting standards. To ensure reliability, the information obtained from the accounting process and financial statements must be accurate, timely and verifiable.

More specifically, public sector accounting should set a foundation for public accountability by capturing how the government used taxpayer resources, and whether resources are being used efficiently, effectively, and transparently. Public sector accounting performed in accordance with international standards improves quality and comparability of financial information reported by public sector entities around the world.⁴² Further, a strong public sector accounting system is able to generate meaningful and reliable data for the government to demonstrate how it used public funds.

This chapter describes the features of an effective public accounting and reporting system. It starts with a discussion of the basis (or methodology) of accounting, and how that impacts the information included in financial reporting. It then describes the importance of the chart of accounts to properly capture the range of expenditures, revenues, assets and liabilities within the public sector. This is followed by a section discussing the use of Integrated Financial Management Information Systems (IFMIS) to manage the public accounting and reporting functions of government. The chapter concludes with an overview of common challenges in public sector accounting and reporting and reform approaches.

⁴² p. 1, [IPSASB-Handbook-2022-Volume-I](#), International Public Sector Accounting Standards Board

VII.I BASIS OF ACCOUNTING AND ACCOUNTING STANDARDS

The basis of accounting is the method and timing of reporting transactions in the account records used to prepare financial statements. The three primary methods for reporting transactions used in modern accounting are the cash, accrual, and modified accrual/cash basis. Governments adopt accounting standards to define the basis of accounting, provide consistency and comparability across public sector agencies within a country, and comply with accepted international practices for purposes of transnational comparability for reporting transactions and developing financial statements. The primary international accounting standards include the International Public Sector Accounting Standards (IPSAS) and International Financial Reporting Standards (IFRS),⁴³ which support moving from cash to accrual accounting. These standards are considered part of Generally Accepted Accounting Principles (GAAP) which is a broad term used to describe the profession's accepted principles and standards.

VII.I.1 CASH BASIS ACCOUNTING

Under cash basis accounting, transactions are only recognized when money has been received or paid. The recording and reporting of transactions occurs when cash moves in or out of the MDA and/or its accounts. Cash basis accounting is easy to implement, and accurately tracks cash on hand. If an MDA incurs expenses in one month but does not pay the invoices until the next month, no expenses are recorded until the payments are made in the subsequent month. Similarly, if an MDA is owed payment, it would not record the income until the cash was actually received. Also, accounting for any long-term government obligation does occur until cash is disbursed.

As a result, cash basis accounting does not necessarily fully correspond to actual expenses incurred and future earnings generated in a period. It does not provide a full picture of the financial implications of operations or available funds because it does not accurately reflect outstanding receivables, payables, assets, liabilities, and other obligations. Consequently, cash basis accounting is most suitable for households or small, simple businesses, rather than governments. However, due to its ease of use it is often used for governmental accounting despite its level of inherent inaccuracy.

VII.I.2 ACCRUAL BASIS ACCOUNTING

Accrual basis accounting records financial transactions as incurred, rather than waiting until cash is paid or received. Accrual accounting provides a better picture of the financial condition of an MDA and available funds and potential shortfalls against a budget or plan because it includes the financial implications of operations and a more accurate assessment of available funds. For instance, if an MDA agrees to buy some services, it records the liability for the expense once a commitment is made for the services that will be paid in the future. It thus accurately reflects outstanding receivables, payables, assets, liabilities, and other obligations.

⁴³ See definitions for IPSAS and IFRS in the Glossary.

Exhibit 37: International Support for the Adoption of Accrual Accounting

In a letter dated June 15, 2010 to the G-20 nations, the International Federation of Accountants (IFAC) and IPSAS encouraged the adoption of accrual-based accounting as it reinforces the principles of transparency and accountability. The letter notes that “most significantly, the accrual basis for accounting records and reports assets and liabilities that are relevant to fiscal policy and long-term fiscal sustainability.”

The International Public Sector Financial Accountability Index, the 2021 Status Report, 46 analyzes information from 165 jurisdictions and found that globally 30% of jurisdictions reporting on accrual in 2020 – up 6% since 2018.⁴⁴ Growth is projected to continue to be strong with IFAC projecting that 50% of jurisdictions globally will report on an accrual basis by 2025.⁴⁵

Accrual accounting is more complex due to the specialized knowledge needed to accurately report transactions and prepare financial statements that include assets and liabilities in accordance with internationally accepted accounting standards such as IPSAS. Accountants and others without specific training on accrual accounting may not understand accrual principles when compared to those used in cash basis accounting. However, accrual basis accounting using IPSAS provides a more correct picture of the financial condition of the MDA and government. In the United States, the GAAP for state and local governments is developed by the Governmental Accounting Standards Board (GASB) and uses accrual basis accounting. GAAP for U.S. federal government is developed by the Federal Accounting Standards Advisory Board (FASAB) using accrual basis accounting.

VII.I.3 MODIFIED ACCRUAL/CASH BASIS ACCOUNTING

Modified accrual/cash basis accounting combines elements of the two systems. A cash basis is used for revenues, but an accrual basis is applied to expenditures, although there may be exceptions for specific purposes. This system recognizes revenues when they become available and expenditures as they are incurred. For example, a government can recognize income when taxes are received because this meets the criteria of availability and measurability. When an invoice is received, the government records the expenditure, even if cash is not paid until a later date. This system increases the government’s ability to control and monitor cash levels by restraining expenditures before revenues are actually received. In other countries, the most commonly adopted standards for public sector entities are the International Public Sector Accounting Standards (IPSAS). The IPSAS standards are based on International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), but also combine certain aspects of cash and accrual accounting. IPSAS is considered to be the best practice in public sector accounting and has been widely adopted by developed and developing countries.

VII.I.4 TRANSITIONING THE BASIS OF ACCOUNTING

Cash basis accounting has been the predominant system used by most governments. However, there has been a growing trend to adopt accrual accounting in order to provide greater visibility into the use

⁴⁴ International Federation of Accountants, “[International Public Sector Financial Accountability Index: 2020](#)”, June 16, 2021,

⁴⁵ Chartered Institute of Public Finance and Accountancy, “[Global public sector shift to accrual accounting forecast to continue](#)”, June 16, 2021,

and management of public funds. Many governmental accounting systems may continue to retain cash basis accounting at different levels of government or for specific governmental organizations even when accrual-based accounting systems are in use at the central level. Moving from a cash-basis to an accrual or modified-accrual basis system allows for more accurate budgeting and planning and can improve a government's ability to build and manage budgets that are realistic and based on experience. Under accrual-based accounting, managers are accountable for assets and liabilities and must report on their financial position, cash flows, commitments, and contingencies.

Cash accounting reporting has a short-term (1-year) focus by reporting cash received and paid during the year while accrual accounting has a longer-term perspective by reporting financial transactions as incurred that extend beyond 1-year to support a more useful time horizon for decision-making.

However, many developing countries continue to struggle to adopt accrual accounting basis systems. Systems, processes, and staff have often been set-up around familiar cash-based processes, and extensive revision of policies and procedures, guidance and staff training are required to implement accrual accounting. Transitioning from a cash basis to an accrual basis is often a multi-year process, gradually rolled out ministry-by-ministry. Further, implementation will be reliant on ongoing organizational and political support, funding, and general appetite for reform.⁴⁶

Because the complexity of accrual accounting and capacity of the government may inhibit implementation of a full-accrual system, it is often best for developing countries to use a modified accrual/cash basis. If capacity to develop and implement a modified accrual system is limited, strengthening cash-based systems is a viable temporary alternative when linked with efforts to increase capacity. When contemplating the transition to accrual or modified cash/accrual accounting, the following issues should be considered.

SCOPE, TIMING, AND SEQUENCING. Scope refers to the number of MDAs that will phase-in a new accounting method. While central governments may adopt reforms quickly, many countries experience difficulty implementing accrual accounting in decentralized, provincial or local governments or agencies that may have lower institutional capacity. Careful and comprehensive planning should be used to mitigate anticipated scope-related difficulties, to set appropriate milestones and timing, and to consider the cost of the transition. Policies and procedures will need to be revised, adopted, and implemented, including capacity development and change management support. Specific sequencing of implementation as modified by both scope and timing must also be included in operational plans, with careful attention paid to issues of capacities, competencies, and the inevitable difficulties that will arise.

Exhibit 38: Examples of Transitioning to Accrual Accounting

One of the first countries to adopt accrual accounting was Chile in the mid-1970s, followed by New Zealand in 1990. By 2000, only six central governments had adopted the accrual basis for their annual financial accounts. In the U.S., the federal government adopted the accrual basis in 1997, but U.S. states and local governments only began adopting the accrual basis in the early to mid-2000s. In France, accrual accounting was adopted at the local level in the 1990s and in 2007 at the central level.⁴⁷

⁴⁶ Rob Whiteman, "Improving Accountability Around the World Through Accruals," Forbes, June 17, 2021.

⁴⁷ [Accrual Accounting the Public Sector](#), CEDifo DICE Report 5, Institute for Economic Research: 2007

While progress on the adoption of accrual accounting was initially slow, the pace of adoption has accelerated. As of 2020 data IFAC indicates that about 50 countries report using accrual basis accounting and by 2025, more than 80 countries anticipate to use accrual accounting.⁴⁸

HUMAN AND FINANCIAL RESOURCES. There may be resistance to change among management and staff. Key individuals must be “sold” on the benefits of transitioning to accrual or modified accrual accounting. Training will be required so that government accountants understand how to correctly record transactions under accrual accounting. The government can also consider hiring private accountants to assist in the transition to accrual accounting.

COMPUTERIZATION. Computerization makes accrual or modified cash/accrual accounting easier to implement. MDAs will need to make decisions on whether the new accounting system will be manual, or fully or partly computerized. If computerized, will it be customized or use off-the-shelf software? An off-the-shelf system will be much cheaper and faster to implement but may be less flexible and might not meet all of the needs of the government or MDA.

TAX SYSTEM. The type of tax system may also influence the choice of accounting system basis. Accrual accounting is more applicable if most revenues are from income or property taxes because they are largely dependent upon billings and other less variable calculations. Tariff, fee and sales tax revenues tend to be more variable, and may thus be more easily managed through cash accounting. As most governments depend upon a mixture of revenue types, revenue systems may need to use some form of modified accrual accounting even if the main accounting system used by a government is accrual based.

VII.2 CHART OF ACCOUNTS

A chart of accounts (COA) is a list of all financial accounts used by a government including revenues, expenditures, assets, and liabilities. 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. The COA contains the basic building blocks of an accounting system. It is critical for effective budget management, including tracking and reporting on budget execution and evaluating results. It also serves to standardize governmental financial information to apply public sector accounting standards so that government-wide financial statements can be consolidated and reported.

The COA specifies how transactions are recorded in a series of accounts (general and subsidiary ledgers) using accounts and codes (the coding hierarchy structure) required to report financial transactions. Each account is assigned a unique identifier or an account number based on useful information tags. For example, these tags may denote the cost center (the department or unit responsible for the transaction), program or purpose, and nature of the transaction.

Coding is most effectively expressed through the use of numerical identifiers, which are essential for computerization of accounting systems. For example, an account beginning with “1” can indicate an asset, “2,” a liability, and “3,” equity. Subsequent digits in the identifier provide additional information on the transaction. While most countries do not have a statutory chart of accounts for private sector

⁴⁸ “[Global Impact Map](#)”, IFAC, 2021

organizations, most do have mandatory COA use requirements for governmental units to allow consolidation of government-wide financial information.

The COA may differ based on many governmental and regulatory requirements for internal and external reporting, budgeting, and cost tracking. Failure to adequately document requirements and design the COA accordingly can necessitate expensive re-engineering and result in poor data integrity. As the complexity of the COA increases, the reliability of data may decrease. With proper accounting, the COA data can be used to support good management and decision making. For example, proper categories of expense accounts can lead to a clearer understanding of spending trends and facilitate greater understanding of an organization's revenue needs.

Some key attributes a government should consider in designing a COA include, but are not limited to:

- Classification type (by fund, organization, location, program, and economic function);
- Budgeting and planning methods (cost versus activity-based budgeting);
- Linkage to international or mandatory budget classification frameworks;
- Stakeholder expectations;
- Regulatory requirements;
- Basis of accounting and application of public sector accounting standards;
- Management and internal decision making needs;
- Logistical considerations; and
- Balancing cost and efficiency of the accounting system.

COAs should incorporate or be compatible with leading standards, such as the United Nations' **Classification of the Functions of Government (COFOG)** and the IMF's **Government Finance Statistics (GFS)** framework and public sector accounting standards such as IPSAS, COFOG, GFS, and IPSAS where consistent. COAs should also 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.

COFOG, GFS, and IPSAS are generally organized by government functions (e.g., general public services, defense, public order and safety, economic affairs). Each major category is separated into divisions and then classes. Each class has a description that describes the included activities. An example of how the health and education functions are defined by divisions is provided in the box below.

Exhibit 39: Classification of the Functions of Government (COFOG)—Health and Education

Health	Education
<ul style="list-style-type: none">• Medical products, appliances and equipment• Outpatient services• Hospital services	<ul style="list-style-type: none">• Pre-primary and primary education• Secondary education• Post-secondary non-tertiary education• Tertiary education

- Public health services
- R&D health
- Health n.e.c.
- Education not definable by level
- Subsidiary services to education
- R&D education
- Education n.e.c.

A government should use the COFOG to roll-up financial reporting and economic information. Compliance with the COFOG is mandatory for many multilateral development assistance programs, such as IMF reporting. COFOG only provides general guidance. Application of COFOG can be achieved through the use of frameworks and manuals published by the United Nations and the IMF's GFS Manual (GFSM), some of which include transition guidance for reforms changing traditional accounting-based classification systems into COFOG/GFS-compatible systems. It is important to note that adoption and implementation of functional classification compatible with COFOG/GFS may be used as a step toward implementation of MTEF and program and performance-based budget systems. See the OECD library for the current version of the COFOG/GFS.

Exhibit 40: IMF GFS vs. IPSAS

GFS focuses on preparation of reliable national accounts statistics while IPSAS has a broader application to the public accounting system. Accounts and statistics serve overlapping but not identical purposes. Both allow assessment of a government's finances, but accounts are mainly concerned with the accountability of a given entity, whereas statistics are designed to aggregate the finances of groups of entities, such as all governments in a given region (national or supranational). Also, although many assets and liabilities appear on the balance sheets of both IPSAS and GFS, there are some differences. Obligations to make payments in only certain circumstances are more likely to be recognized in IPSAS than by GFS. One reason is that in statistics the presence of a contingent liability of the government sector's balance sheet implies the presence of a contingent asset on another sector's. Last, assets and liabilities are not always valued in the same way: GFS favors market (fair) values and IPSAS allows other values, such as depreciated historical cost.⁴⁹

VII.3 FINANCIAL MANAGEMENT INFORMATION SYSTEMS

A Financial Management Information Systems (FMIS) is a powerful tool to support real time, meaningful financial reporting, and may also help support the transition to an accrual-based accounting system. A FMIS stores and organizes real-time financial information for current and past year spending and approved budgets for the current year, detailed inflows and outflows of funds, and inventories of

⁴⁹ Cangiano, Marco, Currstine, Teresa, and Lazare, Michel. 2013. "Public Financial Management and its emerging architecture." pp. 272-273 Washington, D.C.: International Monetary Fund

financial assets and liabilities. Controls can be incorporated in the FMIS to prevent overspending of the total budget of an MDA or specific sources and uses of funds, down to the line-item level.

A comprehensive FMIS has many potential benefits, including that it:

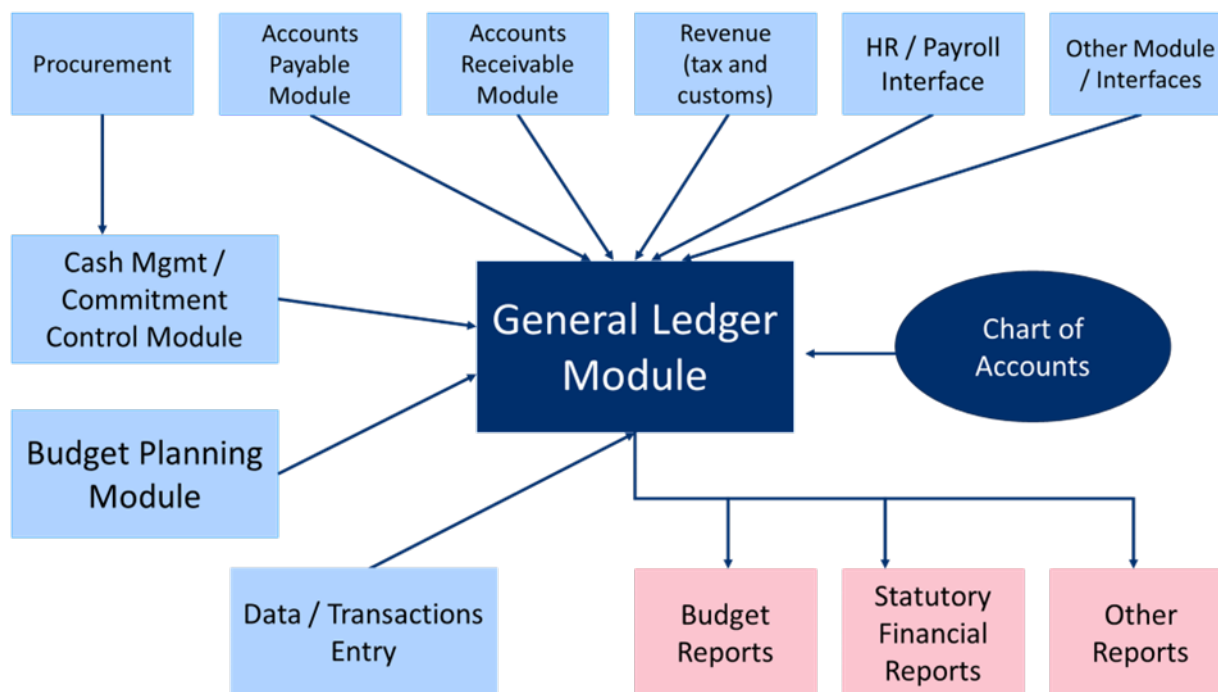
- Provides timely, accurate, and consistent data for management and budget decision making;
- Supports government wide as well as agency level policy decisions;
- Integrates budget and budget execution data, allowing automated controls and reducing opportunities for discretion in the use of public funds;
- Provides information for budget planning, analysis, and government-wide reporting;
- Facilitates accurate and timely financial statement preparation; and
- Provides a complete audit trail.⁵⁰

The scale and scope of a 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. A 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).

The general ledger is the core of any FMIS (Exhibit 41). It is the primary accounting record. Every transaction entered into the system posts to (is entered into) the general ledger, starting with the allocation of budget funds and down to payments for goods and services. All transactions should simultaneously post to the general ledger and appropriate sub-ledgers following the rules contained in the standardized chart of accounts.

⁵⁰ [Integrated Financial Management Information Systems: A Practical Guide](#), USAID, 2008

Exhibit 41: Typical FMIS Structure



Adapted from: Schick, Allen "Getting the Basics Right"

In addition to the general ledger, other core FMIS components and their main functions include:

- **Budgetary accounting** — Records the approved budget and any supplementary budgets, as well as transfers (also known as virements) made within legal thresholds.
- **Accounts payable** — Processes invoices for government expenditures, authorizes payments, and maintains a record of liabilities. Payments should be generated directly from the system.
- **Accounts receivable** — Processes all inflows received, including nontax revenues and fees.
- **Commitment control** — Ensures that there is sufficient cash allocated for an expense and the allocation matches the approved budget before a commitment to purchase is made.

There are a large number of other potential add-ons (non-core components) that can be included in a FMIS, including fixed assets, grants, budget planning and preparation, revenue administration, payroll and human resources, debt management, e-procurement, and grants management.

Many different software platforms have been used internationally for FMIS, including Free Balance, Systems Applications and Products (SAP), EPICOR's Enterprise Resource Planning (ERP), and Oracle. Increasingly, use of application programming interfaces (APIs) and/or other forms of system interoperability may allow governments to connect modules that are not a part of the core FMIS system.

The various modules and the platform used in a FMIS often depend on other existing systems, such as the payroll system used, the capabilities of public financial management officials, and financial resources. Although implementation of a FMIS is an accepted good practice, many countries have struggled to implement a well-functioning system. Contributing problems include the lack of political will, resistance across the government bureaucracy, corruption and fraud, and weak human capacity.

A common problem in implementing a FMIS is being overly ambitious at the outset. Schick suggests that countries should “Operate a reliable accounting system before installing an integrated financial management system.”⁵¹ Otherwise, existing problems are simply compounded. A FMIS should be tailored to the specific needs of the country. If the FMIS is too cumbersome, hard to maintain, or provides too much detail, it will become a cumbersome and expensive infrastructure to service and its utility may be limited. Instead, FMIS configurations should be built gradually as employees and management gain the requisite skills and practices become more sophisticated.

Countries, and their donor partners, must be realistic about the time and money required to fully operationalize an FMIS. A 2011 World Bank study found that it took an average of 7.9 years to implement a FMIS at an average cost of over \$39 million dollars, including IT hardware.⁵² Key success factors for implementing an FMIS include⁵³:

- Strong leadership and a conducive political environment
- Attention to capacity building early in the process
- Adequate preparation
- Attention to FMIS priorities and sequencing

Phased implementation of a FMIS has proven to be a successful approach for governments. Implementation can be gradually expanded to different user groups and the complexity of the system can be increased as financial and human resources allow. For example, a country might begin implementing the core FMIS modules for the central government and then expand out to sub-national governments.

Exhibit 42: Phased FMIS Implementation in Uganda

Uganda began implementing a pilot FMIS in March 2003 in six line ministries and four local governments. The second phase of implementation included the remaining line ministries and six additional local governments. The third and final phase extended the system to the remaining local governments.

Source: [Integrated Financial Management Information Systems: A Practical Guide](#)

Once the core modules are operational, a country can add additional modules as needed. Careful preparation and political commitment are critical, whether or not implementation is phased. It is also important to note that off-the-shelf commercial FMIS products (e.g., SAP or Oracle) often work better than fully customized solutions. While they generally require some degree of customization, they are still usually quicker to install, if also usually more expensive.

While the introduction of an FMIS does not automatically resolve problems in either PFM or public accountability, the information that can be made available and the greater degree of verifiability of that information are necessary prerequisites for effective and accurate e-governance. If partner country systems, human resources, and infrastructure are either sufficiently developed or planned for

⁵¹ Schick, Allen (1998). [A Contemporary Approach to Public Expenditure Management](#), World Bank

⁵² Demer Cem, Joanna Alexandra Watkins and William Leslie Dorotinsky, [Financial Management Information Systems: 25 Years of Work Bank Experience on What Works and What Doesn't](#), World Bank: 2011

⁵³ *Ibid.*

development, introduction of a linked, articulated, and comprehensive FMIS may allow them to “leapfrog” or pass over intermediate stages in the development and implementation of effective e-governance systems. The availability of easily accessed and secure interfaces to the FMIS would be of material assistance in this regard.

VII.4 PROFESSIONAL ORGANIZATIONS FOR ACCOUNTANTS

As of November 2020, there are 180 professional accountancy organizations (PAO) across 135 countries and jurisdictions with more than 3 million professional accountants. These 180 PAOs are members of the International Federation of Accountants (IFAC) where membership obligations require PAOs to adopt international standards, establish quality assurance and conduct investigation and disciplinary actions to the POA membership.⁵⁴ IFAC’s membership requirements recognize that PAOs around the globe operate under different national, legal, and regulatory frameworks. Therefore, some PAOs have differing degrees of meeting membership requirements and can benefit from increased engagement, support, and sustainability to protect the public interest from fraud, waste, and abuse through proper financial reporting.

PAOs can provide significant benefit in regulating accounting standards and professional accountants. They connect professionals, promote quality of accounting services, and conduct fora on national and international standards and practices. They can also operate certification systems and continuing education systems to increase the level of professional knowledge of public accountants, promote professionalism and credibility, and establish and enforce codes of conduct and disciplinary actions. USAID experience in supporting such organizations is that they have generally been of assistance in encouraging and implementing accounting reforms.

VII.5 COMMON CHALLENGES IN PUBLIC SECTOR ACCOUNTING

Some of the common challenges developing countries face in the design and management of their accounting systems and regulation are discussed below.

VII.5.1 WEAK REGULATORY ENVIRONMENT

Many countries lack a defined regulatory environment for accounting such as an accounting standards board, a supreme audit institution (SAI), and parliamentary enforcement ability.

Accounting standards boards make crucial decisions to define accounting and reporting rules on the treatment of financial transactions and adoption of standards. They also provide a mechanism for discussion and feedback on rules. Supreme audit institutions help to determine if the rules are being interpreted and utilized properly by ministries. Parliamentary enforcement fosters an environment where reporting and accounting weaknesses are corrected in a timely and effective manner.

⁵⁴ International Federation of Accountants, [Membership](#)

The lack of legally mandated financial disclosure rules can result in disparate bases of preparation, inaccuracy, inconsistent presentation, or may prevent consolidation of government-wide statements. This may reduce foreign investment incentives for donors and create unnecessary burdens on government capacity. Governments and stakeholders should ensure that regulatory mechanisms are put into place to create good accounting regulation to support transparency, reduce fraud, and ensure efficient utilization of public funds.

VII.5.2 LIMITED TECHNOLOGY

In the U.S. and Europe, MDAs often have automated information technology systems to plan and implement financial reporting. Developing country governments must be aware of the cost and difficulty of implementing any new accounting system. In some developing countries, manual accounting processes performed on Excel spreadsheets or smaller manual internal systems are used in place of integrated systems, inhibiting reporting and management oversight. These manual systems often suffer from poor document retention policies, insufficient audit trails, and poor controls over data entry. In designing a new automated system under these conditions efficiency, judgment, transparency, and oversight will need to be built in from the start.

VII.5.3 HUMAN RESOURCES

Because of weak educational systems and resources and the lack of strong PAOs, many developing countries have a small pool of well-qualified and experienced accounting professionals. Private companies often pull the best accountants from the public sector because they can offer better salaries and benefits. This may force government organizations to keep recruiting inexperienced or less well-educated accountants and maintain extensive ongoing training. Government accountants often cannot keep up with the growing scope, techniques, and complexities of their work. The challenges of identifying, training, and retaining staff are generally worse at the sub-national level, where the public sector is competing with the national government as well as the private sector and local amenities and services are less developed.

VII.5.4 FINANCIAL RESOURCES

Financial resources for development, acquisition, and implementation of accounting tools and systems are often scarce in developing countries and affect the affordability of hardware, software, and staff capacity development. Donor involvement has often been a key to the provision of additional resources.

VII.5.5 TAX SYSTEM

The structure of the tax system and how well it is enforced have implications for the type of accounting system. For example, a tax code that requires reporting in the year tax is collected may use cash basis of accounting while reporting that requires in the year the tax is earned should use accrual accounting.

VIII. AUDIT AND EVALUATION

“Top Three” Reference Materials: Audits and Evaluations

1. [International Organization of Supreme Audit Institutions Framework of Professional Pronouncements, \(IFPP\): 2021](#)
2. [International Standards on Auditing, International Auditing and Assurance Standards Board \(IAASB\): 2020](#)
3. [International Standards for the Professional Practice of Internal Auditing, Institute of Internal Auditors: 2017](#)

An audit is a systematic and independent examination of data, statements, records, operations, and performance of a government for a stated purpose like regulatory compliance, operational effectiveness, or financial accuracy. Audits involve collecting and analyzing sufficient and adequate evidence to support an auditor’s opinion on management’s representations for reliable financial reporting, efficient operations, and compliance with law and regulation. Audits also consider key risk factors facing government organizations and potential mitigation solutions. Donors and other external stakeholders commonly use audit reports to obtain reliable information on the operations and risks within an organization.

There are three primary types of formal audits serving different functions:

- **Financial:** Determine whether, in the auditor’s opinion, the financial results were presented fairly, in all material (significant) respects, the organization’s financial position, results of operations, and cash flows in accordance with local laws, regulations, or generally accepted accounting principles.
- **Compliance:** The extent that legal and regulatory requirements and donor and financial institution terms and conditions are being met and proper management systems and procedures are being used. Compliance audits may examine one or more programs or functions, to assess whether the organization is using resources appropriately and efficiently.
- **Performance:** Examine a program, operation, or process of an organization to assess if they are effective (achieving the desired results). Performance audits are a type of evaluation.

Note that these forms of audit are fully distinct from what is often referred to as “pre-audit” of

individual expenditures at the time of payment to ensure that they are executed in accordance with contracts, procedures, and rules. It is important that pre-audits or other forms of controls be administered independently of the formal audit function.⁵⁵

⁵⁵ “Pre-audits” are more accurately classified as a form of internal controls. In some cases, particularly when the same auditors are involved in pre-audit and post-audit activities, the application of pre-audit may interfere with the independence of the audit function.

Audits are also classified by the entity conducting the audit. Internal audits are conducted by the organization's own employees or personnel assigned to a permanent role in the organization, and are generally used for management and performance purposes. External audits are conducted by an independent third-party, such as the Supreme Audit Institution in the country. Both internal and external auditors can provide all three types of audits.

VIII.I INTERNAL AUDIT

An internal audit (IA) is "...an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."⁵⁶

Management and governing boards are responsible for the risks faced by an organization and adoption and implementation of controls to mitigate those risks. An internal audit (IA) function provides assurance to management and stakeholders that the organization manages risks that might impede its objectives.

The internal audit function has been described as the "eyes and ears" of management. It includes periodic or on-going monitoring to assess how well the internal controls are functioning. Internal controls help to ensure orderly, ethical, and efficient operations, compliance with laws and regulations, and proper safeguarding of assets. In the public sector, it also means focusing on accountability obligations to taxpayers and donors. Some examples of items internal auditors may review include:

- Assessing the 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.

In recent years, internal audits have changed from a reactive function to a more proactive risk-based approach. A risk-based approach identifies factors that can jeopardize achievement of an organization's objectives or mission and rates each risk based on the likelihood and impact of occurrence. The result is a portfolio view of risk that provides context to concerns and highlights significant trends or problems. Risks with higher probabilities or potential for interfering with the objectives or mission may be given a high priority for mitigation and monitoring. A risk-based approach enables an internal audit unit to anticipate. Internal auditors should be well versed in the strategic objectives of the organization and have a clear understanding of the operations of any given part of the organization as well as the bigger picture. The internal audit function is crucial to good governance and alignment of incentives and accountability for use of public funds.

⁵⁶ Web definition from the Association of Internal Auditors

VIII.1.1 INSTITUTIONAL ORGANIZATION

In the public sector, internal auditors typically either report directly to management and an independent audit committee or serve as the arm of an external agency, such as an auditor general. Both arrangements have advantages and disadvantages in developing nations, as discussed below.

INTERNAL AUDITORS REPORTING TO MANAGEMENT

Internal auditors who report to the top level of management should have dual reporting to an audit committee (a body of non-executive, non-management members that oversees audit work plans and recommendations). The audit committee oversees relationship management, sets the budget for internal audits, and ensures that the process and reports are free from interference by management. The internal audit committee also serves as a mechanism for reporting significant risks and keeping the function accountable with budgets and performance goals. This arrangement is common in countries without significant public sector accounting oversight bodies. Properly implemented, it can be an effective tool to encourage accountability and effective use of funds.

The Government of Rwanda uses this type of internal audit system. There is a standard internal audit charter used across all ministries and agencies that defines the purpose, authority, and organization required of each internal audit unit. While each internal audit unit reports to their MDA's management, the Office of the Government Chief Internal Auditor (GCIA) oversees and coordinates the internal audit function throughout the government. The GCIA does not perform audits directly, but defines methods, policies, and initiatives to improve the quality of Rwanda's public financial management systems.

Exhibit 43: Advantages and Disadvantages of Internal Auditors Reporting to Management

ADVANTAGES	DISADVANTAGES
<ul style="list-style-type: none"> • Easier to set-up than an independent government audit agency • May be more cost effective • Facilitates on-going monitoring and specialization within a specific institution • Direct access to management on an on-going basis can provide quick results • May allow audits to focus on value added and high-risk areas, rather than government legislated audits 	<ul style="list-style-type: none"> • Active audit committee required to prevent management interference with IA; • Inadequate implementation of follow-up activities from management; • Limitations on scope of audits; • Auditors may be sourced from inside the organization, which reduces independence from other staff.

INTERNAL AUDITORS FORM AN INDEPENDENT GOVERNMENT BODY

Some countries rely on a single government agency to coordinate or conduct government-wide internal audit activities independent of the agencies audited. Budgets, hiring, and payment of the internal auditors are all handled by this organization. As a result, the auditors tend to have a greater degree of independence and may be more qualified, if the audits are well designed and adequately funded.

Exhibit 44: Advantages and Disadvantages of Internal Auditors Forming an Independent Government Body

ADVANTAGES	DISADVANTAGES
<ul style="list-style-type: none"> • Auditors are not paid, influenced, or managed by the organization being audited • Allows for rotation of auditors • Auditors do not have close ties with management or staff of the agencies audited • Empowered by legislation 	<ul style="list-style-type: none"> • May be difficult to set up and require legal statutes • Might not give adequate consideration to management initiatives • Potentially less on-going monitoring and ministerial expertise since individual auditors may cover multiple agencies

VIII.1.2 CHALLENGES FOR INTERNAL AUDITS

Regardless of the choice of organization for the internal audit function, the following challenges should be kept in mind:

- Modern audit practices should rely on risk-based approaches to use scarce audit resources effectively. This is still often not the case in developing countries, where the internal audit function performs as another level of supervision of day-to-day operations (e.g., reviewing payments as they are made rather than ensuring that internal controls are in place and testing their effectiveness).
- In the absence of a true audit culture, audit reports might not be read by key officials and recommendations might not be followed-up on or implemented.
- The traditional model of public internal audits focused solely on compliance issues instead of reviewing performance in all aspects of government operations. Internal audits can be more useful if they address process design and efficiency in addition to internal control weaknesses.
- Too often, the executive branch or organization leadership interferes in the audit function to make it less effective. This can be done simply by minimizing the importance of the audit function through the ‘tone at the top’, inadequate funding and staffing, or restricting the scope of the audits, and making the reports inaccessible.

VIII.2 EXTERNAL AUDIT

Unlike internal audits, external audits are performed by a governmental body independent of the audited organization, usually known as a Supreme Audit Institution (SAI), or a service provider to that independent government body. External audits of public sector entities 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 worldwide affiliation of SAIs, International Organization of Supreme Audit Institutions (INTOSAI). INTOSAI issues the International Standards on Supreme Audit Institutions (ISSAIs). ISSAIs serve as a basis for INTOSAI members to develop their tailored professional approach in accordance with their mandates and national laws and regulations.⁵⁷

⁵⁷ INTOSAI (2020), ISSAI 200 Financial Audit Principles, p. 5. International Organization of Supreme Audit Institutions (INTOSAI).

Also, the International Auditing and Assurance Standards Board (IAASB) issues the International Standards on Auditing (ISA) for external public sector audits. ISSAIs contain guidance on the SAI application of relevant ISA. 61⁵⁸

VIII.2.1 INSTITUTIONAL ORGANIZATION

Supreme Audit Institutions (SAIs), financial enforcement bodies, ethics bodies, IAASB, professional accountancy organizations, and parliamentary committees may provide oversight for the public sector. SAIs often have primary responsibility for external audits. They are independent of the government and provide the highest level of external audits. These organizations typically take the form of an auditor-general reporting directly to the legislative branch and funded as a line agency. This arrangement reduces the risk of undue influence on the audit process, withholding of resources or reports, and manipulation of the audit scope. The audits can either be performed directly by the SAIs or outsourced to independent firms. Regardless of the implementation option selected, SAIs should leverage international best practices codified in international audit standards and other similar frameworks to provide a basis for audit quality.

To be successful, SAIs should foster strong relationships in the wider government. They are most likely to be effective if the executive branch and legislature empower them fully and there are strong checks and balances between the executive and legislative branches. Typically, the Ministry of Finance has responsibility for implementation of the budget, while the SAI audits review the spending of all MDAs to verify that funds were used appropriately and efficiently. The legislature will also need to recognize the importance of the SAI's work.

Common weaknesses in governments include insufficient institutional capacity and information sharing. SAIs, legislatures, and Public Accounts Committees (PACs) within legislatures often lack access to the expertise needed for auditing central banking institutions and other specialized ministries. SAIs and PACs also need a means to keep government stakeholders up-to-date on important issues and changing requirements and best practices.

VIII.2.2 CHALLENGES FOR EXTERNAL AUDITS

There are many challenges in setting up or supporting an SAI. A selection of some of the most common challenges includes:

- Some legislatures might not understand that adequately funding an SAI and adopting ISSAI can increase the efficiency and effectiveness of government or may be more concerned about political ramifications or the potential for revenues from corruption. In doing so, they may not act properly on SAI recommendations, or to hold executive branch agencies accountable for reversing audit deficiencies identified by the SAI;
- Even should the legislature wish to hold MDAs accountable, in many systems they lack substantive mechanisms to require MDAs to address audit findings do so;
- The ISSAI are complex and may be difficult to merge with local audit manuals and standards;

⁵⁸ Ibid. p. 6.

- Priorities for external audits should be risk-based. Attempts to provide universal audit coverage without prioritization often do not have the resources to succeed available;
- Many SAI have limited or partial coverage for performance and compliance audits;
- Suboptimal appointment and control laws, rules, and regulations can limit the options available to SAI based upon their organizational legal status. Inability to report to legislatures, appointment of SAI officials by executive branch leaders without effective advice, consent, or oversight and a general lack of true independence can all cripple SAI effectiveness;
- A weak follow-up process for audits may result in failure to implement recommendations and/or amelioration strategies. Overcoming such weaknesses requires that legislatures, SAIs, and Public Account Committees ensure that significant risks are reduced and can exert sufficient political capital to afford compliance and successes; and
- Limited capacity of public and private sector accountants and auditors may be a problem. A substantive sidebar to such problems in many partner countries is an inability to retain qualified financial personnel for public sector organizations in growing economies due to private sector opportunities, including with auditing firms.

USAID, INTOSAI, the IMF, World Bank, and other donor organizations have engaged with all of the above problems through a variety of activities. Often the first active step, which is especially useful since it adds a level of cachet, is that the SAI should join or even expand its engagement with both INTOSAI and its regional branch. INTOSAI provides a host of academic and guidance materials, training, and support in finding technical assistance for improvements or reforms. In particular, INTOSAI's International Development Initiative matches SAIs technical assistance requests with donor or INTOSAI funding, and is able to organize twinning arrangements between SAIs.⁵⁹ [INTOSAI's website](#) is an excellent resource.

While INTOSAI participation can be helpful, particularly in improving networks and staying up to date on evolving good practice, other support is available. For example, at the mission OFM colleagues are often helpful as many OFM staff have direct experience with SAI audits. Additionally, USAID's CFO is on the INTOSAI board and manages a relationship with United States' GAO Center for Audit Excellence (CAE). USAID holds a five-year Inter-Agency Agreement (IAA) with the GAO CAE to partner in strengthening the capacity development of accountability institutions such as partner country SAIs. Missions develop and tailor their scope of work (SOW) for an accountability institution based on the country context when partnering with the GAO CAE under the IAA.

Very successful support and technical assistance has been offered by USAID and other donors, and are often low cost and high impact activities. Cross-sector programming with legislative strengthening, rule of law, and civil society colleagues can be highly productive, particularly when in situations with legal or procedural deficiencies. Consultation and potential engagement with the partner country's SAI should be a routine consideration for any USAID activities that may need to engage with PFM, DRM, or governance (local or national). At the very least, SAIs can inform programming and MEL, and there may be low cost opportunities to reinforce activity outcomes by engaging with the SAI.

⁵⁹ [INTOSAI Donor Cooperation Global Call for Proposals](#)

VIII.3 PARTNER COUNTRY MONITORING AND EVALUATION

Partner countries' own monitoring and evaluation policies for PFM are a vital ingredient in ensuring accountability and transparency, as well as being essential management tools. Routine budget reporting should include analyses of expenditures and revenues, and should be made publicly available, even if in a somewhat simplified form. This provides the opportunity to executive and legislative branch organizations, stakeholders, and civil society to accurately assess progress in budget execution. A good baseline for such reporting efforts should minimally include quarterly to monthly reports of expenditures by major programs, ministries, and/or categories, hopefully compared to original and/or modified appropriations. An annual budget execution report and annual budget submissions, published within the first quarter of the following fiscal year and when budgets are presented to the executive and legislative branches, should include budgets as originally appropriated, revised budgets, and actual expenditures. Where budgets also include totals of authorized employee positions, the same information should be presented for these reports.

In addition, partner countries that have progressed to recording and evaluating the performance of their programs should reflect these in periodic and annual reports, as well as incorporating them into budget submissions, medium term expenditure frameworks, and progress toward the achievement of strategic plan goals and objectives.

While full implementation of such reporting regimes is often administratively, politically, and systemically difficult, with ongoing political will it remains possible. PEA and extensive knowledge of local systems, as well as cordial relations and partner capacity are vital to success.

Not only will the use of such reports improve governments' ability to manage their operations and activities, but analytical and evaluative reporting forms the essential basis for an informed dialogue with citizens and other stakeholders about government achievements. In other words, these, along with audit reports, form the very basis of PFM transparency, and thus make democratic accountability possible. In competitive democratic environments they can be an effective way for parties and governments to build positive relationships that support both their positions and effective and efficient development.

IX. SUBNATIONAL GOVERNMENT AND PFM

“Top Three” Reference Materials: Subnational PFM

1. [Subnational Public Finance Programme Briefs \(UNICEF\)](#).
2. [Improving Subnational Domestic Resource Mobilization \(USAID\)](#)
3. [Approach Paper: Evaluation of the World Bank Group Engagement on Strengthening Subnational Governments](#)

Around the world and across sectors (such as health), subnational governments are increasingly responsible for expanding equitable access and improving essential services at the local level. When central governments devolve greater service delivery mandates (such as education) to local and regional governments, it has important implications for how they prepare and execute their own budgets and secure the resources—whether through own-source revenue, intergovernmental transfers, or other means—to meet those service delivery needs.

Many factors that impact PFM at the subnational level actually stem from the national level, from what responsibilities are legally assigned to local levels to the actual flow of finances across the intergovernmental system. While subnational governments have varying levels of autonomy and responsibility, they never operate entirely independently from the central government. This chapter lays out several distinct aspects of the PFM system at the subnational level - starting with a description of the legal framework, then moving to discussions on the unique characteristics of subnational governments' revenue mobilization, budget planning, and budget implementation systems. The chapter concludes with a description of common challenges and reform approaches for subnational PFM, with some distinct consideration given to challenging contexts such as conflict-affected areas.

IX.1 LEGAL FRAMEWORK FOR SUBNATIONAL PFM

Subnational governments' responsibilities, authorities, and fiscal powers vary greatly between countries, and are generally defined within the legal framework. A country's subnational PFM legal framework may be embodied in multiple documents, including the constitution, the PFM Act, and the Local Government Act or Decentralization Act, as applicable. Additionally, sector specific laws, such as an Education Act, may govern allocations and expenditures within a sector, such as how educational infrastructure is built or maintained. Legal frameworks typically address the following key topics for subnational PFM:

- The service delivery mandates that subnational governments are expected to fulfill through the implementation of their budgets and programs.

- The rights of subnational governments to collect and retain revenues, the types of revenue collected at the subnational level, and revenue sharing rules. This includes which taxes and fees they can levy, whether they retain them or remit them to the central government, and the degree of autonomy they have to set tax rates, define the tax base, or grant tax allowances and reliefs.
- The relationship of subnational government budgets to the national, central, or consolidated budget. This includes procedures for budget planning, format, preparation and approval as well as for budget execution, reporting, and oversight.
- Accountability requirements, such as whether subnational governments must use a central government mandated financial management information systems (FMIS).
- The intergovernmental transfer system, including the types of transfers (e.g., conditional or unconditional) and sources of funding. This includes the design of the formulas that determine the size of transfers, their periodicity, and how often the formulas are reassessed.

Analyzing a country's legislation reveals the extent of fiscal decentralization. Fiscal decentralization refers to the legal delegation of revenues and expenditures from national governments to subnational governments and administrative units. The intent should be to ensure subnational governments have sufficient resources and authority to provide legislatively authorized services or competencies. When fiscal systems are highly decentralized, subnational governments have broad authority and discretion to make and enact choices appropriate to their local context. Fiscal decentralization, along with political decentralization and administrative decentralization, determines the extent to which subnational governments are able to act independently of the central government. While all three dimensions of decentralization may have implications for PFM, fiscal decentralization is the most directly relevant. For a more comprehensive discussion on decentralization, its forms, and relevant parameters, please refer to the [USAID Democratic Decentralization Programming Handbook \(2021\)](#).

IX.2 INTERGOVERNMENTAL FISCAL SYSTEM

Understanding the intergovernmental fiscal system is essential for identifying barriers and what types of reforms or interventions will help improve subnational PFM in a given context. Again, while each country has its own unique context, stakeholders at the national level always play a critical role in subnational PFM. The most important national government stakeholders typically include the Ministry of Finance, the Ministry of Local Government, Planning and Finance (Grants) Commissions, and the Office of the Prime Minister or President. The National Legislature, which amends or creates new Acts, can also be very important in efforts to improve the existing framework. Moreover, understanding how specific ministries, departments, and agencies work can be an important component of the intergovernmental fiscal system. This is especially true when an activity is targeting a specific sector. The intergovernmental fiscal system may establish incentives for local governments to raise own-source revenue or may actually encourage subnational units to run budgetary deficits in order to attract additional central funding.

There are several tools to learn more about a given country's intergovernmental system. For example, PEFA assessments include a key indicator to assess the transparency and timeliness of public funds transferred from the central government to subnational units. Moreover, countries are increasingly using the subnational PEFA assessment to explore PFM performance at the subnational level. Details on the intergovernmental fiscal systems of specific countries and territories are also available via the World Observatory on Subnational Finance and Investment.

IX.3 SUBNATIONAL REVENUE SYSTEMS

Across USAID partner countries, total subnational government revenue (comprising both intergovernmental transfers and own-source revenue) accounts for 23 percent of general government revenues and six percent of GDP on average.⁶⁰ However, there is significant variation both across and within countries and between urban and rural areas.

In allocating revenue sources, it is important to consider which level of government is best placed to manage a source of revenue. There are economies of scale in some forms of tax collection and some taxes are just more appropriate for the central level. For example, economists generally recommend that personal or corporate income taxes are better taxed at the central level rather than at the local level because their tax bases are “mobile” (households or businesses may just relocate to achieve a lower tax burden) and are not tied to the receipt of specific goods or services from the government.⁶¹ Property taxes, on the other hand, are not “mobile,” and generally better suited for the local level. In fact, for those local governments that have the authority to collect them, property taxes generally account for about one third of local revenue. Nonetheless, in most developing countries about half of subnational revenues come from transfers; and, in some countries, transfers may account for 75 percent or more of subnational revenues (i.e., Kenya, Rwanda, Peru, Mexico, and Azerbaijan). Unsurprisingly, rural areas tend to be more dependent on transfers than municipalities. Typically, municipalities have more vibrant and formalized economies and, therefore, higher levels of own-source revenue.

IX.3.1 INTERGOVERNMENTAL TRANSFERS

Even as subnational government revenue systems mature, intergovernmental transfers are likely to remain the most important source of funding for subnational governments. This is because the central government generally controls the tax bases that generate the most revenue (i.e., value-added tax, personal or corporate incomes taxes, and taxes on international trade). From a central government perspective, transfers are important to address fiscal imbalances and promote equity between different parts of a country. Transfers can help accelerate development in more marginalized areas or promote a more even development across a country. Transfers may also enable the central government to reinforce its national priorities at the subnational level, such as the allocation of transfers specific to health. Finally, while there are strong reasons to support greater tax collection at the local level, there can be efficiency gains if the national government is collecting taxes; there are economies of scale in some forms of tax collection and some taxes are just more appropriate for the central level. For example, economists generally recommend that personal or corporate income taxes are better taxed at the central level rather than at the local level because their tax bases are “mobile” (households or businesses may just relocate to achieve a lower tax burden) and are not tied to the receipt of specific goods or services from the government.⁶²

Each country’s transfer system is designed to meet specific policy goals or practical considerations. The design of the transfer system has important implications for subnational PFM. Intergovernmental transfers or grants can be broadly classified into two categories: (1) general-purpose (unconditional)

⁶⁰ Eldridge, Matthew and James Ladi Williams (2021). [Improving Subnational Domestic Resource Mobilization](#), United States Agency for International Development.

⁶¹ Bird, Richard (2011), [Sub-national Taxation in Developing Countries](#), Journal of International Commerce, Economics and Policy, Vol. 02, No. 01, pp. 139-161

⁶² *Ibid*

transfers that subnational governments can allocate and spend in a flexible way; and (2) specific-purpose (conditional or earmarked) transfers that incentivize subnational governments to undertake specific programs or activities. A third category of transfers, called block grants, fall somewhere between general-purpose and specific-purpose transfers. Block grants are used to provide broad support in a general area of subnational expenditures, such as education, while allowing subnational units some discretion in allocating the funding within that sector. Transfers can also impose process requirements (such as requiring citizen participation in budget planning or specific reporting requirements) or service delivery outcomes. As governments adjust transfer requirements, it is important to keep an eye on the compliance costs for subnational governments to avoid making it too hard for them to access such funding. Transfer requirements can help the central government to promote policy priorities set at the national level. However, there is a trade-off as the more that funding is conditional, the less autonomy subnational units have to respond to local needs.

How transfers are formulated and administered can incentivize the collection of own-source funds or discourage it. For example, some transfer formulas include a requirement for a match in spending from own-source revenue. This can spur local governments to put more effort into collecting local fees and taxes. Some formulas prioritize those geographic areas with the greatest funding gaps. While this is intended to promote equity, it can run into challenges with areas gaming the formula. For example, an area might put less effort into raising own-source revenues deliberately to retain a higher area of visible need. There are many potential ways to design a strong formula; and the right approach for a given jurisdiction will be context-specific. However, critical elements of well-designed transfer systems are identified in the box below.

Exhibit 45: Some characteristics of good transfer systems

Transparency and Predictability: Formulas should be transparent, simple, and publicly disclosed, and the projection and delivery of transfers should be predictable and allow subnational governments to both execute their budgets and plan for the future. The subnational government's share should be based on objective factors, such as population size and tax capacity. Hence, there should be no hidden political calculus that determines which areas or politicians receive central funding.

Consistency: Transfers should be generally consistent from year to year. This also facilitates subnational budget planning. At the same time, the transfer system should be flexible enough to accommodate unforeseen changes in the fiscal or economic situation of recipients.

Equity: The size of transfers should vary directly with the fiscal need of each locality and inversely with their tax capacity.

Support Autonomy: A long list of conditionalities should be avoided; rather, subnational governments should have sufficient independence and flexibility in setting priorities.

Sufficient: Transfers should support subnational governments having adequate revenues in line with delegated roles and responsibilities.

Incentives: The transfer system should provide incentives for sound fiscal management. Care should be taken to avoid penalizing local governments that demonstrate stronger own-source revenue collection.

While transfers are a critical source of revenue for most subnational governments, in many USAID partner countries transfers are unpredictable in both timing and amount. They may be delayed, never actually transferred and/or less than anticipated. (This can even be true when a legal amount is 'guaranteed' through legislation.) There also may be hidden agendas at play, where only the territories controlled by members of the ruling political party receive their transfers on time or in full. [Section IX.5](#) provides a more detailed discussion of this challenge.

IX.3.2 OWN-SOURCE REVENUES

Own-source revenues may include taxes (especially property taxes), user fees (such as parking or market fees), property income, and sometimes royalties (such as on a wildlife park or mine). Some subnational governments have authority to borrow money and so debt may also be a source of financing (see Exhibit 46). Own-source revenue does not tend to produce enough to offset the amount lost in transfers that do not reach subnational units in a timely fashion. However, it can still be an important and empowering resource. Own-source revenue can permit local governments to respond to some citizens' needs and may promote accountability due to the stronger association between the collection of funds and the projects or services they pay for.

Exhibit 46: To Borrow or Not to Borrow?

Subnational government borrowing in low- and middle-income countries is often limited to large municipalities and regional governments. A key risk is that subnational governments may accumulate debt or other financial obligations that they later find themselves unable to meet. These contingent liabilities can suddenly become actual liabilities for the central government, which may need to step in and assume the debts. Therefore, promoting greater subnational borrowing may first require efforts to enhance the fiscal capacity and creditworthiness of subnational governments. It may also require efforts to improve the design, selection, and implementation of development projects to be financed. Advocating for increased authority for subnational governments to borrow to finance specific infrastructure projects should be done with a careful assessment of whether subnational governments will be able to pay back their loans. This may only apply where there are strong municipal or regional governments.

As mentioned earlier in this chapter but worth emphasizing here, property taxes can be a substantial source of revenue; generally representing one third of local government revenue (where local governments have the authority to collect property taxes). However, well-functioning property taxation requires a significant investment in local capacity and administrative infrastructure. Local governments need to generate property rolls, conduct property valuation, and administer the collection of taxes. There needs to be a transparent, equitable process that permits property owners to appeal when they perceive their property tax valuation to be unfair. There also should be transparent processes for taxpayers and the broader public to understand how revenue from the property tax is then allocated to respond to citizen needs. In some places, a certain percentage of property tax receipts may be earmarked for a specific sector, such as education. For more on property tax reform, see this [useful brief](#) from the [African Tax Administration Forum's Local Government Revenue Initiative](#).

Exhibit 47: Uganda Mass Property Tax Valuation Project, Working at the Local Level

Due to automation and taxpayer sensitization efforts supported by USAID's Domestic Revenue Mobilization for Development (DRM4D) activity, eight out of 10 partner cities in Uganda recorded impressive revenue growth between 2020 and 2022. Among other efforts, DRM4D enabled a mass valuation of properties which is projected to double cities' revenue in its first year of implementation. As of July 2022, 150,000 properties had been valued compared to the 20,000 properties on the property rolls across all 10 cities prior to the intervention. While revenue collection based on the new valuations had not yet begun, city government officials consulted during a mid-term review of the DRM4D activity conveyed a sense of empowerment and confidence in their ability to reap the benefits of these efforts. Project staff and local government officials are working with local stakeholders, including CSOs, to identify budget priorities for the additional local revenue and to put in place lasting coordination structures.

IX.4 BUDGET PLANNING AND IMPLEMENTATION

Improvements in budget planning and implementation create important opportunities to improve the transparency and responsiveness of the subnational PFM system, augmenting the potential for citizen engagement. At the same time, national finance and sector ministries impose often changing regulations, procedures, and systems that impact the budget planning and formulation process. Subnational governments may be left scrambling to balance local needs with the requirements of responding to national budgetary priorities and guidelines, as well as using new administrative systems.

IX.4.1 BUDGET PLANNING

While budget planning at the local or subnational level aims to respond to local needs, it often faces constraints based on national priorities, systems, and processes. Moreover, as a significant portion of local revenue comes from central block or conditional grants, subnational governments may have little discretion in the actual allocation of resources. For example, even if a town has sufficient school facilities but is in need of a health clinic, they still may only have access to funds to build a school due to the conditionality of the grants they receive. Budgets at the local level also often need to have the formal or informal buy-in from national line ministries for spending specific to a given sector or purpose. For example, if a village or municipality would like to build a school, they may need approval from the Ministry of Education (whether at the central or regional level). Even if a local community is able to build a school using its own-source revenues, teachers' salaries are often paid by the central government and the community may not be able to staff the school without proper coordination.

Obtaining approval of subnational budgets can be complex. When countries have both elected and appointed officials at the local level, both types of officials must generally approve a budget before it can go to the national ministry of finance or ministry of local government for their approval. If a budget needs to be amended over the course of the year, it will also typically require approval from both local and national officials. Due to the difficulty of amending subnational government budgets, it is important that projections of revenue streams and expenditure needs are as accurate as possible. For example, if own-source revenues are higher than anticipated, subnational governments may not have the authority to expend any resources that exceed those provided for in their annual budget. For a subnational government, it is critical that the forecast of future revenue is based on an updated understanding of: the taxpayer base; cost and demand for fee-based services; and compliance rates, among other factors.

IX.4.2 BUDGET IMPLEMENTATION

Similar to budget planning, subnational governments are subject to central government processes, requirements, and oversight in the implementation of their budgets. The extent of central government control in budget implementation varies greatly based on the level of fiscal decentralization. For example, in countries with a high level of centralization, subnational governments may be subject to national government commitment and payment controls. Even in more decentralized systems, some forms of conditional grants may require prior approval before funds can be spent.

In addition to constraints posed by central government controls, when subnational governments rely on PFM systems designed for the national level, this can result in challenges for budget implementation. For example, budget codes or guidance provided by national authorities may not be aligned with spending needs at the local level. This can impede efficient spending, delay payments, and disrupt cash management.

IX.4.3 PARTICIPATION AND TRANSPARENCY IN SUBNATIONAL PFM

Budget transparency and participation are key for increasing citizen engagement and subnational government legitimacy. This can also have an impact on the allocation of resources to reflect where citizens have the most concerns. This is especially true when inclusionary activities are built into the budget process to increase the participation of marginalized groups such as women and people with disabilities. One example of community participation in the local level budget process driving positive changes in resource allocation for health and education comes from a [USAID/Senegal](#) Mission activity.

Transparency and participation is not just limited to the formulation of the budget but also to monitoring expenditures and increasing the availability and accessibility of budgetary information. In general, such activities are most effective when both the end-users in communities and the local officials collaborate on information to be disclosed and how to make it available. The International Budget Partnership offers some tips for improving the accessibility of budget information at the local level, including through the use of [Citizens Budgets](#).

Digital systems have the potential to improve the accessibility of subnational budget information but varying levels of internet access and the diversity of local languages may limit their impact. In many places, efforts to inform and engage the public on budget issues will need to leverage multiple media, including internet, television and radio, newspapers, and other channels. In addition, reforms to improve transparency may need to explicitly consider language challenges. For example, in an area with diverse national or local languages, PFM documents may need to be rendered in multiple languages instead of just the official one.

In conclusion, while local officials need to be responsive to local demands and needs, there is often only a small amount of room for truly discretionary allocations in a subnational budget. However, as a subnational unit's own-source revenue increases, the scope for its discretion also increases. Community participation and greater transparency across the budget cycle for subnational governments can increase compliance with user fees and local taxes, generating additional revenue and creating a virtuous cycle where the most immediate local needs are better addressed.

IX.5 COMMON CHALLENGES

Challenges in subnational PFM include:

- Conflicting, overlapping, and missing laws
- Assignment Problems also known as Unfunded Mandates
- Transfers are late, less than anticipated or even non-existent
- Limited PFM capacity

These challenges are discussed in more detail below.

IX.5.1 CONFLICTING, OVERLAPPING, AND MISSING LAWS

Legal provisions impacting the subnational level are often scattered across multiple laws and may even contradict each other. There also may be a piece of authorizing legislation that was always envisioned but never passed. This may mean that it is necessary to work for a specific reform at the national level prior to advancing PFM reforms at the local level. For example, in the case of Nepal the constitution was amended to create a federal system of government, creating the need to amend a wide variety of laws at the national, provincial, and local levels. This led to some cases where revenue assignment and expenditure responsibilities were unclear or overlapping. For example, trekking and tourism fees were established under the authority of both provincial and local governments due to an apparent conflict between the Constitution and the Local Government Operation Act.⁶³

Further, with respect to the design of USAID programming, it is important to recognize that work at the subnational level is situated within the context of the national legislative framework. It may be possible to have a pilot project designated with specific limited authorities in the short-term, but unless there is political will for legislative reform, such pilots are unlikely to endure. For example, USAID may provide grants to promote participatory budgeting at the local level, but unless the national government legislates a mechanism to provide grants to continue this type of activity it is unlikely to yield a sustainable impact.

IX.5.2 ASSIGNMENT PROBLEMS ALSO KNOWN AS UNFUNDED MANDATES

In principle, fiscal decentralization ensures subnational governments have authority and resources to implement their competencies in sectors within strictures imposed by national laws, rules, and regulations. However, decentralization reforms may expand delegated responsibilities without a commensurate increase in resources. One way to address this 'assignment problem' is to match functional responsibilities to financial revenues. This may entail supporting a review of responsibilities delegated to the subnational level and linking this with budgetary implications/estimated costs of such responsibilities. This can help show where the appropriate level of funding is not being delegated to match responsibilities. It is essential to recognize whether there is a gap in what the legal framework

⁶³ Asia Foundation (2017), [Diagnostic Study of Local Governance in Federal Nepal](#) - The Asia Foundation, Australian Aid and the Asia Foundation, page 23

provides for versus what is actually being implemented. In other words, the law may appropriately delegate the correct level of funding, but the funding may not actually be allocated to the local level.

Alternatively, a law may be nonexistent or exist but with outdated provisions that direct funds to the central ministry that formerly held the responsibilities now delegated to the subnational government. In implementing reforms, it is critical to improve alignment of the PFM framework along with decentralization reforms. As local control of expenditures increases, there is also greater need for subnational units to be subject to legal budget constraints to improve the quality and transparency of subnational spending decisions.

IX.5.3 TRANSFERS ARE LATE OR NON-EXISTENT

As discussed earlier, transfers, generally the most important source of revenue for local governments, are often unpredictable in their amount and timing. Recognizing and taking into account the real frequency, dependability, and transparency of transfers should help shape PFM activities at the local level. This may also inform some local sector-specific activities; for example a team planning for a health activity might want to factor in the history of conditional transfers and whether additional advocacy is needed in order to leverage the ministry of health to push the ministry of finance to improve the situation. Understanding why transfers are late, less than predicted or even non-existent requires a political economic lens. This lens can help illuminate the incentives and power dynamics driving the distribution, timing, and consistency of intergovernmental transfers. It is important to identify whether working on the underlying problem is within USAID's manageable interests; and whether approaching the problem indirectly, such as through increasing own-source revenue mobilization, will help or might actually make the situation worse by reducing incentives for the central government to improve the timeliness and adequacy of transfers.

IX.5.4 LIMITED PFM CAPACITY AT THE SUBNATIONAL LEVEL

Local governments may lack the human resources or know-how as well as the systems to efficiently manage assets, allocate expenditures, and track financial obligations. Subnational governments must increasingly comply with resource-intensive accounting and reporting requirements as well as respond to findings from audits and legislative inquiries. PFM capacity deficits can impede quality and equitable service delivery. For example, inefficient procurement can lead to stock-outs on commodities, while ineffective cash management can lead to deferred spending or costly short-term borrowing, reducing the resources available to respond to citizens' needs. Subnational units may also lack physical infrastructure such as an IT system that is necessary to access a nationally required system or to streamline tax collection.

IX.6 IMPLEMENTING REFORM

Subnational PFM or fiscal decentralization reforms can address a range of opportunities and challenges, including developing the legal framework, increasing the transparency and stability of transfers, improving subnational governments' fiscal autonomy through own-source revenue mobilization, and reinforcing the capacity for those governments. PFM capacity building might include on-site technical assistance, convening local officials for a workshop, remote learning, or providing coaches. Training is most effective when it is tailored to the tasks, functions, and skills that are immediately needed. Implementing such reforms requires different approaches in different contexts. The sub-sections below

outline special considerations in cases where local governments are elected, in authoritarian contexts, and in conflict-affected environments.

IX.6.1 PFM REFORM IN DEMOCRATICALLY ELECTED SUBNATIONAL GOVERNMENTS

Where local governments are democratically elected, fiscal decentralization can help to increase both political accountability and transparency. This might be done by increasing the value of fiscal transfers, reducing conditionality in fiscal transfers, or increasing revenue, especially by augmenting tax authority at the subnational level. Delegating tax authority in these contexts can have more positive effects on accountability and should be considered as a prioritized reform area. When a larger share of the tax burden is paid at the subnational level, taxpayers tend to be more motivated to hold government officials accountable for the spending of those revenues.

However, when implementing legal reforms to increase tax authority, consideration for subnational governments' tax collection capacity needs to be a factor and in many cases will require boosting through technical assistance or other support. Moreover, the assignment of appropriate tax bases to the subnational levels should also receive careful consideration. For example, it is generally held that those license fees, user charges, and taxes that are tangibly linked to a specific service or benefit should be used to the maximum extent feasible at the local level. This is because these generally avoid equity problems and cannot be easily avoided by local beneficiaries. Academic studies suggest that in democratic contexts, work at the local level increases trust and legitimacy in local government so bolstering PFM is working with the grain and increasing tax authority can be a positive reform.

IX.6.2 PFM REFORM IN AUTHORITARIAN CONTEXTS

On the other hand and surprisingly, those same academic studies also suggest that under an authoritarian form of central government, working at the local level decreases trust in the local government and increases trust in the central authoritarian regime. This means that increasing tax authority at the local level may ironically work towards entrenching the consolidation of power at the central level, which tends to be problematic in an authoritarian context. For example, local officials may be blamed for collecting tax revenue, while decisions about expenditures will still be taken at the central level and transparency remains opaque. Moreover, the central authorities may blame local government officials when services are not delivered even when the problems stem from the central level. There may also be more challenges with petty corruption from having more revenue collection at the local level. This then becomes more visible to citizens and further undermines legitimacy at the local level, while inversely impacting the national level or increasing the legitimacy of the authoritarian center. So in implementing PFM reforms, it is important to consider the wider context and the trade-offs across USG objectives. In an authoritarian context, supporting subnational PFM may have hidden costs for advancing democracy.

IX.6.3 SUBNATIONAL PFM REFORM IN CONFLICT-AFFECTED CONTEXTS

It is important to recognize that promoting fiscal decentralization can be destabilizing, especially in conflict-affected environments. Programming in this context needs to be a careful balance, reflecting strong conflict sensitivity considerations. Emphasizing linkages between local governments and the central government to reinforce the legitimacy of central government authority tends to be more

important in conflict-affected environments, especially ones where there are separatist tendencies. Supporting fiscal decentralization reforms and projects that bolster own source revenue at the local level can inadvertently reinforce separatism by giving separatist (local or regional) entities the sense that they can go off on their own. This may contribute to conflict tendencies.

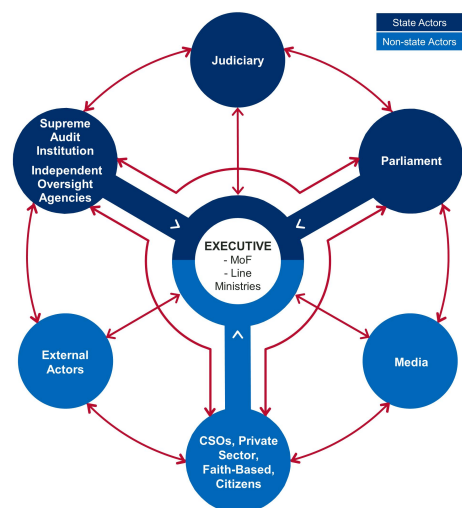
Understanding that there may be several different functional systems at play in a conflict-affected environment and recognizing how a project will likely interact with these existing systems is essential to understand how to improve PFM towards better service delivery objectives, while reinforcing movement towards stability. Indeed, the design of PFM activities in conflict-affected environments should be maximally flexible, building in as much monitoring, learning and adaptation as possible. In this way, the impact of project activities on conflict dynamics can be assessed and adjustments can be made as necessary. It is not sufficient in such environments to equate increasing the efficiency of the system or augmenting revenue with achieving positive results. Delving deeper to probe at who is benefiting and how communities are experiencing reforms or activities is necessary to ensure that projects exemplify a Do No Harm approach.

X. STAKEHOLDERS FOR EFFECTIVE PFM

There are multiple stakeholders for effective public financial management in every country, which include a range of state actors across the branches of government as well as non-state actors in civil society, the media, and other external actors, per Exhibit 48.

It is critical to consider the relationships and interactions between these stakeholders. For example, the media and civil society may engage with the legislature around challenges they observe within the PFM system that are inhibiting service delivery.

Exhibit 48: PFM Accountability Ecosystem



Alternatively, the Supreme Audit Institution might engage with external parties like the International Organization of Supreme Audit Institutions (INTOSAI) or its regional bodies to bring its audit techniques in line with international standards. Understanding how these various actors interact (or do not interact) within the system can be helpful to understand where greater collaboration might support better system performance.

In addition to understanding the formal roles of and relationships between each of the stakeholders within the PFM system, it is important to recognize that there may be divergent views and interests between sets of stakeholders and within a particular group of stakeholders. For example, private contractors who have an inside track to government contracts may resist procurement reform. For this reason, use of Political Economy Analysis (PEA) is important to the design and implementation of PFM reform and system strengthening activities. A technical note describing common themes across [PEAs of PFM reforms is available here](#).

X.I EXECUTIVE BRANCH

The Ministry of Finance is a major stakeholder across many PFM functions, and is usually responsible for providing analysis to inform fiscal policy, coordinating budget formulation and execution, establishing and supporting the implementation of accounting policy, managing the FMIS, creating standards for and supporting the implementation of internal controls, and compiling financial reporting. Depending on its structure, the Ministry of Finance may also include responsibilities for tax and/or customs

administration. There are various models for the internal organization of an MOF, but coordination with MDAs and sub-national governments and clear delineation of each institution's responsibilities are critical. Although treasury functions are often performed by a subunit of the MOF, some countries have a separate Treasury at the cabinet or sub-cabinet level, and some may have independent Revenue or Customs authorities.

Additionally, some countries have a Ministry of Planning (sometimes also called a Ministry of Economy) that is separate from the MOF and that takes a lead in macroeconomic analysis and planning, capital budgeting and public investment programs. Because of the importance of linking planning and budgeting, many countries combine these two roles in a single Ministry of Finance and Planning. In general, many countries have been moving away from a highly centralized planning system in favor of an approach where the Ministry of Planning focuses on the long-term strategic vision and each MDA has a responsibility for developing their own plans.

The MOF collaborates with all MDAs in the budgetary process. Typically, after the MOF issues budget instructions, initial budget preparation work is done by the MDAs responsible for the execution of the budget, often in collaboration with entities at the sub-national level. Agency budget requests must fall within the guidelines set by the MOF, usually set at the beginning of the process (but which may be amended). The MOF subsequently manages the flow of funds and monitors execution to ensure compliance with the budget. Depending on whether the accounting system is centralized or decentralized, the MOF will either record expenditures or an MDA will record its own expenditures and be responsible for its own accounting.

Executive leadership within the Office of the President or Prime Minister is responsible for setting national strategies and priorities. Budget allocations should reflect these priorities. In some countries, the President or Prime Minister submits budgets, with MOF support, to the Legislature. A strong system usually starts at the central level and then flows down to the regional or local level, where budget execution, procurement, design, and implementation occur.

The Central Bank is part of the Executive Branch but is typically and preferably independent from the Ministry of Finance often reporting separately to the legislature. The Central Bank has an important role in managing the currency's exchange rate and in producing macroeconomic forecasts that are required for monetary policy execution – these forecasts provide a check on those prepared by the Ministry of Finance and are often more widely trusted. It buys and sells national government securities and often acts as fiscal agent for the treasury and other government accounts.

Executive branch agencies and actors should have systematic, regular, and legally mandatory engagement with other stakeholders, including external actors via participatory methods and processes, in order to foster transparent, accountable, and citizen-responsive PFM. They should also work to publicly disclose the fiscal information required for other stakeholders to engage in accountability and oversight activities.

Exhibit 49 below provides an illustrative list of executive stakeholders that promote PFM through operational and functional capacities or help to ensure accountability.

Exhibit 49: Executive Branch PFM Stakeholders

OPERATIONAL AND FUNCTIONAL	ACCOUNTABILITY
<ul style="list-style-type: none"> • Ministry of Finance • Ministry of Planning • Central Budget Office • Central Procurement Unit • MDAs (budget, accounting and procurement units) 	<ul style="list-style-type: none"> • Supreme Audit Institution • Anti-Corruption Agency • Procurement Regulatory Body • Financial Disclosure Enforcement Entity • Ethics Body • Internal Audit Units • Professional Accountancy Board

Note: Supreme Audit Institutions may also be part of the legislative or judicial branch

X.2 LEGISLATIVE BRANCH

A legislative body has three functions: 1) represent its citizenry; 2) law-making; and 3) government oversight. Drawing on these three functions, legislatures have an inherent role within PFM through establishing the legal framework for PFM (law-making), approval and input into the national budget (representation), and identifying and addressing problems in budget implementation (oversight). Some countries have increased the role of the legislative branch as their PFM and governance systems mature. In these countries, the legislative branch takes a larger role in the design of PFM systems and approval and oversight of the budget. An effective legislature can hold the executive branch accountable and oversee government performance.

Many national constitutions require legislative approval of appropriations and changes to taxation. Good practice in PFM includes a separation between the institutions that authorize funding through appropriations and those that expend the funds authorized. For this reason, many countries require that legislative bodies scrutinize and approve the executive budget independently, even when the budget is prepared and submitted by the executive branch. This further improves accountability to the citizens and other stakeholders in systems where legislatures are democratically elected.

Many legislatures have limited resources and capacity to analyze the draft budget law carefully. In many countries, legislative decisions on budget proposals or public finance are prepared by some form of standing committee on the Budget and Public Finances. Many legislatures, especially in former British colonies, have a Public Accounts Committee responsible for oversight of the financial and performance accountability of executive branch agencies. Further, Public Accounts Committees are headed by the minority party, which does not control the executive, to ensure accountability.

Since many legislatures lack the staff and/or capacity to evaluate and analyze government budget submissions, these functions can be materially strengthened by the creation of a legislative fiscal analysis unit. This unit is frequently known as a “Parliamentary Budget Office”(PBO).⁶⁴ Not only is this good development practice, but it has been successfully implemented in many countries. Exhibit 50 provides several examples of USAID’s work to support PBOs in East Africa.

⁶⁴ See Exhibit 50 on PBOs for background. Also see “[Strengthening the Role of Budget Offices in the Parliament](#)” by the Westminster Foundation

Exhibit 50: USAID Support for Parliamentary Budget Offices

Starting in the early 2000s, USAID engaged with a number of legislatures in East Africa to establish or reinforce PBOs as a means to support parliamentary reformers seeking to overcome executive dominance.

One of the first partnerships was with the Ugandan Parliament. USAID provided training, equipment, and technical assistance as the Ugandan PBO grew into its new functions following its establishment in 2001.

This was closely followed by Kenya, where USAID supported reformers in the Kenya National Assembly who established their PBO in 2007 as a unit under the Directorate of Information and Research Services through a resolution of parliament. The Fiscal Management Act 2009 (FMA), strengthened the PBO's legal standing by establishing it as an office in the Parliamentary Service Commission (of note, establishing new legislative functions and offices by law or constitutional amendment helps ensure their longevity). In 2010, the office was elevated to a directorate, and both offices continue to effectively serve their parliaments.

The growth of PBOs in East Africa illustrates the principle that reforms in a country can be effective in encouraging comparable reforms among neighboring countries.

The legislature can also help ensure the transparency and legitimacy of budgeting and budget execution through engagement with civil society and the public. Legislative involvement is particularly important in reforming the legal framework for public financial management (e.g., organic budget laws, tax laws, procurement laws), addressing fiscal consolidation, and reviewing program results. The addition of media coverage and online access to hearings or even to make comments directly upon the budget can serve to bring further transparency and accountability to legislative actions related to PFM.

Legislative bodies and actors should have systematic and continuous engagement with other stakeholders, including external actors via participatory methods and processes, in order to foster transparent, accountable, and citizen-response PFM. Some examples of approaches for legislatures to engage with other actors in the course of their fiscal management duties include:

- **Public hearings and consultations:** Legislative committees can undertake public consultations or hearings on tax policy issues, pre-budget policy prioritization, the executive's budget proposal, and evaluation of budget implementation and outcomes. These consultations are frequently held by the budget or finance or Public Accounts committee.
- **Committee meetings:** Legislative committees can hold meetings on sectoral budgeting priorities and may call on experts (including from line ministries, PBOs, the SAI, the anti-corruption agency, or think tanks, among others) to present at committees holding debates on budget priorities or broader fiscal policy decisions (e.g., debt sustainability).
- **Online consultation tools or interactive platforms:** Legislative committees can use online surveys or platforms to gather public input on tax proposals or budget priorities within a sector or more generally. Contributors can post their comments publicly on the platform to enable others to respond and for Members of Parliament (MPs) to participate in the conversation. A summary of feedback can be reported within the relevant legislative committee as an input to policy making and budget scrutiny activities.

- **Social media:** MPs can use social media and surveys through these platforms to connect with their constituents regarding budget priorities at any phase of budget formulation. MPs may also share fact sheets or short videos explaining tax policy priorities, the budget process, and spending priorities, among others.
- **Publications and analytics:** PBOs may also public citizen budgets or other publications to explain the priorities within the budget, cost implications of new legislation, or new revenue policy proposals. These analytics and publications may contribute to a more informed debate on fiscal policy issues.
- **Town hall meetings and private sector engagement:** MPs can hold town hall meetings and meetings with private sector actors in their home jurisdictions to share information regarding tax and budget policy and prioritization and to seek constituent feedback on how these proposed policies might impact their communities to inform them about the executive's budget proposal and dialogue with them to understand how it will impact them.⁶⁵

Exhibit 51 below describes USAID support for the Parliament in Somalia to begin public hearings as a part of its budget process.

Exhibit 51: USAID Support for Parliamentary Hearings in Somalia

In 2017, the Somali government, with support from USAID's Strengthening Somali Governance (SSG) project, held the first public budget hearing in the country's history, inviting the public to listen and offer opinions on how public resources would be used to deliver goods and services. The budget hearings began with the presentation of Parliament's analysis of the executive budget proposal - an important counterpoint to the Executive's own analysis. The hearings were then opened for engagement and inputs from the public, including civil society.

The SSG activity also supported processes to seek public input on PFM legal and regulatory reforms and feedback on fiscal reporting. In Somaliland, SSG supported the parliament to hold public hearings on key public financial management and revenue bills, as well as the consolidated financial statements - the first-time financial governance legislation and financial statements have ever been presented for public comment.

USAID's work to establish systems and capacity to support meaningful public participation in legislative processes has continued through the Damal project, which has extended Parliament's engagement activities to include public dialogues or forums on topics such as Somalia's debt relief, the FY2020 supplemental budget and other financial legislation, and the impact of COVID-19. The COVID-19 pandemic created an impetus to move these consultations from being in person only to also being live streamed and televised to enable greater transparency and reach.

This introduction of participatory hearings and other forms of consultation on fiscal issues was a needed precedent for a state recovering from war, where government secrecy was the norm.

Source: Strengthening Somali Governance (SSG) Project Objective 1 Extension Final Report, Chemonics, 2018

⁶⁵ Adapted from: ParIAmericas (2020). [Strengthening Accountability through Fiscal Openness: A Toolkit for Parliamentarians in the Americas and the Caribbean](#), ParIAmericas, July 2020.

X.3 PUBLIC OVERSIGHT AND ACCOUNTABILITY AGENCIES

Many countries also have specialized bodies that promote fiscal accountability through spending controls or audit responsibilities.

One of the most common of these oversight institutions is the Supreme Audit Institution (SAI), which provides accountability by reviewing the government's revenue collection, spending, and compliance with financial laws and regulations and reports to the legislature. SAIs should produce timely reports, foster financial transparency, and provide assurance to oversight bodies. Government institutions are subject to various kinds of audits, including financial, compliance, performance, ethical, and value for money. In some cases these may be semi-autonomous agencies within the executive. In others, they may be a part of the Legislative branch. And, in still others, they may be a part of the Judiciary. In many francophone countries, the SAI is a part of the judiciary (*cours des comptes*) that hears audit cases and is complemented by an *Inspection générale des finances* (IGF – General Inspectorate of Finance), which completes much of the audit evaluation activities.⁶⁶ The placement of an SAI within government, the process through which they receive their budget, and the extent of Executive influence over their hiring decisions can all impact the independence and the effectiveness of these institutions.

Many countries complement the work of the SAI with other complementary oversight and accountability agencies. For example, some countries have an Anti-Corruption Agency with enforcement and investigative powers to help ensure transparency and prevent the misuse of funds. In other countries a public Ombudsman's Office has a mandate to receive complaints and conduct investigations regarding good governance and public integrity. In cases where there is malfeasance or serious mismanagement in the use of public funds by a civil servant, a civil service commission might also be involved. Across countries, public prosecutors and the justice system may be engaged to review cases where misconduct and misuse of funds is of a criminal nature.

In countries where there are multiple public agencies engaged in oversight and accountability activities, it is important for these agencies to have strong collaboration to avoid conflicting mandates, poor information sharing, or gaps in coverage. Many of these oversight agencies may also benefit from engagement with civil society and media actors. For example, SAIs are increasingly using Social Audit techniques, which leverage the knowledge and expertise of community level actors to monitor the implementation of service delivery and public infrastructure construction activities.

⁶⁶ More on the francophone model of *Inspection générale des finances* is available here: [PFM blog: The French General Inspectorate of Finance](#).

Exhibit 52: Citizen Participatory Audits in the Philippines

Launched by the Philippines Commission on Audit (COA) in 2012, the Citizen Participatory Audit (CPA) is a value-for-money or performance audit jointly conducted by the COA (the Philippines SAI) and individuals selected from civil society organizations (CSOs). ‘Citizen auditors’ selected by COA participate on a voluntary, non-remunerator basis. The use of joint audit teams aims to improve the transparency of the audit process and improve the responsiveness of the service delivery system to citizen needs.

Since its launch in 2012, COA has experimented and conducted various modalities to involve citizens in different aspects of public auditing. Citizens may engage in the design of audit data gathering tools, share technical knowledge, help to simplify audit reports to make them easier to understand for the public, among others. COA has also applied this approach in a number of different sectors, including conducting Citizen Participatory Audits of a major flood control project, Local Disaster Risk Reduction and Management Fund, local government solid waste management projects, local health centers, water, sanitation and hygiene projects, tourism road infrastructure projects and farm-to-market road projects. The CPA program has incorporated the use of technology to facilitate citizen audits - including having citizen auditors use their cellphone cameras to collect data by taking photos of specific locations on the road project, recording the GPS coordinates using Google maps, and uploading the data in the COA’s systems. This helped the COA obtain more timely data to monitor the road project’s actual progress, particularly in remote locations.

The CPA approach was launched with funding from the Australian Department of Foreign Affairs and Trade and the World Bank, but is now a formal part of COA’s policy framework and costs of sustaining the program are included in the COA’s national budget. The Philippines CPA approach was awarded the Open Government Partnership Impact Award in 2021.

Sources: [2021 OGP Impact Awards: Philippines – Citizen Participatory Audit](#); [Experience of SAI Philippines](#)

X.4 OTHER STAKEHOLDERS

Non-government stakeholders have an important role to play in each stage of the budget cycle and should be consulted in the course of the design of policy, laws and regulations related to PFM. These external stakeholders may engage via both formal and informal channels and may be generally considered to include civil society, the media, and the private sector.

Civil society includes a constellation of actors, each of which has its own interests in how the government spends public resources. According to the USG’s Foreign Assistance Standardized Program Structure (the [F-framework](#)): “Civil society organizations includes, but is not limited to, human rights organizations, youth movements, informal groups, religious organizations, labor and trade unions, professional associations, indigenous organizations, women organizations, LGBTI+ organizations, and think tanks.” Many countries have watchdog civil society organizations with specialized skills and tools to conduct oversight and advocacy around budget planning and expenditures. Some countries also have think tanks that regularly host debates and publish white papers on issues related to fiscal policy. But, because public spending systems affect every sector and member of society, virtually any civil society actor might find a strong reason to weigh in on debates around public finance, and their engagement helps improve the accountability of the public finance system. For example, human rights organizations might weigh in on whether a new human rights observatory has sufficient budget allocations to be functional. Alternatively, youth organizations might have an interest in advocating for increased funding

for community colleges. Social movements have also become increasingly influential, as can be seen in mass mobilizations to protest changes to tax policy in Colombia and Hungary.⁶⁷ Overall, civil society can serve as a watchdog, aggregator of citizen interests, and ultimately increase transparency, accountability AND citizens participation and engagement in PFM.

The media plays an important role in bringing timely and accurate information about public financial management issues into the publics' view. The media can be an important partner to improve the transparency and inclusiveness of the budget planning and implementation processes. Media outlets can carry reporting on policy discussions over trade-offs in various budget proposals. Investigative journalists have frequently engaged to expose mis-use or mis-management of government resources, as shown in Exhibit 53. Similarly, media actors can publicize opportunities for the public to engage in debates over budget allocations, including consultations conducted by the executive branch as well as legislative budget hearings. Broad dissemination of this information helps to ensure that opportunities for engagement are not limited to the political and economic elites.

Exhibit 53: Example of Press Coverage of PFM System Issues



The screenshot shows a news article from the website 'INSIDER'. The article title is 'Zimbabwean Finance Minister Says the Country Has Just \$217 In The Bank'. The byline is 'Agence France Presse Jan 29, 2013, 4:11 PM'. There are social media sharing icons for Facebook, Twitter, and LinkedIn. The main text of the article reads: 'After paying public workers' salaries last week, the balance in cash-strapped Zimbabwe's government public account stood at just \$217, Finance Minister Tendai Biti said Tuesday.'

Source: Agence France Presse Jan 29, 2013, 4:11 PM

The **private sector** includes a diverse set of actors, ranging from large multinational to small, informal businesses. Regardless of the scale of their operations, the public financial management system also has an important impact on private sector performance. For example, the private sector may have a role in sharing information about how various investments in public infrastructure might benefit different segments of the private sector and help businesses better reach export markets. Similarly, when governments are considering changes to taxation or procurement laws and regulations, the private sector may weigh in on the impact of these proposals on their operations. When engaging with the private sector, it is important to ensure that small and disadvantaged businesses have an ability to

⁶⁷ For more on Colombia, see [CIVICUS: Protests against tax reform lead thousands to the streets in Colombia](#). For more on Hungary, see [Reuters: Hungarians rally against Orban's reforms, skeptical of change](#).

advocate for their needs, in addition to large businesses that often have outsized access to decision makers in government.

External stakeholders in civil society, the media and the private sector can provide an essential check on PFM powers and bring the government closer to the people they serve. This is particularly the case where budgets and government actions are transparent and the media are free. However, in closing or closed societies, where government actors restrict access to information and where participation opportunities are limited, these actors face challenges and barriers for meaningful PFM engagement and development partners may need to push for enhanced protections for civil liberties to avoid placing these stakeholders in harm's way.

Exhibit 54 below summarizes significant opportunities for engagement and collaboration of these major stakeholders across the elements of the public financial management system

Exhibit 54: Opportunities for Stakeholder Engagement in Public Financial Management

ELEMENT	CIVIL SOCIETY	MEDIA	PRIVATE SECTOR
Budget Planning and Preparation	<ul style="list-style-type: none"> • Educate the public about budget processes and allocations • Aggregate and advocate for community needs within the budget • Engage in participatory budgeting (Section III.5.2) • Provide an independent check on the impact of spending decisions on marginalized groups⁶⁸ 	<ul style="list-style-type: none"> • Share information on what is included in budget proposals • Provide a platform for open debate over appropriate use of public resources • Disseminate information on how the public might participate in budget prioritization 	<ul style="list-style-type: none"> • Provide information on how public spending decisions might affect private sector investment • Advocate for spending that might enhance economic growth overall or in key sectors
Budget Implementation and Oversight	<ul style="list-style-type: none"> • Conduct research on the effectiveness and efficiency of budget implementation • Engage in social audit activities to monitor the progress of public investment programs (See Section XI.3) • Examine eProcurement data and other financial management data to detect potential cases of waste, fraud and abuse in spending • Advocate for increased independence of oversight and accountability actors, such as SAIs 	<ul style="list-style-type: none"> • Publicize information regarding the progress of public spending programs • Engage in investigative journalism to identify cases of waste, fraud and abuse in government spending or revenue collection 	<ul style="list-style-type: none"> • Engage in integrity pacts to support norms of integrity across private sector actors accessing government markets • Report cases of observed irregularities or abuses in the public procurement system
Public Revenue Collection	<ul style="list-style-type: none"> • Estimate the distributional impacts of new and existing public revenue policies, particularly on marginalized groups • Engage with the public through taxpayer education efforts 	<ul style="list-style-type: none"> • Share information regarding taxpayers rights and responsibilities • Engage in investigative journalism to identify cases of corruption in revenue collection 	<ul style="list-style-type: none"> • Provide feedback on the costs associated with tax compliance • Issue complaints on corruption or coercion in tax administration practices

⁶⁸ May include, but are not limited to, women and girls, persons with disabilities, LGBTQI+ people, displaced persons, migrants, Indigenous Peoples and communities, youth, older persons, religious minorities, ethnic and racial groups, people in lower castes, and people of diverse economic class and political opinions. These groups often suffer from discrimination in the application of laws and policy and/or access to resources, services, and social protection, and may be subject to persecution, harassment, and/or violence.

ELEMENT	CIVIL SOCIETY	MEDIA	PRIVATE SECTOR
Macro-fiscal Planning and Public Debt	<ul style="list-style-type: none"> • Provide an independent check on revenue projections (i.e., think tanks) • Disseminate information about the composition and level of public debt 	<ul style="list-style-type: none"> • Disseminate information regarding the sustainability of public finances • Host public debates around the appropriate levels of indebtedness • Conduct investigative journalism to identify cases of hidden debt 	<ul style="list-style-type: none"> • Provide reporting data required for macroeconomic projections
PFM Legal and Regulatory Reforms	<ul style="list-style-type: none"> • Organize roundtable discussions on options for reforms to PFM laws • Advocate for policy changes with MPs and executive branch policy staff 	<ul style="list-style-type: none"> • Publicize accurate information regarding policy proposals • Provide a platform for debate over specific policy provisions 	<ul style="list-style-type: none"> • Organize roundtable discussions on options for reforms to PFM laws • Advocate for policy changes with MPs and executive branch policy staff

XI. DESIGNING AND SEQUENCING PFM REFORMS

“Top Three” Reference Materials: Sequencing PFM Reforms

1. [Using PEFA to support Public Financial Management Improvement, PEFA Secretariat, 2020](#)
2. [Background Paper 1: Sequencing PFM Reforms, IMF: 2013](#)
3. [Public Sector Reform: What Works and Why? World Bank Independent Evaluation Group: 2008](#)

Given the scope and complexity of the PFM system, countries beginning a PFM reform and system strengthening processes may face challenges in identifying the right priorities and sequencing their efforts. Furthermore, PFM reforms often take a decade or more to fully complete - particularly when the reform requires changes across all of a country’s MDAs as well as sub-national governments. This means that PFM reforms often span over electoral periods and the reforms supported by a previous administration may be dropped by a new administration. This complexity is often further exacerbated by varied and sometimes conflicting donor priorities and inconsistency in funding to complete reforms.

As a result, it is important for countries’ PFM reform strategies to be based on a robust analysis of what improvements are most needed as well as the appropriate sequence of when reforms should be implemented. This section will outline good practice in the use of PFM Assessment to identify what reforms are needed, and will proceed to outline several approaches to sequencing reforms.

XI.1 PFM DIAGNOSTIC AND ASSESSMENT TOOLS

Before developing a sequenced strategy for PFM reforms, it is important to understand the baseline performance and challenges of the current system. This will help stakeholders to define priorities for the focus of reforms. PFM diagnostic and assessment tools are invaluable to identify the aspects of the PFM system that are most in need of reform or improvement.

These tools may be useful to assess the performance of core PFM systems and processes, PFM performance at a sub-national or sectoral level, and political economy or other contextual factors that might affect PFM system performance.

XI.1.1 TOOLS TO ASSESS CORE PFM SYSTEM PERFORMANCE

When a new reform process is being launched, many countries start with a comprehensive assessment of the performance of their PFM system. There are several potential tools that countries can use for this purpose, but the most commonly used tool is the Public Expenditure and Financial Accountability (PEFA)

assessment, which was developed by the World Bank in consultation with a number of development partners and the IMF. Exhibit 55 below provides an overview of several commonly used tools for assessing the overall performance of the PFM system.

Exhibit 55: Commonly used PFM System Assessment Tools

NAME	DESCRIPTION
Public Expenditure and Financial Accountability (PEFA) assessment	Last updated in 2016, PEFA measures 94 sub-indicators under 31 key indicators across seven pillars of performance including: (1) budget reliability; (2) transparency of public finances; (3) management of assets and liabilities; (4) policy-based fiscal strategy and budgeting; (5) predictability and control in budget execution; (6) accounting and reporting; and (7) external scrutiny and audit. PEFA evaluates PFM system quality and deficiencies but is not formulated to assess risk or generate risk mitigation measures.
Public Expenditure Review (PER)	The PER is a World Bank process to assess PFM and to assist the client country in reforming public expenditures by identifying needed reforms. Its specific focus is on developing programs for PFM problems that can be associated with the Bank’s Country Assistance Strategy. It examines fiscal discipline, allocative efficiency and technical efficiency. It may also include specialized chapters on specific sectors (e.g., health) or PFM topics (e.g., public investment management).
IMF Fiscal Transparency Code and Fiscal Transparency Evaluation	The IMF’s Fiscal Transparency Code (the Code) is an international standard for disclosure of information about public finances. The IMF’s Fiscal Transparency Evaluations (FTEs) are based on the Code and support countries to strengthen fiscal surveillance, accountability, and management. Overall the framework includes four pillars including: (1) Fiscal Reporting; (2) Fiscal Forecasting and Budgeting; (3) Fiscal Risk Analysis and Management; and (4) Resource Revenue Management.
USAID’s Government to Government (G2G) Risk Management Approach	USAID’s seven stage G2G Risk Management process includes a holistic review of all risks included in USAID’s Risk Appetite Statement (RAS): (1) fiduciary risks; (2) reputational risks; (3) programmatic risks; (4) legal risks; (5) security risks; (6) human-capital risks; and (7) information technology risks. The context setting phase of this risk management process generally includes the preparation of a country context report that provides details on partner country systems for budgeting, cash management, procurement and contracting, audit and reporting, internal controls, human resources and information technology (IT) systems for financial management and control. The main risk assessment and evaluation stages explore these issues within the G2G partner MDA.
Other development partners fiduciary risk assessments	The Asian Development Bank, African Development Bank, Interamerican Development Bank and bi-lateral donors like the UK’s Foreign, Commonwealth & Development Office (FCDO—formerly DFID) all conduct Fiduciary Risk Assessments. FRAs, like the PFMRAF, are designed to assess fiduciary risks when working through government systems. They are generally confined to a single sector or program.

The above PFM system performance assessments are generally able to provide a good sense of which PFM functions or sub-systems to focus on. That said, they do not provide enough detail to understand what specific interventions or reforms might be most important to pursue. For that reason, there are numerous diagnostic tools that are used to assess specific public financial management functions—for example audit or procurement. A summary of several of these tools is provided in Exhibit 56.

Exhibit 56: Commonly used PFM Sub-System Assessment Tools

NAME	DESCRIPTION
<u>Tax Administration Diagnostic Assessment Tool (TADAT)</u>	TADATs provide an objective assessment of the strengths and weaknesses of key components of a country's system of tax administration with reference to nine Performance Outcome Areas (POAs): (1) Integrity of the Registered Taxpayer Base; (2) Effective Risk Management; (3) Supporting Voluntary Compliance; (4) On-time Filing of Declarations; (5) On-time Payment of Taxes; (6) Accurate Reporting in Declarations; (7) Effective Tax Dispute Resolution; (8) Efficient Revenue Management; (9) Accountability and Transparency.
<u>Tax Policy Assessment Framework (TPAF)</u>	The IMF has been rolling out a tax policy assessment framework, with factors separated by tax type. The IMF has published a module on the Value Added Tax and the World Bank has published a module on Excise Taxes. Coverage of the tool will expand over time.
<u>OECD Methodology for Assessing Procurement Systems (MAPS)</u>	MAPS is an international standard and the universal tool to evaluate any public procurement system. Its indicator framework includes four thematic pillars, including: (i) legislative, regulatory and policy framework; (ii) institutional framework and management capacity; (iii) procurement operations and market practices; and (iv) accountability, integrity and transparency of the public procurement system.
<u>INTOSAI Performance Measurement Framework (SAI PMF)</u>	The SAI PMF provides Supreme Audit Institutions (SAIs) with a framework for holistic and evidence based evaluation of SAI performance. Includes 25 indicators for measuring SAI performance against international good practice in six domains: (1) independence and legal framework; (2) internal governance and ethics; (3) audit quality and reporting; (4) financial management, assets and support structures; (5) human resources and training; (6) communication and stakeholder management.
<u>Public Investment Management Assessment (PIMA)</u>	A comprehensive framework to assess infrastructure governance practices across three key stages of the public investment cycle: (1) planning of sustainable investment across the public sector; (2) allocation of investment to the right sectors and projects; and (3) implementation of investment projects to deliver productive and durable public assets.
<u>Debt Management Performance Assessment (DeMPA)</u>	DeMPA is a diagnostic tool used to evaluate a country's debt management processes and institutions. The pillars included in this assessment tool include: (1) Governance and Strategy Development; (2) Coordination with Macroeconomic Policies; (3) Borrowing and Related Financing Activities; (4) Cash Flow Forecasting and Cash Balance Management; (5) Debt Recording and Operational Risk Management; (6) Subnational DeMPA.

A more [comprehensive list of PFM assessment tools](#) developed by the PEFA Secretariat is available on their website.

XI.1.2 TOOLS TO ASSESS SUB-NATIONAL AND SECTORAL PFM SYSTEMS

As the PFM system reaches across sectors and levels of government, stakeholders exploring PFM reform challenges may also leverage findings from other complementary tools, such as those in Exhibit 57 and Exhibit 58.

Exhibit 57: Commonly used PFM Sectoral Assessment Tools, Local Government Assessment Tools

NAME	DESCRIPTION
<u>Sub-national Government PEFA</u>	The Sub-national Government PEFA framework adapts the performance areas from the standard PEFA assessment to the structures in place at the subnational level. It also introduces a new pillar with performance indicators related to intergovernmental fiscal relations.

NAME	DESCRIPTION
USAID's Democratic Decentralization Handbook	USAID's Democratic Decentralization Handbook includes a chapter that lays out a decentralization assessment framework that explores political dynamics, the extent of political, fiscal and administrative decentralization, major actors and their interests regarding decentralization reforms, and potential areas of focus to advance democratic decentralization.

Exhibit 58: Commonly used PFM Sectoral Assessment Tools, Sectoral Assessment Tools

NAME	DESCRIPTION
Public Expenditure Tracking Survey (PETS)	PETs are a diagnostic tool that is similar to an audit of financial flows. It tracks the proportion of government resources released from the central level that actually reaches the service delivery level—for example schools or health clinics. This can help to identify weaknesses in PFM process and systems within sectors that leads to a loss of resources. The scope can vary according to sector, the type of expenditures tracked, and of the number of levels of government involved.
USAID Health Sector Assessment Approach	The Health Sector Assessment Approach or HSAA v3 is the primary health system assessment tool deployed by USAID. It is designed to analyze the performance of policies and regulations in the context of core health system functions: service delivery; human resources for health; medical products, vaccines and technologies; health information systems; health financing; and governance.
World Bank School Finance Framework, Rubric and Questionnaire (part of SABER toolkit)	This is an Education finance assessment framework that aims to create a knowledge base and to evaluate the quality of school finance systems. The assessment framework calls for the collection of comprehensive and standard data in five core areas: (i) School conditions and resources; (ii) Allocation mechanisms; (iii) Revenue sources; (iv) Education spending; and (v) Fiscal control and capacity.

XI.1.3 ASSESSING CONTEXT AND POLITICAL ECONOMY FOR PFM REFORM

PFM reforms often fail if the economic or political context is unfavorable. It is important to understand the local context and the degree of ownership of key stakeholders in the reform process. It can be useful to examine why PFM reforms have or have not succeeded in a given country or similar countries in the past. These lessons can guide the new reform approach. The context may also explain if a reform is timely - for example, due to the political calendar or market conditions (e.g., low prices of major export products may make macro-fiscal reforms a higher priority). Some important contextual considerations for PFM include:

- History and culture
- Politics
- Organization, structure, and staffing of the government
- Structure and performance of the economy (including production, prices, trade, and debt)
- Internal or external conflicts
- Macroeconomic risk, and control risk specific to PFM systems and execution
- Current or previous support from donors or other development partners aid, especially in the PFM space.

These factors can have an important impact on the effectiveness of PFM reforms. Weaknesses in the PFM system often endure despite years of work because the actors within the system have political, social and economic incentives to maintain those weaknesses. For this reason, it is important for local reform stakeholders and development partners to carefully consider the political and broader governance context in the design and implementation of PFM reform efforts.⁶⁹ USAID's Democracy, Human Rights and Governance Strategic Assessment Framework is one way to examine the governance context. Another category of tools are political economy analysis (PEA) and thinking and working politically approaches. PEAs can help practitioners to unpack the complex interests of stakeholders and identify areas where there may be a window of opportunity to move reforms forward. It is difficult to label all stakeholders as either pro-reform or anti-reform. Instead, stakeholders generally support some aspects of a reform and not others. PEA can help reformers better craft and communicate about PFM reforms in ways that will be more likely to garner the support they need to succeed. A PEA should be performed prior to final activity design and should be repeated periodically throughout activity implementation.

XI.2 SEQUENCING APPROACHES

Countries at every level of development need to prioritize and sequence their PFM reform efforts; it is too disruptive to attempt to reform the whole system at once. PFM reforms are usually prioritized on the basis of one or more of the following factors:

- **Quick wins:** Start with one or more discrete actions that are relatively straightforward to implement, on which there is broad consensus and that will yield demonstrable success (i.e., low-lying fruit).
- **Most buy-in:** Start with the areas where the authorities have most interest, ensuring maximum commitment to the reform.
- **Respond to shocks:** In some cases prioritization of reforms may shift due to events within the country that raise the importance of certain reforms. For example, a major corruption scandal might lead to a prioritization of procurement or internal controls. Alternatively, a drop in commodity prices for a resource rich country might lead to prioritization of cash management and revenue mobilization.
- **Weakest link:** Choose the area that is the weakest (e.g., has the lowest PEFA scores) based on the argument that a system is as strong as its weakest link.
- **Basics first:** If not already in place, start with fundamental reforms that focus on establishing basic accounting, compliance and control functions, along with basic credibility within a line item budget, and move to other reforms thereafter.
- **Platform or staged approach:** A corollary to the “basics first” approach, prioritize reform activities based on complementary packages of reform that proceed in a logical sequence, where one reform sets the basis for the next one moving from less complex to more complex. A more detailed discussion of this approach is provided in Exhibit 59.⁷⁰

⁶⁹ See “[Political Economy of Public Financial Management Reforms: Experiences and Implications for Dialogue and Operational Engagement](#)” from Fritz, Verhoeven, and Avenia of the World Bank.

⁷⁰ list expanded on and adapted from [Diamond \(2013\)](#)

Overall, USAID recommends a phased approach to PFM reforms that takes into consideration where stakeholder buy-in is strongest. Depending on the country's context, there may also be a need to begin developing and implementing some higher-level systems concurrently when there is strong political will to do so. Countries should begin preparing for future phases to reduce the risk of delays and decreased commitment for reforms that are more complex or difficult to implement.

It is also important to apply a higher level of scrutiny and attention to sequencing when implementing PFM systems building in post conflict and fragile settings. For a more detailed discussion on working on PFM in fragile and post conflict countries, please refer to [Gallagher \(2007\)](#).

USAID missions often apply an additional layer of analysis on sequencing of reforms in terms of how various PFM options might support sectoral outcomes within our broader Country Development Cooperation Strategy (CDCS). For example, USAID might work with the Ministry of Finance to prioritize the Health, Education, or Agriculture sectors as pilot sectors for new budgeting reforms. Similarly, USAID might advocate for and support a focus on audit and procurement in cases where we support government-to-government programming that includes payments for goods and/or works.

Exhibit 59: Platform Approach to Sequencing PFM Reforms

Under the platform approach, PFM reforms are implemented sequentially in a series of interrelated reform packages ("platforms"), rather than as individual measures. Each of these platforms is designed to have clearly defined outcomes and constitute a step toward adoption of the next package. Properly designed platform approaches disaggregate reform steps so that each can reasonably be expected to be sustainable, effective, and desirable within each platform. Thus, even if subsequent reforms are delayed or abandoned their incremental precursors remain and benefit the partner country's PFM system.

Diamond (2013) proposes a platform approach that recommends that countries carry out PFM reforms in the following order:

- 1) **Establish core PFM functions:** establish a realistic budget, basic controls, timely and comprehensive accounting, revenue administration, cash management including a treasury single account.
- 2) **Consolidate system by strengthening IT, accounting and legal basis for PFM:** improve accounting, for example, through use of cash-based accounting IPSAS standards, introduce IFMIS modules and related updates to procedures and change management, modernize the legal and regulatory framework
- 3) **Move from annual to medium term budget perspective:** introduce medium term fiscal framework and expenditure ceilings, improve linkage between medium term planning and budgeting, move toward accrual accounting
- 4) **Strengthen performance orientation of the budget:** introduce program and performance budgeting, make needed upgrades to the accounting and IT systems to facilitate new budgeting approach, strengthen performance audit capacity

Individual countries may have different variations on sequencing based on the current status of their PFM system and stakeholder priorities, but this approach helps to advance through reforms in a logical and mutually reinforcing manner.

Source: Jack Diamond, [Background Paper I: Sequencing PFM Reforms](#), IMF: 2013, p. 13–14

XI.3 GOOD PRACTICES IN IMPLEMENTING REFORMS

The various approaches to sequencing PFM reforms emphasize the importance of incremental implementation at a pace that partner country institutions can absorb effectively. USAID experience in Kosovo, Kazakhstan, and many other countries indicates that a graduated and sequential approach to reforming PFM sub-systems is likely to be more effective than attempts to alter many systems or subsystems simultaneously.⁷¹ However, the absorptive capacity of partner governments varies and those experiences may not be generalizable if sufficient capacity development assistance is provided and the political will exists.

Moreover, governments and the development partners they work with should plan steps necessary to move through all the stages of a reform. PFM reforms often start with the development of a new law, regulation or guideline and proceed through its piloting and roll-out across all relevant implementing units. This process should accommodate opportunities for internal and external stakeholders to weigh in on the reform and allow for training and change management for the government staff who will need to implement new policies and procedures. Many PFM reforms apply to all MDA and/or local government units. As a result, the reforms need to be feasible within the wide variety of implementing units and the scale of training and change management can be time consuming and should be planned in advance. Exhibit 60 provides additional lessons from a PEFA study on PFM reforms.

Exhibit 60: Lessons Learned on Implementing PFM Reforms from PEFA

A review of Public Expenditure Framework Assessment (PEFA) results over time provides some key lessons on additional factors that affect successful PFM reform:

- Reforms that involve many actors are slower than those with fewer stakeholders;
- Countries often establish new laws, regulations, and plans, but implementation often lags or falls short;
- Significant reform progress can be made in post-conflict countries despite low capacity, continuing insecurity, underdevelopment, and the lack of prior successful experience with independent statehood;
- Reforms are more successful when country-specific challenges are addressed, rather than borrowing reform approaches from other countries; and
- Reforms do not have to be perfect; they just have to be improvements over the status quo. Reform approaches can be refined during implementation.

⁷¹ However, note that a too gradual approach may cause reforms to stall. Care should be taken to check assumptions of organizational absorption capacities against actual experience and partner country commitments, while programming to increase those capacities.

Regardless of the exact sequencing of PFM activities, it is paramount that the reforms are designed, paced and phased in close coordination with the partner country.

Adapted from: [Fritz, Verena & Lopes, Ana & Hedger, Ed. \(2012\)](#)

Country ownership of the reform process is essential for effective implementation and sustainability. Ideally, the partner country, rather than donors, should develop a PFM reform strategy and action plan that donors can then support. However, in most situations, PFM reform strategies and programs are developed through discussions among major multilateral and bilateral donors (especially the IMF and World Bank) and the government. In addition to partner government ownership of reform strategies, USAID requires discussions with other stakeholders. The sequencing incorporated in the reform strategies should reflect the country's own priorities and context, including human and institutional capacity, political economy, and stakeholder agreement. The partner government should set a realistic timetable for reforms and be willing to make multi-year commitments to the process.

XII. CONCLUSIONS

A strong PFM system is essential for economic growth, government efficiency, and public sector effectiveness. It is a key element in increasing accountability, transparency, and legitimacy in governance. PFM includes the mobilization of revenue, allocation of funds, expenditures, accounting, and monitoring, audit, and evaluation. Sound PFM systems are fundamental to the appropriate use of development partner assistance, particularly as development partners increasingly rely on partner country systems for budget development, execution, and control. Successful implementation of PFM reforms depends on maintaining a focus on fiscal discipline, allocative efficiency and technical (or operational) efficiency. To truly embrace PFM reform, governments must commit to transparency and accountability to the public and all stakeholders in addition to legal, technical, and capacity enhancements.

PFM processes and outputs are structured around the budget cycle and can help ensure that public expenditures are well planned, executed, recorded, monitored, reported, and evaluated. The planning process should engage key stakeholders in a participatory manner and be realistic in goals, timeframes, resources, and other constraints. The budget cycle planning and development processes should start with a macro-economic framework, fiscal framework, and strategic plans that reflect the country's own priorities and economic context. Key aspects of strong budget execution include a transparent and competitive procurement system, expenditure controls that require adherence to the budget, a sound cash management system, and a good accounting system to record and report on revenues, expenditures, assets, and liabilities. Finally, a robust and comprehensive system of audits, monitoring and evaluation, and reporting are necessary to inform future budgetary and programmatic decisions.

PFM reform initiatives depend on the partner government's interest and ability to take ownership of the reforms, build a strategy, and invest in human and institutional capacity development. Governments should be responsible for setting their own PFM strategies including the sequencing of reforms, implementation schedules, and the financial and human resources required with the support of development partners. Reform strategies should not be driven by development partners, although informed discussions between development partners and the partner country government may influence funding, strategic elements, and the timing of reforms.

The PFM system must be tailored to country-specific contexts; thus strategy, planning, and implementation will differ across and within countries. However, good functional practices in PFM remain important guarantors of fiscal discipline, allocative efficiency and technical efficiency, and USAID should support their adoption and implementation in partner countries. There is no singular formula for PFM reforms that can guarantee success. Nevertheless, better knowledge of existing PFM systems and processes as well as standards and good practices can improve the results.

ANNEXES

ANNEX I: TECHNICAL RESOURCE LIBRARY

CROSS-CUTTING PFM TECHNICAL RESOURCES

RESOURCE AND ORGANIZATION	DESCRIPTION
Guidelines for Public Expenditure Management (IMF 1999)	This handbook provides a framework for thinking about how governments can attain sound budget performance and gives guidance on the key elements of a well- performing public expenditure management (PEM) system.
Political Economy of Public Financial Management Reforms: Experiences and Implications for Dialogue and Operational Engagement (World Bank 2017)	This report maps out what PFM progress looks like across countries, regions, and income groups, and then explores the underlying nontechnical drivers and constraints reformers faced, and how these influenced the feasibility and robustness of efforts to strengthen PFM.
PEFA, Public Financial Management, and Good Governance (World Bank 2019)	This book explores the several components of good governance and their relationship with PFM performance, including; (1) political institutions, electoral systems, and political parties; (2) fragility; (3) corruption and (4) tax administration.
Using PEFA to support Public Financial Management Improvement (PEFA Secretariat 2020)	This handbook provides guidance on how to use PEFA assessments as part of a stakeholder dialogue to develop and sequence PFM reform initiatives.
Strengthening PFM in Post-Conflict Countries (World Bank 2011)	A cross-country study of public financial management reforms in post-conflict situations shows examples of progress in difficult circumstances, as well as explores patterns of sequencing and progress that differ from standard assumptions.
Background Paper 1: Sequencing PFM Reforms (IMF 2013)	This Good Practice Note aims to assist in the successful design and implementation of PFM reforms by addressing the issue of appropriate sequencing. The study provides an overview of the literature, describes a three stage sequencing framework, and unpacks some of the non-technical considerations to sequencing, such as political economy.

BUDGET PLANNING TECHNICAL RESOURCES

RESOURCE AND ORGANIZATION	DESCRIPTION
Beyond the Annual Budget: Global Experience with Medium Term Expenditure Frameworks (World Bank 2013)	A comprehensive review of country experience with Medium Term Expenditure Frameworks (MTEFs) worldwide over the period 1990 to 2008. The report defines what an MTEF is and what it aims to achieve, classifies MTEFs according to their stage of development, explores the impacts of MTEF adoption, and shares lessons learned from supporting MTEF implementation.
Introducing the new PPB: Pragmatic Program Budgeting (World Bank 2022)	This paper identifies challenges for countries implementing program budgeting, especially in budget execution, and suggests means to resolve them. It provides guidance to help resolve the tensions between planning, management, and control in pursuit of higher performance from governments.
Budget Transparency Toolkit (OECD 2017)	The OECD Toolkit on Budget Transparency introduces the institutions, instruments and standards that relate to budget transparency, considers institutional or sectoral issues, and provides guidance on how to draw on this set of tools to achieve more open, transparent, inclusive and accountable budget processes.
Gender Responsive Budgeting in Practice (UNFPA 2006)	The training manual on gender responsive budgeting (GRB) was designed to support the application of gender budget analysis tools. It provides a comprehensive overview of entry points for gender responsive budgeting within national budget cycles.
Gender Budgeting: Fiscal Context and Current Outcomes (IMF 2006)	This paper provides an overview of the policies and practices associated with gender budgeting as they have emerged across the world, as well as examples of the most prominent efforts in every region of the world.
Participatory Budgeting: An Evidence Review (Public Policy Institute for Wales 2017)	This report summarizes the existing evidence in relation to participatory budgeting and outlines the main issues that need to be considered when looking to implement participatory budgeting techniques.
Climate-Sensitive Management of Public Finances—“Green PFM” (IMF 2021)	A technical note that outlines the history of green PFM, entry points within the budget cycle for climate considerations, and guiding principles for a green PFM reform effort.

BUDGET EXECUTION TECHNICAL RESOURCES

RESOURCE AND ORGANIZATION	DESCRIPTION
Expenditure Control: Key Features, Stages, and Actors (IMF 2016)	This technical note and manual describes: (1) stages in the government expenditure chain; (2) controls exercised at each stage; (3) key institutional actors exercising controls; (4) variations across countries; (5) common weaknesses in controls; and (6) options for strengthening expenditure controls.
Guide to Enactment of the UNCITRAL Model Law on Public Procurement (UNCITRAL 2014)	This paper identifies challenges for countries implementing program budgeting, especially in budget execution, and suggests means to resolve them. It provides guidance to help resolve the tensions between planning, management, and control in pursuit of higher performance from governments.
Electronic Government Procurement Implementation Types: Options for Africa (World Bank 2022)	The OECD Toolkit on Budget Transparency introduces the institutions, instruments and standards that relate to budget transparency, considers institutional or sectoral issues, and provides guidance on how to draw on this set of tools to achieve more open, transparent, inclusive and accountable budget processes.
Public Procurement Toolbox (OECD)	The training manual on gender responsive budgeting (GRB) was designed to support the application of gender budget analysis tools. It provides a comprehensive overview of entry points for gender responsive budgeting within national budget cycles.
Public Investment Management (PIM) Reference Guide (World Bank 2020)	This paper provides an overview of the policies and practices associated with gender budgeting as they have emerged across the world, as well as examples of the most prominent efforts in every region of the world.

REVENUE TECHNICAL RESOURCES

RESOURCE AND ORGANIZATION	DESCRIPTION
Tax Administration Reform Primer (USAID, 2012)	This paper provides an overview of the tax administration reform process, highlighting areas frequently in need of reform and providing case illustrations of successful reform.
Tax Policy Reform Primer (USAID, 2022)	This primer provides an overview of tax policy and tax policy reform in developing countries, drawn from international experience and best practices.
Innovations in Tax Compliance: Building Trust, Navigating Politics, and Tailoring Reform (World Bank, 2022)	This book presents a conceptual framework to advance tax compliance through greater emphasis on building trust, navigating political resistance, and tailoring reform to unique local contexts.

TREASURY OPERATIONS AND CASH MANAGEMENT TECHNICAL RESOURCES

RESOURCE AND ORGANIZATION	DESCRIPTION
Cash Management and Commitment Control—Principles and Problems in Practice. (World Bank 2021)	This Practice Note helps practitioners identify specific cash management and commitment control problems, their underlying causes, and the most relevant approaches for addressing them.
How to Build Cash Management Capacity in Fragile States and Low-Income Developing Countries. (IMF 2022)	The paper offers practical approaches, examples of country practices, and proposed approaches to design and implement cash management system strengthening.

RESOURCE AND ORGANIZATION	DESCRIPTION
Public Debt: A Primer for Development Practitioners. (USAID 2022)	This primer covers key concepts and tools that are central to public debt theory and practice to assist USAID and other development stakeholders to understand how to detect early warnings of debt vulnerabilities and mitigate risks.

PUBLIC SECTOR ACCOUNTING AND REPORTING TECHNICAL RESOURCES

RESOURCE AND ORGANIZATION	DESCRIPTION
Chart of Accounts: A Critical Element of the Public Financial Management Framework (IMF 2011)	This technical note discusses the purpose of a chart of accounts and its importance in public financial management and key steps for identifying data requirements and structures for a chart of accounts.
Handbook of International Public Sector Accounting Pronouncements (IPSAS Board 2022)	This Handbook contains the complete International Public Sector Accounting Standards, published as of January 31, 2022. It also includes the Conceptual Framework for General Purpose.
Integrated Financial Management Information Systems: A Practical Guide (USAID 2008)	This paper discusses “best practices” for designing and implementing Integrated Financial Management Information Systems (IFMIS) including guidance on IFMIS implementation in developing and post-conflict countries.
Introducing Financial Management Information System in Developing Countries (IMF 2005)	This paper investigates the reason for failures to implement and sustain IFMIS in developing countries and offers suggestions for addressing common challenges in IFMIS implementations.
A Handbook on Financial Management Information Systems for Government (World Bank 2014)	This handbook discusses practical and operational issues related to the design, procurement and implementation of FMIS for Government. It is based on experience on over twenty projects in countries in the Soviet Union, Eastern Europe, Africa, the Caribbean, and South and East Asia.

AUDIT, OVERSIGHT AND ACCOUNTABILITY TECHNICAL RESOURCES

RESOURCE AND ORGANIZATION	DESCRIPTION
INTOSAI Framework of Professional Pronouncements. (IFPP) (INTOSAI 2021)	This is a collection of the formal recommendations of the INTOSAI Community, drawing on the professional expertise of INTOSAI’s members to provide INTOSAI’s official statements on audit-related matters.
International Standards on Auditing (International Auditing and Assurance Standards Board 2020)	This is a compendium of the International Auditing and Assurance Standards Board’s set of standards, resources and pronouncements.
International Standards for the Professional Practice of Internal Auditing (Institute of Internal Auditors 2017)	This is a compendium of the Institute of Internal Auditors’s set of standards.
Supreme Audit Institutions Independence Index: 2021 Global Synthesis Report (World Bank 2021)	This report summarizes the results from a World Bank assessment of 118 countries on the independence of Supreme Audit Institutions (SAIs).
Assessing the Role of Parliament in the Budget Process (Westminster Foundation 2020)	This paper focuses on how the Public Expenditure and Financial Accountability (PEFA) Framework can be used to assess the role of parliament in the budget process.

ANNEX 2: CASE STUDIES OF PFM REFORM

CROSS-CUTTING PFM CASE STUDIES

RESOURCE AND ORGANIZATION	DESCRIPTION
Public Finance Management Reform: Case Study Slovakia (World Bank, 2019)	This interactive eLearning course explores the strategy taken to Slovakia's PFM reforms.
Strengthening public financial management reform in pacific island countries (ODI 2017)	This report examines experiences of PFM reform in two Pacific island countries—Tonga and Kiribati—focusing on the research period 2010–2014.
Evaluation of Public Financial Management Reform Burkina Faso, Ghana and Malawi 2001–2010 (AfDB 2012)	This report summarizes a set of evaluations of the overall programmes of PFM reform conducted over 2001 to 2010 in Burkina Faso, Ghana and Malawi and of the external support provided to these reforms by Development Agencies.

BUDGET PLANNING CASE STUDIES

RESOURCE AND ORGANIZATION	DESCRIPTION
Introductory Guide to Participatory Budgeting (PB Network 2015)	Participatory budgeting can take many forms and serve different purposes. The case studies in this guide provide an overview of several examples of participatory budgeting approaches from the United Kingdom.
Finance and Planning to Coordinate Capital and Recurrent Expenditure (Cabri 2017)	Integrating capital and recurrent expenditures appropriately is a budget coordination problem faced by many ministries of finance in Africa. This report assesses the effectiveness of mechanisms used by the finance ministries of Botswana, Namibia, Rwanda and South Africa to integrate these expenditures within the overall budget process.
Program Budget Structure in the Health Sector (International Budget Partnership (IBP) 2018)	Case studies from Brazil, Indonesia, Mexico and the Philippines on shifting toward program budgeting in the health sector.
Integrating gender and climate change in public budgeting: The case of Mexico (IBP 2021)	This case study describes how Mexico is taking steps to reflect the intersection of gender and climate change in elaborating its central government budgets.

BUDGET EXECUTION CASE STUDIES

RESOURCE AND ORGANIZATION	DESCRIPTION
Improving the execution of capital expenditure financed from state resources in the Central African Republic (Cabri 2019)	This case captures the experience of the Central African Republic's Ministry of Finance and Budget (MFB) in resolving the persistent problem of the underspending.
Managing Budget Reallocations & Arrears in the Gambia (Cabri 2018)	This case captures the experience of the Ministry of Finance and Economic Affairs (MoFEA) to address the long-standing problem of virements (budget reallocations) and arrears leading to a misalignment in the appropriated budget and spending.
Public financial management and the digitalisation of payments (ODI 2019)	This paper explores the linkages between the digitalisation of payments and PFM through case studies in India, Mexico, Estonia and Ghana.

REVENUE CASE STUDIES

RESOURCE AND ORGANIZATION	DESCRIPTION
DRM Case Studies (USAID 2016) Bosnia and Herzegovina Nepal Philippines	This set of case studies highlights recent experiences of five developing countries in improving domestic resource mobilization (DRM) and forging more transparent, efficient, and effective public revenue systems.
DRM—Business-Friendly Reforms Boost Revenue for Georgia’s Transition	This case study shares the experience of Georgia following the “Rose Revolution” and the election of a reform government in 2004, when the country embarked on a flurry of reforms designed to stamp out public sector corruption and create an attractive environment for investment and job creation.
El Salvador Tax Reform Boosts Revenues for Development	This case study taxes the experience of El Salvador increasing its domestic resources as a new administration took office in June 2004 and how it increased tax revenues to meet major fiscal demands to recover from the 2001 earthquakes and to cover the cost of moving to a fully funded pension system.

TREASURY OPERATIONS AND CASH MANAGEMENT CASE STUDIES

RESOURCE AND ORGANIZATION	DESCRIPTION
Cash management in Lesotho (Cabri 2020)	This case study discusses cash management arrangements in Lesotho, explores some challenges related to cash management, and describes the country’s approach to introducing a treasury single account.
Improving cash management through effective coordination The Mauritian experience (Cabri 2021)	The case study reviews the legal, regulatory and institutional frameworks for PFM, with a special focus on cash management, discussing how cash forecasting is performed and describing the coordination mechanism that exists among key stakeholders.

PUBLIC SECTOR ACCOUNTING AND REPORTING CASE STUDIES

RESOURCE AND ORGANIZATION	DESCRIPTION
Benefits of Accrual Accounting in the Public Sector (PULSAR, 2022)	This report describes the various benefits of introducing accrual accounting and includes case studies from Cyprus, Greece, Portugal, France and the United Kingdom.
Implementing Integrated Financial Management Information Systems (GSDRC, 2015)	This report provides general guidance and specific cases on IFMIS implementation in Tanzania, Ethiopia, Uganda, Malawi, Rwanda, and Kenya.
South Africa’s financial management information architecture: Workable transversal system or outdated legacy system? (Cabri 2021)	This case study describes South Africa’s existing IFMIS system, challenges associated with the system, and an ongoing IFMS project to replace it. The study concludes by drawing general lessons for other countries considering modernizing their administrative systems.

AUDIT, OVERSIGHT AND ACCOUNTABILITY CASE STUDIES

RESOURCE AND ORGANIZATION	DESCRIPTION
Guardians of Accountability: A Field Experiment on Corruption & Inefficiency in Local Public Works (Lagunes 2018)	This study describes the outcomes from a randomized control trial experiment to identify how community based and government oversight can lead to cost and time efficiencies in the delivery of public works projects.
Nepal: Civil society and public auditors join forces to combat corruption and inefficiency	A case study describing how increased collaboration between civil society and the Office of the Auditor General in Nepal came about and the impacts of that collaboration.
The Impact of Audits in Argentina, India, and the Philippines (IPB 2016)	This series of case studies documents the impact of audits in Argentina, India, and the Philippines. The cases also demonstrate the importance of public opinion, media, judiciary, CSOs, and other accountability agencies in taking audit findings and recommendations forward to hold those audited accountable.
Good Practices in Supporting Supreme Audit Institutions (OECD 2010)	As a part of a broader review, this report describes successes and lessons learned from audit strengthening activities in Bangladesh, Indonesia, and Tanzania.
Promoting Integrity and Fighting Corruption - Activity Vignette Series (USAID 2021) Ghana GSAM Indonesia CEGAH Uganda GAPP	A series of case studies describing recent USAID project experience to improve accountability over the use of public resources—includes cases from Ghana, Indonesia, and Uganda.

ANNEX 3: COMMITMENTS REGARDING PFM REFORMS FROM MAJOR AID EFFECTIVENESS ACCORDS

The Paris Declaration on Aid Effectiveness (2005) confirmed donor commitment to some key reforms for public financial management:

- Strengthening partner country development strategies and planning, budgeting, and performance;
- Increasing alignment of aid with partner country priorities, systems, and procedures and helping to strengthen their capacities;
- Enhancing donors and partner country accountability on development policies, strategies, and performance to their citizens and legislatures;
- Eliminating duplication of efforts and rationalizing donor activities to make them more cost-effective;
- Reforming and simplifying donor policies and procedures to encourage collaboration and align with partner countries' priorities, systems, and procedures; and
- Defining measures and standards of performance and accountability for PFM, procurement, fiduciary safeguards and environmental assessments, in line with good practices, and helping to ensure their timely application.

In the aid effectiveness conferences in Accra, Ghana (2008) and Busan, Korea (2011) further commitments were made to deepen and broaden the measures agreed to in Paris. Participants agreed to:

- **Enhance Ownership:** Countries should have more say over their development processes through wider participation in development policy formulation, stronger leadership on aid coordination and more use of country systems for aid delivery. In Busan, the non-governmental sector was also added, along with other non-traditional development support, as stakeholders in development processes.
- **More Inclusive Partnerships:** All partners - including donors on the OECD Development Assistance Committee and developing countries, as well as other donors, foundations and civil society – should participate fully in development. Busan added an emphasis on South-South and triangular cooperation as well as using the diverse resources offered by non-governmental and non-traditional actors.
- **Deliver Results:** Aid should be focused on real and measurable development impacts, which should be concrete and sustainable. Successful initiatives should be scaled up, and a general improvement in managing for results, communications, and monitoring and evaluation is necessary.
- **Strengthen Capacity Development:** The ability of countries to manage their own future should be central to development. Not only should their capacities be developed, but developing countries should be encouraged to engage with diverse sources of development funding and activities.

As donors adhere to these commitments, they are reexamining how they provide assistance and consequently how best to strengthen partner countries' public financial management systems. The United States has indicated its support for the above conclusions and prescriptions.

ANNEX 4: GLOSSARY

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 has received 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.

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 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: Per the F-framework, “Civil society organizations includes, but is not limited to, human rights organizations, youth movements, informal groups, religious organizations, labor and trade unions, professional associations, indigenous organizations, women organizations, LGBT organizations, and think tanks.”

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 Space: Room in a government's budget that allows it to provide resources for a desired purpose without jeopardizing the sustainability of its financial position or the stability of the economy.

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

Non-expendable property: An accounting term for purchase of goods that have a long operational life. In the U.S. Government it is defined as, “Property which is complete in itself, does not lose its identity or become a component part of another article when put into use; is durable, with an expected service life of two years or more; and which has a unit cost of more than \$500.”

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 inefficient 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.

Public Sector Oversight: Mechanisms within the government through which the Legislative branch, independent agencies, and in some countries entities within the Judiciary conduct independent checks on whether the Executive is conducting its activities effectively, efficiently and within the legal and regulatory framework.

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

Social Accountability: A set of approaches to hold public officials and institutions accountable drawing on the actions of citizens, media actors, communities, and/or civil society organizations. It includes, among others, monitoring of public service delivery, investigative journalism, and social audit. It complements but does not replace public sector oversight.

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.

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