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Implementing Public Financial Management Reform

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Changing existing governance systems can be challenging, especially if communication of the changes, the reasons behind them, and the planned or expected results to be achieved are lacking. In fragile and conflict-affected states (FCAS), this can be further complicated by the involvement of international agencies and their relationships with country governments, as well as by other stakeholders.

This reading pack addresses the implementation of Public Financial Management (PFM) Reform (PFMR), which is a key target for donors and recipient governments to improve the management of limited resources. Modern Management Information Systems (MIS) and procedures can assist in evidence-based decision making and policy development by governments. In particular, Financial Management Information Systems (FMIS) aim to improve budgeting by linking it to government approved strategy, and to improve expenditure and revenue execution and recording to support regular reporting by government and its entities and improve openness, accountability and transparency.

Implementation process

1. **Evaluation** of the manual and computerized management information systems in the Ministry of Finance (MoF), line ministries and other government entities. This includes reviewing existing procedures and standards and their compatibility and/or flexibility to integrate and exchange information with new systems.
2. **Formulation of a Whole of Government Approach** (WGA) roadmap based on the evaluation, outlining how proposed system reforms will improve information-based decision making. This requires approval from the MoF and other key government offices, as well as formal approval from the centre of government. The roll-out of the strategy

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will begin with a few selected principal line ministries in the form of a pilot project. After issues with the first phase roll-out have been resolved, it will be followed by a staged roll-out to all ministries, statutory bodies, and independent bodies.

3. **Establishment and/or improvement of management information systems (MIS) and processes:** This includes systems for donor coordination, cooperation and liaison, improved budgetary processes and PFM procedures. It also includes FMIS with a well-designed whole of government approach to the chart of accounts to enable recording financial transactions against activities and financial reporting for audit. An Integrated FMIS (IFMIS) could include cross-cutting systems such as human resources MIS, which would integrate civil service records and payroll with expenditure budgeting. Where a FMIS cannot provide all the required detail, additional MIS may be necessary, such as a Public Expenditure Tracking System (PETS) and spreadsheets for extra detail; this and the ability to import/export (both ways) may be an issue which an IFMIS could overcome in part.

4. **Budget Reform:** Once proper process and systems are in place and the approved budget guidelines are circulated, the new budgetary process can begin. This begins with the Government Operating Budget and probably will encompass programme budgeting which means changing from a “bottom up approach” to a “top down approach” linked to strategy. At the same time, the MoF will require accurate information on externally funded programmes and projects currently being implemented at each government entity to ensure accuracy of the Development Budget, for ultimately incorporating into a Government Consolidated Budget.

5. **Cross-Cutting Reforms:**

   - **Human Resources reform**: Preferably in a comprehensive Civil Service Reform process under the country’s Civil Service Commission, usually with external assistance, but pilot ministries may differ from those selected by the MoF for PFM reform; and
   - **Public Procurement Reform** Can be part of the PFMR process or can be undertaken separately, but generally under the oversight of the MoF with external assistance.

6. **Monitoring and Evaluation (M&E):** These reforms cover oversight procedures of actual-to-budget expenditure and revenue within each government entity, as well as overall oversight by the MoF. Periodic (preferably monthly) M&E via results-based management and results-oriented management supports written reports and presentations to senior management.

7. **Internal Oversight:** This stage includes the development of internal control systems, including general and financial controls, and could potentially include internal audit systems, although the latter are rare due to the time it takes to establish systems and the lack of trained personnel and resources.

   - **General control systems:** Include the development and implementation of standards and procedures such as terms of reference for each government entity and its personnel, Delegations of Authority (DoA) and Segregation of Duties (SoD), all preferably as part of a whole-of-government approach where applicable.
   - **Financial internal control systems:** Enhance efficiency and act as a preventative measure for fraud and corruption, preferably using whole-of-government approach templates. Delegation of Authority standards, for example, should approve relevant positions to authorise commitments to stated amounts; and Segregation of Duties standards, for

example, should state that the same persons committing and signing for receipt of goods or services should not authorize payment.

8. **Regulatory Oversight:** External audit can be undertaken by the Auditor-General's Office, although capacity often is lacking, and/or by private sector firms, but outsourcing can be more expensive. Capacity is often weak and auditors often need to be trained to audit differently: for example, instead of verifying payroll against each ministry's establishment, auditors may need to go deeper to ascertain locations and ensure that staff members are expensed against the correct departments and activities to verify the overall financial statements.

Implementation issues and challenges

1. Evaluation

- Consultants undertaking this task rely on a cross section of key informants as well as observation and document research. As there can be concern relating to change, gaining a rapport with and trust of key informants in the short time allowed can be a challenge, let alone gaining unanimity.

2. Formulation

- **Drafting:** If there is not full cooperation from representative key informants, or as a result of stakeholders' vested interests, a wrongly weighted view can be formed which can impact on the roadmap formulation. Agreeing the roadmap for PFMR can be contentious, especially if there is concern with the MoF gaining additional powers and/or control. In an autocratic system, there is often an aim to continue business as usual and not embrace PFMR for vested reasons, whereas PFMR should include delegation of authority to other government entities and other levels of government to make them accountable.
- **Roll-out strategy development**: Ministries can embrace reform, or can delay it through political interference or by refusing to be a pilot ministry; there may be preferences to let others experience the implementation problems that will hopefully be resolved once it is their turn. Major expenditure line ministries in FCAS may not be included due to large amounts of external funding. For example, reform in Afghanistan's Ministry of Defence and Ministry of Interior Affairs has lagged due to extraordinary levels of external funding and activities deemed to be security sensitive, which has meant a high level of non-accountability, both internally and externally.
- **Donor sector preferences** don't always align with country strategic priorities, which may, for example, prioritise sectors like education and health over governance. However, there has been a realisation that governance (and anti-corruption) need to be included as an important component of reform programmes.

3. Establishment and/or improvement of MIS and processes

- **Resistance to change:** Officers are usually well versed in manual PFM systems with numerous signatures to spread responsibility and accountability, and may resist embracing new systems and procedures that include computerised MIS and (I)FMIS with Financial and Internal Control Systems. Communication of the changes and benefits, including benefits for them, needs to be undertaken in the early stages despite potentially alerting allegedly corrupt individuals who may undertake spoiling tactics. New MIS are also often perceived as a threat by senior staff, who are not always as adept with electronic systems or may benefit from corruption, as MIS supports more regular reporting and anti-corruption through improved transparency and ensuring those responsible are held more accountable for their actions.

- **(I)FMIS:** When an FMIS is implemented, rather than proceeding with a fully integrated FMIS, for simplicity and/or expediency various government entity MIS may continue. As systems continue in operation, it can become more difficult to mesh them to form a truly IFMIS. For example, the World Bank is in the process of commissioning a Systems Study of the Afghanistan MoF-managed FMIS, after 10 years of operation, to ascertain the feasibility of implementing a newer software version that could potentially enable full integration. The study will examine the compatibility of current stand-alone MIS at line ministries and various other government entities with the envisaged new system, and identify potential gaps.

4. Budget Reform

- **Budget Ceilings:** the existing procedure is usually to set budget ceilings for departments and smaller entities based on previous years' budgets. . Timelines for budget submission are not always adhered to, resulting in the financial year commencing before budget approval with authorised expenditure based on the previous year plus an arbitrary percentage increase. Reform requires budget timelines to be set and adhered to, sometimes with penalties for lateness, with ceilings advised by the MoF in the early stages of the process.

- **Programme Budgeting**: in contrast to budgeting based on previous years' expenditure and revenue, programme budgeting requires a "top-down approach" of linking strategy to activities with implementation and M&E plans with budgeted costings. This requires major capacity building within each ministry and their entities; it takes time to develop the necessary expertise whilst normal work processes continue. When ceilings are revised due to unachievable revenue calculations, this requires not only monetary downsizing but considerable time in re-evaluating priority activities and budgets. In practice, staff remuneration expenditure often remains the same and other activity expenditure is reduced to balance the funding allowed. Under PFMR, it is preferable for each government entity to determine its priorities and implement them by a staged process, based on available funding, including downsizing staff. However, as increasing unemployment can weaken civil order in a FCAS political decisions may override. It is unsatisfactory to apply a flat-rate reduction to all budget lines if we are serious about implementing further reforms such as Performance Based Budgeting (PBB), Results Based Management (RBM) and Results Oriented Monitoring (ROM).

- **Equitable Resources Allocation (ERA) model** can be instrumental in determining priorities and funding, as well as in preventing inefficient and costly wastage of time related to the preceding. The allocation of resources to each level of government and entity may be determined based on population and demographic data, and on indications of need such as health and education indicators. For example, health budgets may be allocated in light of information about the prevalence of diseases and need for immunisations; education budgets may be based on populations requiring different levels of education and existing levels of educational attainment; budgets for regional and local economic development may depend on available transport alternatives and distances to markets. However, priority needs to be given to achievable revenue budget determination to enable budgetary ceilings to be indicated with more surety and enhance budget formulation efficiency.

- **Budget Execution:** There appears to have been more success in developing improved budgets than in their execution rate (e.g. the best performing institutions in Afghanistan initially achieved only 50-60% execution of budgeted spending). There can be many reasons for low rates of budget execution, including the result of previous and/or on-going non-merit based recruitment, inadequate human resources for implementing new PFM processes, optimistic activity planning and/or poor implementation, inexperienced activity-based budget calculations, lagging capacity building for new procurement and PFM processes, staff time constraints due to continuing to work with existing systems and senior management demands whilst capacity building undertaken, and more.

- **External Aid Budget:** For the Development Budget to be incorporated into a Government Consolidated Budget, as part of the overall PFMR process, donor governments want to see the new FMIS and PFM processes working reasonably well, as the Consolidated Budget brings a greater degree of risk, particularly in corruption-endemic environments. Consequently, risk management procedures can become unwieldy and/or require onerous reporting, including duplication in reporting to multiple donors which often require reports in different formats.

5. Cross-Cutting Reforms

- **Human Resources Reform** goes hand in hand with implementing PFMR, in that incumbents are frequently employed based on personal connections, favours, or bribery. Human resources reform will be weak if there is a continuance of non-merit based and political appointees, who are more likely to see reform as a threat to the status quo. Governments may prioritise the recruitment and retention of line ministry technical staff (e.g. health and engineering services) over finance personnel, even for finance, procurement and administration roles. Additionally, government personnel are often lured away from government positions by higher remuneration in the private and NGO sectors and donor funded projects, thus undermining capacity building for institutional strengthening. Women often have poor access to opportunities without human resources reform and improvements in education, especially without merit-based recruitment; gender based budgeting can assist in this process. Another issue is the use of salary top-ups, which result in wage disparities that can lead to resentment.

- **Public Procurement Reform** is an essential component of PFMR. Internationally accepted procedures, as required by all donors, must be implemented through the Whole of Government Approach. Tendering procedures, evaluations, decision making and awarding are usually subjected to scrutiny, and a robust and reliable justice system is also essential. However, in many countries the prospects for transparency and accountability reforms remain remote; for example, despite all the interventions, Afghanistan is 166/168 on the Transparency International Corruption Index. (See also US SIGAR's reports.)

6. Other challenges

- **Information Technology:** To implement PFMR, new computer hardware and software, as well as training, is usually required. Existing workstations are often not sufficiently modern to cope with new software, and the need to back up systems and ensure that software is updated are often not given the importance they should be. Support for updates and maintenance, as well as initial outlays for new software, need to be incorporated into budgets to ensure IT sustainability.

- **Accounting:** Initially, systems should use double-entry accounting on a cash basis, to be followed later by implementing accrual accounting. This has been an implementation challenge even for developed countries, although always embraced by the private sector. Expenditure budgets are usually drafted based on actions that incur a cost, however, the payment of that cost can be delayed. Consequently, if cash accounting is used, budgets often demonstrate non-execution because transactions are only considered to be executed when paid, not the when the action took place. Accrual-basis accounting records transactions in the period in which they actually occur, rather than the period in which the cash flows related to them occur. This has ramifications for MoF allocations, usually quarterly, which are cash based estimates for cash flow purposes: underestimating actual payments may result in a shortfall of cash availability whilst over-estimating may mean an under-utilization of available cash resources (which could result in lost interest revenue).

- **Institutional Strengthening & Capacity Building:** This usually involves working with young qualified and/or capable people who may initially lack experience or authority. In FCAS, there is often a lack of qualified people, but sufficient numbers who are intelligent and quick learners. Technical advisers should be embedded and readily available to mentor staff and provide on-the-job training.

- **Conflict** can have a major impact on the success of PFMR implementation given its cross-cutting nature. It is difficult to budget without having information on numbers of refugees, returnees and IDPs, for example, and casualties will have a significant impact on Ministries such as Health, Defence and Interior. In many FCAS, conflict rarely ceases completely, but continues and may shift from one area to another. In such circumstances, short cuts can be undertaken and recording can suffer. A good way to mitigate this risk is to have a contingency line item in the budgets of government entities most likely to be affected, or within the MoF that they can call on (and account for).

- **Natural Disasters** can impact on the overall government budget but may also affect PFMR by causing further disruption to the implementation. Allowances for contingencies can be made in the same manner as for conflict.

- **Donor Expectations/Issues:** once a PFMR project begins, there is an expectation that the pace of reform/change will be readily evident ("hitting the ground running"), but there is also the expectation of sustainability; indeed, this is the ultimate goal of most projects. However, it takes time to build capacity in institutions, particularly if human resources reform is not undertaken at the same time.

- **Politics:** Political will on the part of recipient governments to embrace reform is important. There can also be political issues related to donors' attempts to tie reform to funding, in cases where there is competition among donor governments to be more lenient in attaching conditions to aid in order to gain favour. Funding leniency by some donor governments can undermine PFMR and implementation.

Expected Achievements

Public financial management reform led by a country's own Ministry of Finance, utilising FMIS to ensure system based payment and budget controls on all transactions of public funds, can lead to improvements in financial and internal control systems by modifying payments, accounting, reconciliation and reporting procedures. Some of the specific achievements that can arise from the implementation of nation-wide PFMR, especially utilising a modern FMIS, include:

- Provision of a successful fiduciary framework for the management of government funds, including as a steward of donor funds;
- Preparation of annual financial statements and submission for audit within a reducing and reasonable period of fiscal year end;
- Implementation of additional modules, such as multi-currency capability, for an integrated FMIS;
- Maintain accountability for the government's revenue, budget and expenditures, including of donor funds; and
- Allowing the capability to record transactions and produce periodical and annual financial reports by individual government entities.

Key readings and discussion questions

Reading 1: UK Cabinet Office. (2016). *Machinery of government guidance* (v.4.1), London: UK Cabinet Office.
https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/543355/2016_07_29_machinery_of_government_guidance.pdf

This theory paper sets out a guide to provide an overview of the process for how to plan and deliver a Machinery of Government (MoG) change. It is intended for those leading such changes for government in a more stable context than those in FCAS.

Could such theory be implemented in a developing country, and especially one that is a fragile or conflict-affected state? If so, how? If not, why not?

Reading 2: Public Financial Management: Republic of the Philippines. (n.d.) *Genesis of the PFM reform roadmap*. Retrieved December 6 2016.
http://pfm.gov.ph/pfm-reform-roadmap/genesis-of-the-pfm-reform-roadmap/

This webpage sets out how the Philippines began work on reforming their PFM system in 2009, and notes achievements reached by June 2016. The page includes additional links to information on Budget Treasury and Management System (BTMS), Budget Reporting and Performance Standards (BRPS), Improved Treasury Cash Management Operations (ITCMO).

Could this successful developing country model be implemented in other developing countries? If so, how? If not, why not?

Reading 3: Hendriks, C.J. (2012). Integrated Financial Management Information Systems: Guidelines for effective implementation by the public sector of South Africa. *South African Journal of Information Management* 14 (1), Art.
http://dx.doi.org/10.4102/sajim.v14i1.529

This article highlights that the size and complexity of an IFMIS poses significant challenges and a number of risks in the implementation process. A review of the theoretical literature informs the critical success factors or best practices identified to mitigate these issues.

What are the lessons learnt? Could they have been avoided? Are these lessons applicable generally and/or specifically for other developing countries, especially FCAS?

Reading 4: Government of Afghanistan – Ministry of Finance. (2010). *Public financial management roadmap.* Kabul: Government of Afghanistan.
http://mof.gov.af/Content/files/PFM%20Roadmap%20FINAL%2014%20July%202010.pdf

This document sets out the early history of Afghanistan's PFM systems evolution, its strengths and weaknesses (after approximately 8 years of the reform process). It highlights planned improvements by and within the MoF, as well as reforms to improve the capacity of line ministries.

History repeats, so what hasn't been learnt? What could have been done better without hindsight? What impact did expediency play in not achieving goals?

Reading 5: USAID. (2014). *Assessment of Afghanistan's PFM roadmap and final evaluation of the economic growth and governance initiative (EGGI) project.* Washington D.C.: USAID.
http://pdf.usaid.gov/pdf_docs/PA00K8PS.pdf

This report, prepared for USAID by Cecchi and Company Consulting Inc., assesses the progress of the PFM roadmap covering EGGI's final evaluation in relation to PFM support, the baseline Tashkeel (civil service establishment) assessment, and capacity development. It notes that while the challenges are identified at local level, addressing them requires further international input. As a result of this assessment, USAID began implementing a three-year project, Afghanistan PFM (APFM) Project, at a cost of USD22.1m (July 2015 – July 2018).

What lessons have not been acted upon since 2010? What could have been done better? What impact did expediency play in not achieving goals? How well did the contractors and donor(s) undertake M&E during the project, rather than just at the end?

Reading 6: Free Balance. (2011). *PFM case study: Islamic Republic of Afghanistan.* Ontario: FreeBalance. http://www.aidforum.org/assets/documents/Afghanistan_PFM_Case_Study.pdf

This case study examines how the Government of Afghanistan improved governance through PFMR and capacity building, including identifying lessons learned. It particularly notes the use of technological tools financial management information systems (FMIS) and government resource planning (GRP). The bibliography provides additional reading.

Can this case study be used as a guide for other FCAS? How good is the evidence presented and that above to reinforce periodical M&E? Is it leading by example when developing countries and/or FCAS *are expected to implement Performance Based Budgeting and Results Based Management and Orientated Monitoring?*

Further reading

De Lay, S., Mills, L., Jadeja, K. and Lucas, B. (2015) *Public Financial Management Evidence Mapping*. Birmingham, UK: GSDRC, University of Birmingham. http://www.gsdrc.org/publications/public-financial-management-evidence-mapping/

This paper reviews the extent of evidence for the effect of Public Financial Management (PFM) interventions on outcomes in low and middle income countries. It is based on a database (also available to download) of 197 studies compiled after a rigorous search process.