

SOUND BUDGET EXECUTION FOR POVERTY REDUCTION

A Background Paper For the World Bank Institute Program on “Fiscal Policy for Poverty Alleviation”
Module on Budget Execution

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“Less than 30 percent of funding intended for non-salary spending actually reached the [Ugandan] schools in 1991-1995.”²

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Introduction

Efficient and effective public spending programs are critical to promote economic growth and equitable access to economic opportunities for all segments of society. Well-planned and implemented public spending strategies can promote technical, allocative efficiency and equity through timely and appropriately focussed budget implementation and service delivery.

¹ Disclaimer: The views presented in this paper are solely those of the author and must in no way be construed as representing official IMF or World Bank policy.

² *Do Budgets Really Matter? Evidence from Public Spending on Education and Health in Uganda*; Ablo, Emmanuel and Reinikka, Ritva; The World Bank, Washington DC, June 1998.

Even the best-designed budgets can be undermined by shortcomings in the actual spending of funds. Large differences between approved and executed budgets can appear, especially in countries with limited tracking, monitoring, and controls of public spending.

The link between budget outcomes and the diversion of funds within and between public sector agencies has been well documented in recent years. Likewise, the links between weak budget implementation and high levels of poverty in some developing countries have become quite clear³. Therefore, it is imperative that reforms of budget planning be supplemented by equally comprehensive reforms of public expenditure management (“PEM”), including the implementation of appropriate expenditure controls, budget tracking and monitoring mechanisms, as well as timely and comprehensive reporting on actual budget outcomes, both financial and programmatic.

This paper focuses on the reasons for poor public expenditure execution and suggests ways to improve budget management so that the actual impact of public spending can be better aligned with poverty reduction strategies.

We will discuss systemic constraints, options for effective expenditure tracking and monitoring, the role of institutions (Parliament, the Executive, and civil society) in tracking and implementing budgets; accounting and payment issues, implications for budget planning and the integration of budget management reform in wider public sector reform agendas.

Some Reasons for Poor PEM

The diversion of budgeted funds from their original purpose can be caused by a wide variety of systemic and environmental factors.

These range from outright theft, to deviations of funds within and between public sector agencies, unauthorized diversions, and intra-year interventions (usually in the form of cut backs or deferrals) in budget execution by central agencies, such as the finance ministry or the treasury.

Some divergences between planned and actual expenditures can reflect *positively* on a government and can be justified when they find their origin in a timely and effective reaction by government agencies to unforeseen events during a fiscal year, without jeopardizing implementation of the fiscal program. Typical examples where quick changes in expenditure programs are welcome and necessary are natural disasters, the outbreak of famines, or sudden public health problems of epidemic proportions (the Ebola Virus, for instance).

³ See for instance: *Tracking of Poverty-Reducing Public Spending in HIPC's*; IMF Fiscal Affairs Department and The World Bank, Washington DC, March 2001.

Other divergences can be explained by unforeseen revenue shortfalls during the year, which in turn cause claw-backs by the central budget authority or an intervention by the Treasury.

Unfortunately, most of the remaining divergences can only be explained by systemic shortcomings in expenditure management. These can be traced back to – among others – poorly trained staff in government agencies; a weak legal framework; unclear regulations; the absence of effective rewards and sanctions for civil servants; ineffective central control and audit agencies; poor parliamentary oversight, and outdated information technology infrastructure – or none at all. Depending on the constitutional and administrative set-up of countries, organizational weaknesses at the sub-national level, such as multiple and conflicting reporting lines for some regional or local agencies, or a lack of coherence between sources of funds and reporting lines can add to the problems in budget execution.

When budget outcomes bear little resemblance to original plans, the entire budgetary process loses meaning, often with negative consequences for the poor and the programs designed to benefit them. The quote from a World Bank document on PEM Outcomes in Uganda, used at the beginning of this paper⁴, is but one of many examples of the effects of poor PEM on those sectors of an economy which can have the greatest influence on the lives of the poor. In addition to the difficulties with strategic budget planning, mainly in the social sectors, large divergences between budgets planned and actual spending, can normally be explained by systemic PEM shortcomings.

The Magnitude of Expenditure Drifts

While a country's budget balances as such are relatively easy to observe from one year to the next, divergences between budgeted and actual expenditure are more difficult to track, especially over longer periods of time.

This is due to a variety of factors, including substantial delays in reporting on budget outcomes, which are often due to capacity constraints; variable data quality, and changes in data presentation formats over time.

Traditional public expenditure information sources, such as the Government Finance Statistics yearbooks (GFS) published by the International Monetary Fund (IMF), give some information about budget execution on a year-by-year basis. Individual GFS yearbooks do, however, not allow for comparisons of executed versus voted budgets over time. At present, multi-year data on budget execution have to be compiled manually from multiple GFS yearbooks.

⁴ *Do Budgets Really Matter? Evidence from Public Spending on Education and Health in Uganda*; Ablo, Emmanuel and Reinikka, Ritva; op. cit.

In addition, some countries update their reported expenditure data irregularly and change the data presentation formats, often reflecting – to these countries’ credit – an improving compliance with internationally accepted budget accounting principles.

Therefore, inter-year comparisons of expenditure data in the GFS are fraught with data quality and timeliness-related pitfalls and allows for few conclusions about longitudinal drifts between budgeted and actual expenditure.

A more comprehensive source for this information are the *Recent Economic Developments* (“RED”) supplements to IMF Article IV reports. These supplements are not always readily available to external researchers, and the aggregation of RED data on expenditure drifts over longer periods of time can only be done manually for each country.

Public Expenditure Reviews (PER) done by the World Bank are another source of information about trends in budget execution. PERs are, however, written only every few years and must therefore be supplemented by yearly data obtained from other sources.

For the time being, one must therefore content oneself with an as yet limited array of country-specific PEM studies to get an idea of the magnitude of expenditure drifts.

Another indicator of budget execution quality is the divergence between committed budgets and disbursements, or payments actually made. For a variety of reasons, including sometimes excessive central control over even the smallest payments to suppliers and service providers, or because of cash flow problems at Treasury level, arrears in payments against already committed expenditure can build up to the tune of several months, or even several years. Reliable and, above all, timely information on disbursement arrears in developing countries is not always available. In some instances, it can take many months after the close of a fiscal year until a Treasury or a central budget authority are able to release their best estimates of arrears. Thus, delays in the reporting of arrears, cumulated with the delays already incurred on the payments themselves, can blur the picture of the true state of a country’s public finances even further.

PEM research is readily available on Uganda’s public expenditure outcomes, as this is one country, which has made significant efforts to improve its PEM system in recent years. From one recent study of Uganda’s budget management system⁵ one can, for example, obtain the following comparisons of budgeted and actual expenditure:

⁵ *The Budget and Medium-Term Expenditure Framework in Uganda*; Uganda PRSC Background Papers; Bevan, David; The World Bank, December 2001.

Table 1.**Budget v. Expenditure Commitments in Uganda: 1997 – 2000 (excerpt)**

Fiscal Year	1997/1998	1998/1999	1999/2000
Expenditure Category	Variation (%)	Variation (%)	Variation (%)
Security and Defence	2.83	24.38	-1.48
Roads and Works	-18.20	-17.73	-4.59
Agriculture	-18.77	-37.06	-3.38
Education	3.86	11.16	-5.79
Health	-9.58	-5.73	-5.55
Law and Order	2.03	-3.49	3.77
Economic and Social	-4.08	-6.81	-25.74
Public Administration	10.55	8.54	6.01
Total Variation	-0.92	4.02	-3.60

From this table, one can see that, even though overall divergences between budgeted and committed expenditure remained small throughout the period of observation, there were excessive divergences in some sectors, notably in Roads and Works, Agriculture, Education, Economic and Social, and Public Administration. Under-spending was about as prevalent as overspending during the observation period.

From another study of PEM practices in Latin America⁶, one can obtain some revealing information about budget execution on that continent:

Table 2.**Budget v. Expenditure Commitments in Latin American Countries: 1991-1995 (excerpts)**

Country	Argentina	Brazil	Chile	Colombia	Mexico	Venezuela
Fiscal Year	variation %	variation %	variation %	variation %	variation %	variation %
1991	62.67	-7.13	1.10	1.11	-7.27	9.11
1992	81.41	37.82	-0.74	6.39	3.85	13.73
1993	-4.96	15.56	-0.98	-11.38	3.90	-3.26
1994	3.10	N/A	-2.80	-18.56	6.01	25.44
1995	-0.70	-24.65	N/A	-10.90	22.07	-3.10

While the divergences between budgeted and committed expenditure seemed to improve in Argentina after 1992, no improvement was visible in Brazil. Chile's expenditure commitment remained consistently close to original budgets, while under-commitment in Colombia

⁶ *Budget and Control – Reforming the Public Sector in Latin America*; Petrei, Humberto; IADB, Washington DC, 1998.

worsened over time. In Mexico, only the last year's expenditure diverged considerably from the original budget, while the record in Venezuela remained uneven.

What these data do not tell us is whether expenditures, which were actually committed during a fiscal year, did actually result in the planned delivery of goods and services to the intended end-beneficiaries. One can get a better idea of the actual flow of funds to end-users through independent user surveys, public spending report cards, reviews by government agencies or NGOs, or similar tools, which are slowly becoming more commonplace in developing countries. We will discuss some of these tools later when talking about public participation in the budget process. Some data on the flow of funds to end-users is also being gathered – where available – for World Bank PERs, Tracking Surveys, and sectoral research papers, such as country reviews of health services or education programs.

In a recent study of the usefulness of the World Bank's periodic *Public Expenditure Review* (PER) exercises in client countries⁷, some more general findings about divergences between budgets and actual expenditures were published:

- In the Education sector, of the 20 developing countries surveyed, 54 per cent had reported average divergences between budgeted and actual expenditure of 30 per cent or higher over a number of years.
- In the Health sector, divergences of over 30 per cent were reported by 58 per cent of respondents.
- For Infrastructure spending, divergences exceeded 30 per cent in 36 per cent of the countries, while in Agriculture, spending drifted by over 30 per cent in 44 per cent of the countries.
- More broadly speaking, 26 per cent of respondents rated the quality of PEM in their countries as "Very Poor", while 47 per cent rated it as "Poor to Fair".
- Some 21 per cent rated their PEM as "Moderate", while 5 per cent rated it as "Good", and none rated it as "Very Good".
- In that same survey, 63 per cent of respondents stated that a reconciliation between budgeted and actual expenditure is never published.

Finally, in a paper on PEM in HIPC countries⁸, the IMF found that over 33 per cent of highly indebted poor countries are reporting "significant differences" between planned and committed expenditures.

⁷ *Progress in Public Expenditure Management in Africa: Evidence from World Bank Surveys*; Kostopoulos, Christos; The World Bank, 1999.

⁸ *Tracking of Poverty-Reducing Public Spending in HIPCs*; op.cit.

From this admittedly small sample of studies one can tentatively conclude that expenditure drifts are frequent, and at times very large in many of those countries where well-targeted and effectively delivered public spending could benefit the poor. Especially worrying are the expenditure divergences in the social sectors, which are most closely allied with immediate and tangible intervention in the lives of the poor.

Typology and Outcomes of Poor Budget Execution

Poor budget execution generally leads to poor outcomes for the intended beneficiaries of government expenditure programs. Problems in budget execution can take different shapes, mainly as under-commitment and under-payment. Sometimes, especially in the absence of effective controls, over-commitment and over-payment can also occur.

Under-commitment against specific budget line items can occur when the implementation of expenditure programs is jeopardized for reasons ranging from changing political priorities during the fiscal year to miscommunication or divergences of views between local government agencies and central authorities. Unexpected changes in anticipated government revenue can also impact the level of subsequent expenditure commitments, as can unforeseen events, such as natural disasters, or military events – which in turn, can have a trickle-down effect on commitments in many different segments of government operations.

Disbursement differences can occur because of a lack of cash at the Treasury level, late availability of invoices, delayed approval of payments (often occurring in an overly centralized control environment), or simply because of poor institutional arrangements (lack of qualified staff, poor IT infrastructure, etc.).

All too often, poor budget execution impacts recurring expenses associated with prior capital expenditure in developing countries. Frequently, donor-funded capital projects end up not being properly maintained because expenditure for ongoing operations and maintenance was either not planned, or, if it was featured in the budget, is being diverted to other purposes.

The outcomes of weak budget execution in any or all of the above forms can be severe for the intended beneficiaries of government services, especially for the poorest members of society. Some typical examples are:

- Hospitals and rural nursing stations obtain insufficient supplies and equipment and end up having to turn patients away.
- Schools receive no books, supplies, or furniture, and therefore classes are cancelled, or function in difficult conditions.

- Supplies and fuel for road, rail, river barge, or ferry transportation and maintenance cannot be bought, and therefore goods cannot get to markets, and people cannot get to work, schools or to hospitals in a timely manner, or not at all.
- Funds for the maintenance of power lines and generators do not arrive at local or regional maintenance centres, or water pumps in villages cannot be repaired – making the lives of small business owners and local residents more precarious.

In many developing countries, such outcomes are caused, in part, by *top-heavy institutional arrangements*. Funds meant to be made available to local communities end up being used to maintain a bloated administration at provincial, district, or prefecture level – as the case may be. This thinning of the flow of budgetary funds – down to a mere trickle at the local end-user level – brings home the point that broader governance and public administration reforms are often as necessary as public expenditure management reforms if one wants to improve the lives of the poor. We will discuss these linkages later in this paper.

Sound Budget Management and the Reduction of Poverty

Recent research has emphasized the close correlation between sound PEM practices and the impact of public spending programs on the most disadvantaged members of society.⁹

Studies have highlighted the need to focus not only on poverty-reducing measures when budgets are prepared, but to also ensure that such programs are indeed implemented in a timely and accurate manner. To achieve this, both operational efficiency and effectiveness in line ministries and the timely release of funds to all intended beneficiaries are required.¹⁰

Sound budget management practices have become even more important, now that many poor countries are being given the opportunity for allocating more of their budgetary funds for pro-poor programs under the HIPC scheme of debt reduction. HIPC has put the spotlight on governance and financial management arrangements in the beneficiary countries.

According to the IMF, “Donor countries need assurance that resources they provide under the HIPC initiative...are devoted to poverty reduction.”¹¹

Let us clarify at this point what is meant by “poverty-reducing expenditure. While the traditional definition of “pro-poor” spending was built mostly on social sector spending, including health, social services, and education, more recently development programs in support of the “productive sectors” of an economy, including small business incentives, infrastructure upgrading, rural development, or programs to improve the lives of women have

⁹ See for instance: *Tracking of Poverty-Reducing Spending in HIPCs*; IMF and IBRD, op. cit.

¹⁰ See also: *The Role of the State and the Quality of the Public Sector*; Tanzi, Vito; IMF, March 2000.

¹¹ *Tracking of Poverty-Reducing Spending in HIPCs*; IMF and IBRD, op. cit.

been recognized as also being of a “pro-poor” nature. In general, the budget as a whole affects directly or indirectly the lives of the poor, with some specific safety nets more closely associated with their daily activities.

The onus on HIPC countries is not only to demonstrate that they can channel a maximum of budgetary funds to poverty reduction. If beneficiary countries can improve the transparency and quality of their budget management, donors will be able to “streamline their own conditionality, their reporting, and other procedural requirements, thus relieving the burden on the authorities.”¹² Thus, improvements in the effectiveness and efficiency of budget execution can have exponential benefits for HIPC countries, some internally driven, and some triggered externally by the donor community.

To quote from a paper on the links between budget management and poverty reduction in Honduras:

“...HIPC assistance will allow Honduras to devote a larger share of public resources to key priority programs, if growth in non-priority spending is effectively controlled. ...Many of the remaining challenges, such as improving educational outcomes...or low productivity in rural health posts cannot easily be addressed by increased resources alone, and gains in [poverty-reducing] program outcomes depend critically on improving the efficiency of resource management in the existing programs.”¹³ Thus, one can conclude that improvements in budget management must not only take place at the central level of administration, but also – and perhaps foremost – at the level of those government agencies which deliver services on the ground.

To put the need for better public sector resource management in a broader perspective, one need only refer to one of the key messages of the 2000 World Development Report on *Attacking Poverty*:¹⁴

“Public Administrations that implement policies efficiently and without corruption or harassment improve service delivery by the public sector and facilitate growth of the private sector.

...Access to information, such as budgets, participatory budget mechanisms, and performance rating of public services all enhance citizens’ capacity to shape and monitor public sector performance, while reducing opportunities and scope for corruption.”

¹² *ibid.*

¹³ *Honduras Public Expenditure Management for Poverty Reduction and Fiscal Sustainability*; LAC Region, The World Bank; June 2001.

¹⁴ *World Development Report 2000: Attacking Poverty*; The World Bank, September 2000.

Some Problems in Managing Budgets for Poverty Reduction

While an increasing number of developing countries are focussing specifically on targeting poverty reduction when formulating budgets – frequently in the context of broad targets set in PRSPs, only a few have as yet been able to adapt their budget execution infrastructure, staff capacity, and work processes to meeting the increased need for tracking the actual use of budgeted funds.

In Bolivia for instance¹⁵, budget preparation has greatly improved since the advent of the Fiscal Administration and Government Control System Act of 1990 (Also referred to as the “Safco Law”), and in particular since the introduction of the Popular Participation Law of 1994. Thus, the reduction of poverty has become an explicit goal reflected in Bolivia’s public expenditure programs.

In addition, these laws, combined with the overall strategic development guidance of a Comprehensive Development Framework (CDF)¹⁶, enable greater civil society participation, both in the development of budgets and in monitoring their execution, and allow this to take place in a more formalized environment and hopefully, in a more effective manner.

Unfortunately, while budget preparation in Bolivia is becoming more focussed on fiscal sustainability and poverty reduction, and more participatory in nature, the institutional capacity for executing and monitoring budgets in a timely and effective manner remains weak, both at the central government and – even more so – at the local government level. Thus, capacity building for improved budget management has become the focus of some of the most recent World Bank interventions in this country.

There are other examples of PEM reform in poor, highly indebted countries (HIPC countries), where the focus is not only on enabling better targeted and more sustainable public spending programs, but also on ensuring more effective budget execution, combined with greater civil society participation. Honduras is one such example where macro- economic policy and PEM reforms are being carried out in the context of a PRSP, and in conjunction with related civil service management reforms and public sector infrastructure upgrading programs (see Text Box 1.)

¹⁵ *Budget Execution and Quality of Public Expenditure – The Bolivian Case*; The World Bank, 2001.

¹⁶ With the support of the World Bank, many countries have adopted a holistic approach to development, which implies reinforced ownership and partnerships, a more comprehensive development strategy, and a stronger focus on results.

Text Box 1.**Budget Execution and Poverty Reduction: Reforms in Honduras**

As a highly indebted, poor country (HIPC), Honduras faces the dual challenge of reducing poverty – in part through the more effective delivery of public services, while at the same time trying to ensure the sustainability of public spending.

One of the key features of Honduras' Poverty Reduction Strategy paper (PRSP) which is currently being finalized is the goal to put in place robust institutional arrangements and sound fiscal management practices to carry out a sustainable fiscal policy which is focussing increasingly on improving the lives of the poorest members of Honduran society.

One of the first changes to Honduran budget execution practices consists of the planned devolution of commitment and authorization powers to government agencies, especially those which are delivering services to the public. This devolution is based on an appropriately modified legal framework, as well as the introduction of a modern IFMIS and related training of public officials.

To ensure that devolution of financial management powers does not bring with it a loss of central tracking and control capabilities, the Honduran authorities are planning to reinforce the staff capacity and infrastructure of the Office of the Secretary of Finance (SEFIN), in part through the creation of a central Expenditure Programming and Execution Unit, combined with similar financial management units in line ministries. Likewise, the legal framework and operational capacity of the Controller General's Office is being reinforced, to allow for independent and effective central oversight.

To ensure a higher degree of fiscal transparency and greater precision in expenditure tracking, the Honduran authorities are planning to use a more standardized and better specified expenditure categories during budget preparation. In addition, efforts are being made to make the budget more comprehensive by including more de-centralized agencies in the budget, without jeopardizing the latter's ability to deliver public services in a timely manner, while independently managing their finances.

The above reforms are being introduced in a gradual, yet appropriately sequenced and coordinated manner over a number of years. Thus, required changes in legislation will be supplemented over time by related changes in personnel management and training, combined with improvements in the IT and communications infrastructure.

In Benin, reforms of fiscal policy have also been accompanied by reforms aiming at making budget execution and reporting more effective and efficient.¹⁷

Thus, since the end of FY 2000, budget execution practices, which had remained largely unchanged since the country's independence several decades ago, have been profoundly modified by a decree issued on 19 November 2000. These changes have targeted three main areas where improvements were needed:

1. Reducing delays in the delivery of public services and related payments (and arrears)
2. Increasing the reliability of control processes in budget execution, and
3. De-centralizing and computerizing budget execution.

To achieve these objectives, the Benin authorities have delegated more commitment and authorization powers to government agencies, while at the same time aiming for

¹⁷ *Execution du budget et qualite des depenses au Benin*; WBI presentation, The World Bank, 2002.

better expenditure tracking and reporting through the introduction of an IFMIS platform.

De-centralized Budget Execution

In Bolivia, like in many other countries where de-centralization is being implemented or expanded, the capacity of local government agencies to adequately manage revenue and expenditure has not kept pace with changes at the central government level.

Local government officials frequently lack training in expenditure tracking and rely on slow, paper-based spending approval, verification, and accounting processes, or they have to make do with outdated IT equipment that lacks connectivity with central agencies.

In addition, due to unclear, un-harmonized, and frequently un-enforced rules for re-allocating expenditure within or between central budget line items or programs by local government authorities, diversions of expenditure from the original intended purpose to other destinations is one of the problems encountered in the context of fiscal de-centralization.¹⁸

Even if local government authorities do not specifically intend to use funds from the central budget for purposes not originally intended, mismatches in expenditure classification between categories used at the central government level and those used at the local level can lead to changes in expenditure destinations and/or misreporting. Again, capacity limitations at the local government level are the main cause for these occurrences. While shortcomings in local government accounting and reporting capabilities are among the main culprits, a lack of actually enforced accountability of local government staff is another frequent source of expenditure diversion and misreporting.¹⁹

One must recognize that there are certain inherent tensions underlying de-centralization. On the one hand, the central government wants to empower local authorities to have a greater say in managing their revenue and expenditures, and thus assume greater responsibility for the timely and effective delivery of public services.

On the other hand, especially in instances where local authorities have few revenue raising powers and thus rely heavily on revenue transferred from the central government, central agencies want to maintain a high degree of central control over aggregate public sector spending.

This tension is particularly felt in those countries, which rely heavily on budget support from donors or have agreed to an IMF program, and thus have to report in great detail on the final use of budgeted funds.

¹⁸ *Budget Execution and Quality of Public Expenditure – The Bolivian Case*; op. cit.

¹⁹ See for instance: *Indonesia: Public Spending in a Time of Change*; EAP-PREM, The World Bank, April 2000.

In spite of institutional pitfalls, which can emerge under increased de-centralization, bringing budget execution closer to end-users has many advantages. Indeed, front-line agencies should normally have a better idea of the needs of their constituencies than an official in a comparatively remote central ministry. Thus, end-users have the opportunity to exert great pressure for the delivery of effective services on agencies to which they are geographically close. Such pressure can be applied both when it comes to evaluating the impact of past budgets, and when future budgets are being prepared. As we will see when we talk about public participation in budget processes, pressure by end-users can, however, only be effective if users of government services are well organized and can make their voice freely heard in the media.

De-centralized Budget Execution and Poverty Reduction

Since services delivered by local authorities, such as healthcare, certain types of social services, education, transportation, and some types of housing support are those which can make the biggest, most immediate, and most tangible impact on the lives of the poor, controls and monitoring of poverty reducing expenditure programs planned and funded by central agencies should intuitively take place at the local and final point of service delivery.

Yet, as we said earlier, capacity constraints at the local government level often make this a difficult endeavour. Reliable reporting and controlling of poverty reducing spending programs is further complicated by additional factors, such as unclear or multiple chains of accountability between local agencies and a variety of ministries, or the lack of information about the use of locally raised revenue for poverty reducing purposes.

Nonetheless, whilst there is a clear need in many countries with a high degree of fiscal de-centralization to put in place transparent and standardized methods of tracking poverty reducing expenditure at the local government level, and to better train local authority staff, de-centralization has one very significant potential benefit which is likely to give a major boost to the accountability of public sector agencies: civil society proximity and participation. Indeed, there is empirical evidence that de-centralization – if properly managed – goes hand in hand with improved public sector accountability.²⁰

In Indonesia, for instance, A World Bank Social Safety Net Adjustment Loan (SSNAL), combined with various urban poverty and local development projects in some of the poorest urban areas and villages, has contributed to the achievement of a more participatory implementation of budgets through the involvement of local NGOs, neighbourhood committees, and various local community groups. The proximity of local government to their constituencies and the establishment of formalized communication channels between community groups and local authorities, such as *Keluharan* (neighbourhood) fora has ensured that more accurate reporting on poverty-reducing expenditure is beginning to take place.

²⁰ *Indonesia: Public Spending in a Time of Change*, op cit.

In Mexico, a poverty reduction program has been developed that has, so far, performed well in ensuring that expenditure intended to help the poor in a very decentralized setting is indeed applied in an effective manner: the PROGRESA program of integrated education, health, and nutrition services.²¹

PROGRESA successfully integrates expenditure release conditionality with service delivery at the local government level, compliance of beneficiaries with set requirements, and timely reporting. Indeed, under PROGRESA, social transfers to households, such as income support and various subsidized services, only occur if the intended beneficiaries comply with preventive health checkups and school enrolment requirements for small children, for example. Compliance is monitored at the local authority level, and the release of funding to them by central agencies is conditional on appropriate monitoring and reporting of the ultimate beneficiaries.

Public Procurement and Budget Execution

Even if a budget management system allows for the timely release of budgeted funds to front-line agencies, substantial under-commitment of funds can nonetheless occur. Apart from other systemic causes for such spending gaps discussed elsewhere in this paper, badly managed public procurement processes and procedures are among the main culprits of the slow or incomplete implementation of public spending programs.

In Benin, for example, the World Bank found that it takes on average nearly a year (over 40 weeks) to procure consulting services for major projects and some 39 weeks for goods and supplies.²²

Apart from the delays caused by inefficient procurement in delivering project outcomes on time and within budget, poor procurement methods also represent a significant barrier to entry for NGO and SMEs in project-related work, not least because of their limited scope for work program diversification within a given financial year. Thus, delays in obtaining firm orders for a major contract (project) can cause serious financial problems for an SME with only limited recourse to short-term finance sources – even in industrialized countries.

Sometimes, mis-procurement is a cause for delays in capital spending. Mis-procurement occurs when the selection procedures for project contractors turn out to have been improperly managed, for instance because of non-adherence to standard, internationally accepted procurement methods. Since the participation in a bid for donor-funded project-related work can represent a very significant investment in terms of financial and human resources for an SME or for the smaller NGOs in developing countries, the occurrence of mis-procurement can act as further deterrent to them for future participation in donor-funded activities. This is all the more regrettable, now that many donors try to increase private sector involvement and decentralization in the delivery of public sector investment programs.

²¹ *Pro-Poor Policies in Mexico*; IMF Survey, 11 March 2002.

²² Benin PER, Rural Development, Transport and Public Works Module, The World Bank, 1997.

One of the key measures of any reform program in public expenditure management must therefore be the analysis and enhancement of public sector procurement, be it through changes in relevant legislation, or through additional training for public officials and better central oversight of procurement processes.

Improving Accountability in Budget Management

With regard to problems of fiscal accountability, related to the deviation of public funds from their intended purpose in developing countries, one can argue that a reduction in the corrupt re-routing of public funds, paired with appropriately targeted budget allocations, improved efficiency in budget management, and modernized civil service management methods, are indeed likely to lead to a faster and more effective transmission of public expenditure programs towards the most vulnerable segments of society.

The interdependence between the various steps of PEM required to improve fiscal accountability is somewhat intuitive. Funds allocated for poverty reduction in a national budget must be transferred in a timely and comprehensive manner to those government agencies, which are expected to deliver services to the poor. To be effective and sustainable, greater transparency in budget management processes must be associated with an increased accountability of public officials, obtained through an enhanced legal and enforcement framework, as well as better merit-based civil service pay and performance management.

These steps should eventually lead towards reduced corruption in the public sector and hence, to a more effective delivery of government programs. We will return later in this paper to the linkages between different public sector reform initiatives, which are required for the achievement of sustained improvements in accountability, efficiency and effectiveness of public sector management and, hence, a reduction in the misappropriation of funds.

Review of the Principal Budget Management Processes

Most readers would already be familiar with the basic processes involved in executing budgets, once these have been approved by the legislature. Nonetheless, actual budget management practices still vary widely between countries, and thus a review of the desirable steps of expenditure management may be in order.

The Chain of Events in Budget Execution

A World Bank Technical Paper on PEM processes and systems²³ gives some guidance on a well-designed budget management system. The steps contained in that paper have been supplemented by additional options, to cover the varying degrees of de-centralization of PEM:

²³ *Treasury Reference Model*; Hashim, Ali and Allan, Bill; The World Bank, 2001.

1. **Budget Appropriations are recorded** by the Central Budget Authority (CBA), which is usually the Budget Directorate in the Ministry of Finance. The CBA enters approved aggregate spending limits into the central budget management system, and then communicates individual spending limits to each line ministry. Ministries in turn communicate budget ceilings to agencies under their tutelage.
2. **Cash Requirements are established** and spending warrants are issued by the CBA. These warrants represent the formal spending authority given to line ministries for the fiscal year, in response to their earlier estimates of cash requirements. Sub-warrants can likewise be issued to all agencies reporting to line ministries. The central bank or the commercial banks executing payments on behalf of spending ministries are also informed of the expenditure ceilings.
3. **Commitments are proposed** by ministries or by their reporting agencies.
4. **Commitments are authorized**, either by the CBA, or by de-centralized financial controllers in line ministries.
5. **Commitments are recorded** by ministries, the Treasury, or sometimes centrally at the CBA, or at the sub-national level depending on the organizational arrangements.
6. **Service and Goods Delivery is recorded** and verified by ministries and payment orders are issued either by the spending ministries or centrally by the Treasury, depending on the banking arrangements. Reconciliation of timeliness and completeness against the original transaction details should also be made at this stage.
7. **Disbursements are authorized and payments are made**, either directly by the spending ministries' banks, by the central bank, or by the Treasury, which draws on a central bank account.
8. **Accounting Entries are made** in the financial accounting system once payments have been executed (actually spent), either by the spending ministries or centrally at the Treasury.
9. **Audits are conducted** by internal auditors at the spending ministries and/or by a central audit entity. These audits cover the compliance with PEM rules and regulations and the adherence to set spending limits and purposes. At this stage, such audits would normally be in the form of sampling or spot checks.

The Flow of Information during Budget Execution

We now review each step of the budget management chain of events and the required data entries. We assume that there is a central budget tracking system in place at the CBA, linked real-time or off-line (batch data transmission, diskettes) to similar systems in the line ministries and agencies (Table 3.)

Table 3.**Recommended Information Flow in Budget Execution**

Stage in Budget Execution	REQUIRED DATA ENTRY
Budget appropriations have been approved	Spending ceilings are entered, both in the aggregate, and for each ministry, together with several 'warning flags' which are triggered as the ceiling draws near.
Commitments are requested	Planned commitments are entered in the system, and the CBA, or the de-centralized financial controller authorises or rejects them. In advanced budget management systems, this step can be replaced by ex-post spot checks.
Commitments are made	Each ministry or agency enters purchase orders or mandated transfers (salaries, benefit payments, etc.) into its budget management system, which will trigger a debit against its budget at the CBA, once the entries have been transmitted to the centre. For very large commitments, the entries are copied to the Treasury as advance information for their cash planning.
Services or goods are received	A confirmation that services or goods have been received in the appropriate quantity and quality is entered in the ministries' local budget system.
Payments are initiated	Based on the preceding service and goods receipts, payment instructions are issued, either locally at the ministry for direct execution, or centrally to the Treasury or to the Central Bank. An appropriate "pending payment" entry is made in the ministries' accounting system.
Payments are made	Payments are executed in the banking system and confirmation of the payments is received at the ministries. 'Pending payment' entries in the ministries' accounting system are closed, or they are left open if payment delays occur. A note giving the reason for delays should be made in the accounts. If payments are returned, accounting entries are reversed.
Audits are made	Internal auditors at each ministry, or central auditors, make spot checks, both in the budget system and in the accounting system, and compare expenditure documentation with systems entries.

The above sequence of data entries aims to make a maximum of budget utilization and cash information available at the earliest possible moment of each stage of budget management. It also aims to inform each and every entity involved in budget management.

Thus, it is crucial for line ministries to keep both the CBA and the Treasury in the loop on a timely basis, to avoid surprise calls for budget supplementation (by the CBA) and a cash crunch (at the Treasury). While an integrated budget and payments system cannot prevent exogenous events (policy changes, natural disasters, defence-related events, etc.) from having a sudden and sometimes large impact on budget management, it can at least prevent negative surprises, originating in an incomplete or delayed transmission of budget information between ministries and agencies.

Internal Controls for the Prevention of Conflicts of Interest

To ensure fiscal accountability, and prevent cases of inefficiency or corruption – certain key organisational principles need to be respected.

The most important principle of impartial and ethical budget execution is the respect for a separation of functions. Unfortunately, due to lack of awareness, or because of staffing problems, this principle often finds itself being violated, even in industrialised countries.

The thoughts underlying the separation of powers are that those who *authorize* the draw down of budgeted funds must not be the same persons who *use* these funds. Likewise, those who authorise payments must not be identical to those who make payments.

In addition, those who draw down budgeted funds should not be identical to those who do the accounting for these funds movements.

Finally, and perhaps most importantly, those who control or audit budget-related processes must under no circumstances be identical to those who authorized, used, or paid out budgeted funds.

The other key principle for the prevention of conflict of interest is the clarity of reporting lines. No person involved in budget management must be left in doubt about his or her hierarchical reporting line.

Even though one finds *dual reporting lines*, especially in highly de-centralized institutional environments (out-posted financial controllers, for instance), one must ensure that persons reporting to more than one superior *know to whom they report about what*.

Finally, another important principle of prudent and sound budget management is non-intervention. Often, civil servants complain that members of the executive branch of government intervene directly in budget execution matters and request, for instance, that ‘urgent’ payments be made without prior controls and verifications, or even by-passing all regular budget execution processes. These short cuts can lead to confusion and substantial delays when it comes to the regularisation of payments and *undermine the credibility* of the whole budget process, and of those involved in it. Therefore, proper procedures for unforeseen and truly urgent payments must be in place,

including the availability of key accounting, payment, and control personnel at short notice.

The above principles are all part of internationally recognized prudent financial management practices, which try to ensure that a maximum of transparency and accountability can be achieved at every step of the budget management chain.

Principles of Prudent Expenditure Management

Prudent budget management involves a number of processes crucial to the effective and efficient transfer of funds for the delivery of government programs. To successfully carry out these processes, one must organise the tasks involved in budget management in a logical manner, and respect some important principles when doing so.

The first principle of good expenditure tracking practice is that it should be comprehensive. Indeed, in many countries, not all central government expenditure flows through established budget management channels. This is the case for instance when some public spending is done by extra-budgetary Special Funds, such as Road Funds, Health Funds, or Social Security Funds. Likewise, certain government agencies may enjoy a semi-autonomous status within the public sector, such as regulatory agencies or national commodity trading boards.

In many of these special situations, bulk funding is released from the budget to these entities once a year, sometimes supplemented by earmarked extra-budgetary revenue from non-tax sources. Much of this expenditure is accounted for, and paid out, outside the budget system, and outside the national Treasury and the Central Bank. Many of these special entities may have their own bank accounts, sometimes with commercial banks instead of the central bank. In addition, in many instances these entities only reconcile their accounts with the national Treasury and the central budget authority (CBA) once, at the end of the fiscal year.

One of the first steps to obtain a truly comprehensive picture of government spending therefore should be the promotion of integrated budget reporting.

To achieve this, reporting on extra-budgetary funds, and on the final destination of budgeted funds originally released in bulk to autonomous agencies, should be integrated with the budget reporting system of the CBA. Budget management regulations should call for – ideally - a monthly transmission by all government agencies of data on budget utilization to the CBA, though this may be difficult to achieve in those countries where a reliable IT infrastructure is lacking.

While a modern, integrated Financial Management Information System (FMIS) may be the most efficient channel for the timely transmission of de-centralized budget, accounting, and payment information to the centre, this is by no means the only option. Indeed, integrated FMIS solutions can be very expensive and require

advanced training of public sector employees.²⁴ A more cost effective alternative can often be put into place through the use of PC-based wide-area networks (WAN), or even through the periodic transmission of diskettes with the required data by government agencies to the CBA.

No matter which solution is retained for the exchange of budget, financial accounting and payment data, one of the most important criteria to bear in mind for a successful integrated budget management system is the uniformity of budget management rules, as well as harmonized accounting methods and data formats across all government agencies.

Another key principle of expenditure tracking is the respect of budget management rules, or conversely, the minimization of exceptional procedures. Indeed, especially in very centralized budget management systems, line ministries and agencies often find creative ways to circumvent sometimes slow, tedious, and restrictive central commitment control and payment authorization processes.

Thus, payments to suppliers are sometimes made without prior entries in the budget accounting system, with the idea that ex-post regularizations of accounts will be made in due course. In this environment, the centre is often left in the dark for lengthy periods of time about the true state of ministries' drawdowns against budget line items. Here again, a uniform set of regulations must be put in place and – above all – enforced. If overly strict and slow central control and authorization mechanisms are found to cause the proliferation of exceptional procedures, then the CBA must consider giving greater spending authority to ministries and agencies, albeit combined with enhanced ex-post audits and *tough sanctions in cases of abuse*. (example of Benin, infrastructure sector)

Another important principle, closely related to the previous principles, is timeliness in expenditure tracking.

To ensure the availability of an accurate picture of the state of the budget and the Treasury position, each step of the budget management chain, as it has been presented earlier, needs to be immediately recorded in an information technology (IT) supported system.

Let us briefly touch upon a public expenditure management practice which, although normally addressed in the context of budget preparation, is very relevant to budget execution: mid-year reviews of budget utilization. If there is no formal mechanism in place for an intra-year budget review, there is an increased likelihood of a proliferation of exceptional procedures in budget management, especially later in the fiscal year when the original budget may no longer be a good reflection of actual expenditure requirements. As mentioned earlier, one of the main principles of sound budget management is the minimization of precisely these exceptional procedures. An intra-year re-alignment of the budget with changed expenditure requirements can

²⁴ *Information Systems for Government Fiscal Management*; Hashim, Ali and Allan, Bill; The World Bank, December 2001.

therefore lead to fewer requests for payments made outside of normal authorization and control channels.

Another important budget management principle has to do with the carry over to the following fiscal year of unspent funds. Ministries should be given a clear indication of how much – if any – money they can carry forward, without claw back from the CBA. If ministries are left in the dark about carry over, they are likely to use up all of their budgeted funds – perhaps unnecessarily – as the end of the fiscal year is drawing near. One must recognize, however, that in many developing countries actual carry over of unused budgeted funds occurs very rarely indeed, as budget lines are often used up well before the end of the fiscal year. Likewise, poor budget accounting systems frequently make it impossible to foresee a possible carry over of unspent funds. Nonetheless, as information about budget utilization becomes more accurate and timely with the introduction of better budget management practices and more reliable IT support, clear rules about carry over should be in place.

Finally, in many jurisdictions the end of the fiscal year does not necessarily mean the end of spending against that year's budget. This leads to a poor budget management practice, referred to as using the extended budget year. Frequently, this formally or informally extended budget period has been known to reach 3-6 months.

The cause for late charging against budget lines originates in sometimes very lengthy delays between the commitment of expenditure, the actual payment, and the relevant accounting entry. As budget management systems improve over time, the extended budget period should be reduced, and eventually eliminated altogether.

Other basic budgeting principles include the concept of Budget Accuracy, calls for the recording of actual transactions underlying the use or supply of budgeted resources.

For instance, expected revenue or expenses should not be brought to book until they have actually occurred. If a jurisdiction adopts accrual budget accounting standards, agencies may, however, provision for certain future expenses, and account for most expenses as soon as a related expenditure commitment is made. (can we expand on commitment versus payment/ accrual versus cash system)

The principle of Budget Annuality refers to the need to give each budget a finite life span, traditionally one fiscal year. Occasionally, one finds multi-year budgets and Medium-Term Expenditure Frameworks. While these budgeting tools go beyond a single fiscal year, their life span is nonetheless explicit and finite (this is very important and should be expanded)

Finally, the principle of Budget Authoritativeness refers to the need to limit all public expenditure to that specifically authorized by law (which features, most importantly, the overall expenditure ceiling). In some cases – mainly in civil law traditions - the budget law may make only broad reference to certain types of expenditure, with the understanding that supplementary, so-called 'delegated laws' or regulations will clarify the precise nature or scope of such expenditures. This type of arrangement is

sometimes used for stand-alone Social Security Funds, Road Funds, or some types of national security-related funding.

Managerial Tools for Expenditure Management

Several models have been developed by multilateral institutions, to assist developing countries in designing effective expenditure management systems.

One such model is the Treasury Reference Model developed jointly by the World Bank and the IMF.²⁵

This model is intended as a development tool for public expenditure managers and systems developers, for implementing good practices in expenditure tracking and control, accounting, and budget reporting in accordance with internationally accepted standards and codes.

Another model is the Budget Formulation Model, which targets budget preparation more specifically than budget execution.

Nonetheless, this model provides useful guidance on specifying budget line items and government programs in a manner that allows for the accurate tracking of actual expenditure and the evaluation of program outcomes.

It also guides readers through the complete budget process and discusses incentives for public sector managers to deliver public services effectively and efficiently.²⁶

Finally, with a focus on managing public expenditure specifically for poverty reduction, the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) has developed a set of PEM principles under the heading of The Fiscal Covenant.²⁷ This guide features useful chapters on improving the productivity of public expenditure, transparency, strengthening institutional frameworks, and safeguarding social equity in government programs.

Expenditure Tracking and Monitoring

Let us first clarify the difference between expenditure checking, monitoring, evaluation, and tracking.

Expenditure checking can be understood as referring to a fairly mechanistic observation, through budget accounting reports, of the utilization of budget lines during the fiscal year. No judgement is made as to appropriateness or otherwise of the observed budget use.

²⁵ *Treasury Reference Model*; Hashim, Ali and Allan, Bill; Technical Paper No. 505; The World Bank, April 2001.

²⁶ *Budget Formulation Model*, Public Expenditure On-Line Web pages, PREM Network, The World Bank: www.worldbank.org/publicsector/pe

²⁷ *The Fiscal Covenant: Strengths, Weaknesses, Challenges*; ECLAC, United Nations, New York, April 1998.

Expenditure monitoring can be understood as referring to a more analytical activity where one examines whether money is spent for the right purpose, at the right time, and by the right person or entity.

Finally, the concept of expenditure tracking, as used in the context of *Tracking Surveys* emphasises the need to examine who are the beneficiaries of services financed by public expenditure.

This distinction is of some importance when it comes to widening the cast of expenditure observers from accountants within the public sector to a much broader range of stakeholders, including parliament and civil society.

To the concepts of tracking and monitoring, one can add that of expenditure evaluation. Here one is more concerned with studying the nature of actual spending, and contrasting these findings with the original intent. Here one would also examine the incidence of public expenditure on those priority sectors or populations, which had originally been targeted by policy makers.

With regard to the different players in expenditure tracking and monitoring, one will find that, in most PEM systems, there is a central budget authority (CBA) which tracks budget execution on a consolidated basis for all ministries and government agencies. Given its comprehensive view of resource utilization throughout the 'Central Government' sector, the CBA is therefore best placed to aggregate all data on budget execution and keep members of government informed of the state of the budget at any given time.

Likewise, the Treasury is best placed to give a consolidated picture of cash receipts and payments, and the resulting cash balance in the central government sector.

In addition to the quantitative tracking of expenditure, financial and process audits of the budget management process are required to ensure a maximum of integrity and transparency in PEM.

Internal auditors at each government department and agency should periodically control the conformity of expense documentation with accounting entries and payments, and the adherence to internal authorization and control processes.

A national autonomous audit agency should control the adherence of government agencies to budget management rules and regulations, and whether budget outturn reports produced by the CBA give an accurate picture of aggregate resource utilization in the Central Government sector. To ensure a maximum of impartiality and independence, a national audit agency should report to Parliament, instead of the Executive. Parliament, in turn, needs to be given formal oversight powers over both budget development and budget execution.(any good examples? Would Costa Rica be one of them?)

This brings us to the role of citizens and their parliamentary representatives in the tracking and monitoring of public expenditure.

Parliamentary Oversight

To carry out its mandate of participation in, and oversight of, budget development and execution respectively, the legislature should convene a number of standing committees. These comprise – depending on how the legislature in a country is organized – a Budget Committee and a Public Accounts Committee, or a combination thereof.

The Budget Committee discusses and, if appropriate, proposes amendments to, draft budgets submitted by the Executive. The Public Accounts Committee examines reports on budget outcomes after the end of a fiscal year and if required, ask the Finance Minister for explanations of any major divergence between the budget outturn and the original or amended budget. In addition, the committee should, throughout the fiscal year, keep an eye on budget execution, based on periodic reports provided by the CBA and the Treasury. The Public Accounts Committee reports on its findings and calls for appropriate remedial action by the Executive, if serious divergences between budgeted and committed or disbursed funds have been found.

That at least, is the ideal state of parliamentary oversight over public expenditure.

In many developing countries, parliamentary committees do not yet have the power to put sufficient pressure for change in expenditure management on the government, in part because their reports are not widely circulated and thus not known to civil society at large, in part because overall parliamentary powers are limited in practice, if not *de jure*.

In addition, Parliament in many countries does not have the institutional capacity (e.g. permanent research and support staff for committees, appropriately trained members of parliament) to carry out in-depth examinations of budget execution and program outcomes. Therefore, the strengthening of the institutional capacity of parliament needs to run in parallel with PEM reforms in many cases.

Multi-lateral Expenditure Monitoring and Surveillance

Expenditure monitoring and surveillance by multi-lateral organizations can also be useful, especially for those countries where the legislature can only exercise limited oversight powers (as opposed to formal powers given by the constitution) over public spending. Multilateral oversight of public expenditure is also useful in those instances where the executive cannot get frequent expenditure drifts under control.

Both the World Bank and the International Monetary Fund (IMF) have developed expenditure monitoring tools and procedures which can be used not only when PEM problems are already visible, but also to prevent such problems from emerging in the first place.

Traditional IMF surveillance focuses on macro economic issues and on aggregate fiscal policy, with overall budget outcomes always being discussed in IMF “Article IV” surveillance reports. To complement its observations on aggregate fiscal policy

contained in Article IV reports, the IMF has in recent years engaged in additional diagnostic and analytical activities, which are more closely targeting budget management. One such program is the *Report on the Observance of Standards and Codes* (ROSC).

A ‘ROSC’ summarizes the extent to which countries observe certain internationally recognized standards on the presentation of economic, budgetary and financial information. While a ROSC exercise has a scope much wider than just PEM (it also covers banking supervision, monetary and financial policy transparency, and statistical data dissemination), it does feature a ‘Fiscal Transparency Module’. In that module, the IMF examines whether a country adheres to a set of recommendations contained in their Code and Manual on Fiscal Transparency, namely:

1. Clarity of Roles and Responsibilities of Government Entities
2. Public Availability of Information about Public Expenditures
3. Open Budget Preparation, Execution, and Reporting
4. Assurances of Integrity, and Independent Scrutiny of Fiscal Information.

In a recent ROSC on Mozambique²⁸, for instance, the IMF made the following observations about that country’s budget management practices:

“Extra-budgetary activities are significant in Mozambique, relative to the size of the budget, despite the fact that legislation requires universal coverage by the state budget. ...Budget management is based on a clear separation of powers between the executive, legislative, and judicial branches of government, and the powers of the ministry of planning and finance are clearly defined in law. ...Some stages in the expenditure process, such as commitment and verification, are neither defined nor recorded. ...[Reports on budget outcomes] are presented to the legislature 20 months after the close of the fiscal year.”

The World Bank, for its part, is currently using several monitoring and evaluation instruments with either a pure PEM focus, or with significant PEM components: Public Expenditure Reviews (PERs), Public Expenditure Tracking Surveys (PETS), Country Financial Accountability Assessments (CFAAs), and Institutional and Governance Reviews (IGRs).

Public Expenditure Reviews (PERs) help countries establish effective and transparent mechanisms to allocate and use available public resources in a manner that promotes economic growth and reduces poverty.

Most PERs are comprehensive macro reports with a mandate to focus on the efficiency and efficacy of resource allocation. Topics include an analysis and projection of revenue; the determination of the level and composition of public spending; inter- and intra-sectoral expenditure analysis; financial and non-financial public sector enterprises, the structure of governance, and the functioning and efficacy of public institutions.

²⁸ *Report on the Observance of Standards and Codes (ROSC) – Mozambique: Fiscal Transparency*; IMF, February 2001.

Thus, because of their broadly specified mandate, PERs cannot normally focus much on budget execution processes, except in cases where serious deficiencies hamper the achievement of key government program objectives.

Public Expenditure Tracking Surveys (PETS) for their part are more targeted towards budget management, by focussing especially on how public expenditure leads to the actual delivery of public services.

Surveys of quantity and quality of public services are made, as are reviews of service facilities. PETS typically collect information on facility characteristics, financial flows, outputs, and accountability arrangements. PETS data can have multiple uses, ranging from a simple diagnostic tool for operations to empirical research on cost-efficiency.

PETS are especially useful where there is little reliable public accounting information and no functioning management information systems. Thus PETS can be powerful diagnostic tools, which can in turn recommend specific improvements in budget management and in managerial practices, more broadly speaking.

Country Financial Accountability Assessments (CFAAs), take a more technical approach to analysing national budgeting, accounting, and auditing processes. The emphasis here is put on examining fiduciary responsibilities, by identifying strengths and weaknesses of financial accountability arrangements in the public sector. Building on this analysis, CFAAs identify specific measures required to strengthen the capacity of national institutions involved in PEM.

Institutional and Governance Reviews (IGRs) take a comprehensive approach in examining public sector accountability arrangements, policy-making, and service delivery. IGRs can, among other things, identify specific systemic weaknesses in public sector accountability arrangements, which in turn, can have serious repercussions on financial management processes.

Expenditure Monitoring by Civil Society

We have alluded earlier to the importance of parliamentary oversight over PEM. Since legislatures do unfortunately not always have the means to exert sufficient pressure on the executive to correct deficiencies in budget management, the net of public scrutiny may need to be cast much wider.

Indeed, the more broadly based public awareness of, and response to, PEM issues are, the more effective public pressure on a government can be. This is where NGOs, interest groups, and citizens' associations come into play.

As a recent joint IMF-World Bank conference on the effectiveness of Poverty Reduction Strategy Papers (PRSPs),²⁹ participants agreed that PEM issues are a key component of all poverty reduction strategies.

Periodic reviews, and continuous improvements of national and sub-national budget management methods are needed, so as to make the actual delivery of poverty-reducing programs to their beneficiaries more effective. The need for monitoring of PEM by civil society groups was also once again highlighted as an important tool to promote popular participation in resource management and increase the accountability of governments. Participants saw PEM monitoring by developing country constituencies as one avenue to progressively shift from external donor conditionality towards local empowerment and governance control.

If one reads a recent assessment of the progress made in the preparation of a PRSP for Bénin,³⁰ one realizes once again that popular participation in both the design and the monitoring of poverty-reducing expenditure programs is crucial for their long-term success. Indeed, as this report stated:

“...In spite of favorable economic developments, poverty and inequalities did not decrease in recent years. ...Several economic and social programs and projects undertaken during the period 1990-2000 proved not to be viable...as the local population that was to benefit from them did not participate in their preparation and monitoring.”

In light of these findings, the report pointed out that:

“...Priority areas of the [PRSP] will include...improving capacities for the management and use of public resources; ...also, fiscal policy will continue to be strengthened by...the use of budget monitoring and evaluation mechanisms.

With regard to the need for public involvement in the monitoring and evaluation of public expenditure programs, the report stated:

...Finally, the [PRSP] will include mechanisms for monitoring and evaluating its implementation, which will be based not only on outcome indicators, but also on periodical consultations with the representatives of the civil society and vulnerable groups.”

²⁹ PRSP Review Conference and staff discussions held 14-18 January at the World Bank in Washington DC.

³⁰ *Bénin: PRSP Preparation Status Report*; PREM Network, The World Bank, Washington DC; October 2001.

While few civil society groups in developing countries have as yet the means and the expertise to monitor public expenditure effectively and to publish detailed analytical reports, some NGOs in selected countries have – sometimes with outside start-up assistance – developed a basic capacity to monitor, and report on, public expenditure issues. One good example of such an organization is the *Institute for Democracy in South Africa* (IDASA).

Since 1994, IDASA has concentrated on informing South Africans of PEM practices, as part of its broader analytical work on governance. IDASA has established the specialised Budget Information Service (BIS) to monitor, analyse, and evaluate public sector resource management in South Africa.³¹ IDASA tries to educate legislators, civil society and the media about the importance of the national budget in developing and implementing poverty-reducing policies.

It also tries to raise public awareness of the importance of popular participation in every stage of the budget process, namely: providing input in budget preparation, monitoring budget execution, and publicly discussing budget outcomes.

IDASA has resorted to a variety of communication tools to get its message across to its target audiences. Among these tools, we find *Budget Watch*, a magazine about PEM issues, published every six weeks.

This is a more technical publication, which targets members of parliament and the executive branch. Articles featured in this magazine frequently highlight the links between PEM and poverty reduction and call for appropriate legislative oversight over the budget process. Articles also comment about the composition of the national budget and communicate related views of NGOs to the executive branch.

In addition to *Budget Watch*, IDASA produces *Budget Briefs*, a general interest publication, which targets civil society at-large, including community-based organizations and individual citizens.

Budget Briefs try to stimulate public discussion of PEM and the transmission of related commentary to the legislature and the executive. In this same line of broad mass dissemination of budget-related information, IDASA also produces its weekly radio program *Democracy Radio*, which, as part of its broad governance analysis focus, also features discussions of budget topics. This radio program tries to reach even the remotest areas of South Africa, where illiteracy may still be high, and access to published materials limited.

While it took IDASA's Budget Information Service several years to get sufficient public attention, the feedback they have received about their analysis and discussion of the FY 2000 budget indicates that their dissemination efforts are now beginning to pay off. Especially their more recent focus on availability and quality of public services seems to have struck a nerve among South African civil society.

³¹ For a discussion of the BIS, see: *Transparency and Participation in the Budget Process: South Africa Country Report*; Fölscher, Alta; Krafchik, Warren; Shapiro, Isaac; The International Budget Project, Washington DC; December 2000.

Similarly, the Development Initiative for Social and Human Action (DISHA), a NGO in India, has made major strides in educating civil society about the importance of public monitoring of the budget process.³² Like IDASA, the DISHA network has emphasized the need to closely monitor the actual delivery of public services.

To do so, DISHA has developed a *Report Card*, which monitors and evaluates a range of front-line service delivery indicators.

The Public Affairs Centre, another Indian NGO, piloted PEM monitoring in the city of Bangalore. Both of these initiatives in India have stimulated widespread public debate about the transformation of budgets into public services, although it is too early to judge whether they will enable civil society in India to have a sustained and effective say in public expenditure policy and management.

In other developing countries, notably in Ghana, Honduras, Uganda, and Tanzania, civil society groups are also beginning to organise more effectively for governance monitoring.

In these countries, NGOs are beginning to provide public analysis and comment on PEM, and to put greater pressure on the legislature and the executive to improve PEM processes, all as part of an overall governance monitoring process.³³

Organized efforts of civil society groups in developing countries to achieve a greater degree of public participation in PEM are still few and far between. Nonetheless, the need for public governance control mechanisms has been acknowledged by multilateral and bilateral development agencies.

Public monitoring of governance arrangements is progressively becoming an integral part of long-term development strategies, including the PRSPs prepared by the World Bank and the IMF.

Yet, one must recognize that, even though civil society in developing countries can highlight shortcomings in PEM and the delivery of public services, and call for remedial action on the ground, few citizens groups have the capacity as yet to make wide-ranging public sector management reform proposals.

Also, in many countries, civil society groups may well provide useful comments on budget execution, yet no one in the executive branch listens to them.

This may be because the weight of civil society groups in the national electorate is still limited, or because national elections as such have only a limited impact on the actual formation and functioning of a government (electoral fraud, pro-forma parliament, etc.). Therefore, multilateral development agencies and development NGOs need to intensify the integration of PEM reforms into their overall public sector reform strategies.

³² *Expanding Participation in Public Expenditure*; Public Expenditure On-Line Web Resources: www.worldbank.org/publicsector/pe; The World Bank, Washington DC.

³³ *Civil Society Budget Work in the Context of PRSPs*; Discussion Paper for the PRSP Review Conference; Krafchik, Warren; The International Budget Project, Washington DC, January 2002.

Therefore, we will now turn to the place of PEM reform within the wider public sector reform agenda.

Coordinating PEM and Public Sector Reforms

As this author has argued elsewhere³⁴, seeking improvements in one segment of the public sector usually entails doing the same in other segments at the same time, or in close and coordinated succession. Indeed, there is, for instance, sufficient evidence of the links between successful PEM reform and equally successful civil service reform.³⁵

Likewise, researchers have acknowledged the need for the logical sequencing and close coordination between different public sector reform efforts to achieve sustained poverty reduction.³⁶ Therefore, we now discuss the desirable positioning of budget management reform in the overall public sector reform agenda of a developing country. One should note that, whilst the following suggested sequence of reform steps represent an objective one could keep in mind in a best case scenario, the sometimes rapidly changing political reality in developing countries can easily throw a public sector reform agenda off track altogether, or cause major delays for some of its components.

Nonetheless, one can say that, if one ever wants to achieve successful reform of any part of the public sector, stakeholders must show the will and motivation to do so, and commitment must be sustained over time. Therefore, the first step of any comprehensive public sector reform agenda must imperatively address the question of ownership.

Step 1. Ensuring Reform Ownership

All too often, international development agencies have had to realize that public sector reforms were supported by governments in client countries only until most of the related reform project funds had been disbursed, with a sometimes rapidly vanishing level of commitment thereafter.

Likewise, in many instances, reforms were supported by one ministry, but not by others, thus leading to serious implementation difficulties.³⁷

While some of the blame for the less than perfect track record of public sector reform in developing countries must lie with the development agencies themselves – whose reform proposals were in the past not always well adapted to local conditions and constraints, limited or un-sustained reform ownership in client countries would appear to be the main cause for delays in implementing reforms, or for outright failure.³⁸

³⁴ *Downsizing the Civil Service in Developing Countries*; Peters, Lucien; Public Administration and Development, Vol. 18, pp. 381-386; London, UK, October 1998.

³⁵ For a discussion of inter-dependent, ground-breaking public sector reforms in New Zealand for instance, see: *Government Reform in New Zealand*, Scott, Graham; IMF Occasional Paper 140; October 1996.

³⁶ *Poverty Reduction Strategy Sourcebook*; PREM Network, The World Bank; Washington DC, June 2001.

³⁷ See, for instance: *A Governance Approach to Civil Service Reform in Sub-Saharan Africa*; Dia, Mamadou; The World Bank, 1993.

³⁸ See also: *Ownership and Conditionality*, OED Working Paper Series, No. 8; Operations Evaluation Department, The World Bank; Summer 2000.

Thus, it would appear crucial that the political leadership of client countries is convinced of the need for public sector reforms and fully committed to their timely and comprehensive implementation, before any specific reform projects get underway. Relatively recent inclusive and cooperative development planning instruments, such as the Comprehensive Development Framework (CDF) and Poverty Reduction Strategy Papers (PRSP), are contributing to making the process of achieving strong reform ownership among client country leaders an accepted way of operating.

With these instruments, the donor community can encourage a much more broadly based discussion of proposed reform priorities within client countries, thus broadening the support (political level) and pressure base (civil society) for reforms. Likewise, hitherto fragmented donor proposals for reforms can be presented in a more coordinated and more credible manner through these integrative instruments, thus eliminating donor competition, which, in turn, could have weakened client country commitment.

With more comprehensive development planning tools, such as the CDF and the PRSP, different reforms supported by different donors can be more logically and sequentially presented, thus highlighting their relative importance in the overall reform agenda. Through their participatory nature, these tools can also put some pressure on country stakeholders to walk the talk, i.e. to adhere to reform measures, which they themselves had advocated when a PRSP, for instance, was originally drafted.

Unfortunately, in many cases of PRSP development, for instance, the legislature and civil society at large have only had a very limited input, or none at all.

Therefore, just because a PRSP has been developed, does not always mean that a broad and, perhaps more importantly, a sustained ownership basis for public sector reforms is in place.

It follows that much more needs to be done to ensure that the executive, the legislature, and a representative cross section of civil society support any public sector reform agenda that may have been proposed in a development plan. To achieve this broadly-based buy-in, one must, however, be aware of the political reality in many developing countries and initially work, in most cases, towards strengthening overall national governance arrangements, before tackling more detailed public sector management issues.

Step 2. Ensuring an Appropriate Institutional Framework

Once strong commitment and ownership of proposed reforms has been secured, one must focus on the overall institutional environment within which reforms are expected to be implemented. In the past, too many reform initiatives have been planned on a highly fragmented 'bottom-up' basis, i.e. without due analysis of the adequacy of the enabling constitutional and legal framework, and without taking into account institutional constraints.³⁹

³⁹ See also: *Governance Progress Report: The Africa Region Experience*; Adamolekun, Ladipo and Bryant, Coralie; The World Bank, February 1994.

As a first task, one should embed proposed public sector reforms in an appropriate legal framework, such as the *Modernization of the State* enabling law used as a launch pad for public sector reforms in Ecuador.⁴⁰ This law should assign all reform coordination and implementation responsibilities to specific members of the Executive; feature a timeline for reform implementation, and specify accountability arrangements. More technically oriented laws and regulations for each reform segment, including institutional capacity building, organizational matters, civil service and PEM reform, should supplement the enabling law.

A next task would be capacity building, ensuring that key officials in ministries and autonomous agencies understand and support reform priorities, and that they and their staff have the necessary skills to implement the reforms, initially perhaps with outside assistance. Appropriate training programs may also need to be designed and delivered at this stage.⁴¹

Step 3. Ensuring Commitment in the Civil Service

One can hardly deny that, if civil servants are not motivated to change the work methods they have been familiar with for many years, one can hardly look forward to long-term success in implementing diverse public sector reforms, including PEM improvements.⁴²

It is therefore not surprising that wide-ranging public sector reforms in New Zealand and Australia – now considered best practice countries in this area – have emphasized the importance of adequately preparing and motivating civil servants for changes in work practices, including financial management.⁴³

Therefore, even though some industrialized countries have been able to concurrently implement far-reaching civil service and PEM reforms – sometimes stretching the capacity of their ministries during the implementation phase to the limit – it would be prudent to recommend that developing countries, with their much more reduced institutional capacity, improve civil service management methods before reforming their PEM systems.

Indeed, only when an official has a clear incentive - through his annual performance evaluation, for instance – to manage public funds in an efficient and effective manner, can he be expected to show long-term commitment to PEM reforms.

Step 4. Implementing PEM Reforms

This step would comprise the following, sequentially laid out tasks:

⁴⁰ *Improving Micro Budgetary Performance: The Case of Ecuador*, Reid, Gary; The World Bank, September 1997.

⁴¹ *Tracking Poverty-Reducing Public Spending in HIPC*s, op. cit.

⁴² See, for instance: *Institutional Environment and Public Officials' Performance in Guyana*; Gokcekus, Omer; Manning, Nick, et. al.; The World Bank, May 2001.

⁴³ Graham Scott, op. cit.

- a. Ensuring adherence to existing PEM-related laws and regulations, and that non-adherence is appropriately remedied.
- b. Issuing new budget management regulations, as required (framed within the enabling law mentioned earlier), including specific penalties for non-compliance.
- c. Development of new job specifications for staff involved in PEM, with a view towards improving their accountability.
- d. Introducing modern staff performance management methods, to ensure a closer link between sound resource management and staff promotion and tenure.
- e. Recruitment of qualified staff, made in accordance with the operational needs of the new PEM system
- f. Provision of specialized training for those involved in budget management and their managers
- g. Implementation of a modern IT infrastructure
- h. Development of an evaluation framework for PEM and scheduling periodic evaluation exercises.
- i. Development of mechanisms for transforming evaluation findings into continuously improving work practices.

One should recognize that – given the sometimes very severe capacity constraints found in developing countries – the preceding steps may not all be achievable, and even if they are, they can take many years to come to fruition. Likewise, depending on the size of the country, one may not be able to accomplish all reforms at all ministries and agencies in a timely manner and in an ideal sequence, or as comprehensively as one had hoped for.

Achieving initial success at only a small number of pilot ministries may sometimes provide reformers with a ‘demonstration effect’ that may, in turn, reinforce acceptance of the reforms in other ministries.

Donors would need to ensure that seamless funding continuity is ensured for the implementation of PEM reforms at those ministries, which are scheduled to benefit from the reforms after the pilot phase has been concluded.

Serious disruption of the reform process – and loss of momentum and commitment – can occur if the funding for the pilot phase of PEM reforms forms part of one project, while the subsequent, public sector-wide implementation is covered by another project.

Conclusion

In the preceding chapters, we have seen that the efficient and effective transmission of public funds to ministries and government agencies is a necessary corollary to a well-targeted and realistic budget, if one wants to achieve sustainable reduction of poverty through public sector intervention.

Sound practices in budget execution can reinforce the credibility of a government, not only vis-à-vis the donor community, but also among public officials and civil society. As broad-based support for the modernisation of budget execution practices is built

up in legislatures and in civil society through appropriate dissemination and education programs, the pressure on the executive to achieve durable improvements in the management of public funds can be significantly increased.

PEM reform programs - including efficient and effective budget execution and monitoring methods – can only be successfully implemented if top-level political commitment to reforms is obtained, and broadly-based reform ownership and motivation is ensured among public officials, ideally through a preceding or a concurrent civil service reform program.

Thus, PEM reform should be part of a wider, multi-faceted and integrated public sector reform agenda, which in turn, should represent a key component of a strategic, long-term development and poverty reduction plan, such as those formulated in the context of a CDF.

Technical Annex I

Budget Execution and Accounting

The objectives of a well-performing budget resource allocation and management system (Public Expenditure Management Handbook - World Bank, 1998) are to:

- Control aggregate spending and the deficit;
- Facilitate strategic prioritization of expenditures across policies, programs, and projects for allocation efficiency and equity;
- Improve planning for cash as well as close and timely monitoring of the governments cash position;
- Provide adequate management reporting at various levels of budget execution;
- Encourage better use of budgeted resources to achieve outcomes and produce outputs at the lowest possible cost.

Management of these five objectives is integrated through a perspective that goes beyond the annual budget cycle. This is achieved by linking policy, planning and budgeting in a medium-term expenditure framework at both the overall government and sectoral levels.

Government Fiscal Management (GFM) systems provide decision-makers and public sector managers with a set of tools to support these objectives. The architecture of the information systems network is determined by the basic functional processes that public sector managers employ to achieve these objectives and the overall regulatory framework that underpins these processes. We therefore start with a discussion of these aspects.

Functional processes for Budgeting and Accounting

The functional processes carried out by the central government in the areas of budgeting and accounting, together with the linkages to the control framework, are illustrated in Figure 1. The main elements are briefly described below. As indicated in Figure 1, the functional processes of budgeting and accounting can be categorized as those carried out by the central agencies and those carried out by the spending ministries and agencies. Those of the central agencies are most directly linked to the control framework which include (particularly the ministry of finance) ensuring that the control framework is properly applied throughout government. The functional processes cover two interrelated areas: macro fiscal forecasting, budget preparation and approval; and budget execution, cash management and accounting. The first set of processes supports the objectives of setting fiscal policy and strategic priorities. The second set of processes supports the objective of optimizing the use of budgeted resources and ensuring accountability.

**Figure 1
Functional Analysis, Control Framework,
and Functional Processes**

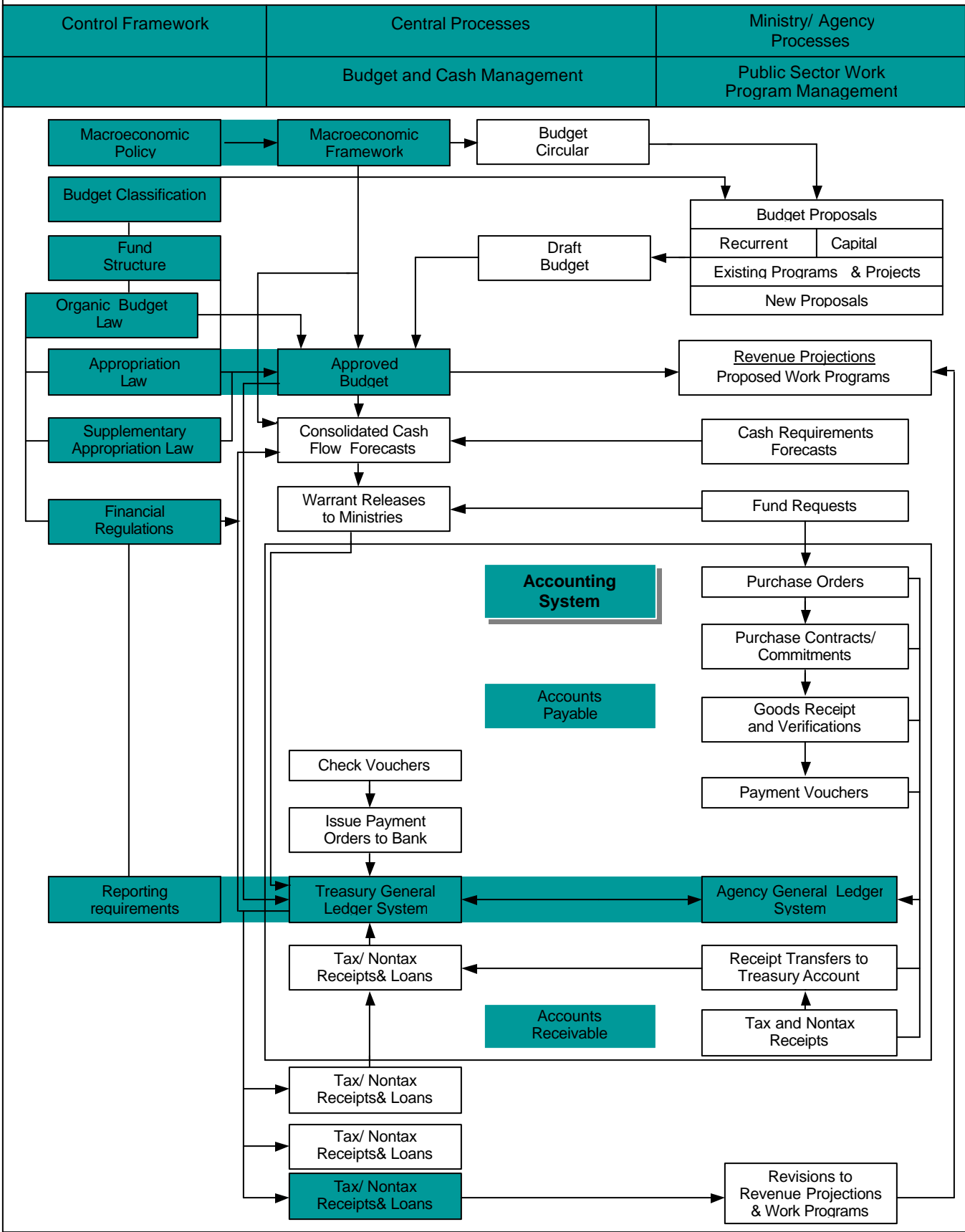


Figure 1 shows the budget preparation processes carried out by the central agencies in the column titled "Budget and Cash Management Processes." The processes that take place at sector agencies which deal with the preparation of estimates for programs and projects that constitute the *Public Sector Work Program (PSWP)* are shown in the column titled "PSWP Management."

At the start of the budget cycle, the central agencies (generally the Ministry of Finance) send the sector agencies a budget circular indicating economic prospects and broad policy objectives and giving the parameters within which the budget for each ministry is to be prepared. The circular may give specific ceilings for expenditure by each agency and program. The sector agencies respond with their budget proposals. As indicated in Figure 1, the financial information in these proposals should be categorized in the following ways:

- By type of expenditure for example by budget classification and, at a broadest level, distinguishing recurrent from capital expenditures;
- According to whether they are continuations of programs approved under existing policy or new project proposals.

Since budget requests generally exceed resources, negotiations at the technical level between central and sector agency staff are required to review costs for existing programs and new project proposals. Cabinet level discussions are often required to set intersectoral priorities and priorities among the program and project proposals to ensure that the selected proposals can be funded within the macroeconomic framework. The framework should be updated frequently, particularly during budget initiation and finalization, as well as for subsequent reviews during the year. As a result of these discussions, a draft budget document is prepared.

After preparation by the executive branch, the legislature reviews the estimates and approves the budget. The duration of legislative consideration and the degree of change that can be introduced at this stage vary considerably among countries.

This approved budget becomes the legal basis of the PSWP to be executed by the sectoral ministries. It gives estimates of expected revenue and borrowing and the amount of expenditure - by budget and accounts classification - authorized to be spent on approved programs and projects. It usually contains data on past expenditures. It may also contain descriptions of programs and projects and data on expected performance expressed in terms of outputs and/or outcomes expected from program outlays during the year. (modifications in the execution phase by supplementary appropriation require legislative approval by the central agencies).

Cash Management, Budget Execution and Accounting

Cash Management

At the start of the year, sector agencies prepare forecasts of cash requirements for the year based on known and anticipated commitments for both recurrent and capital expenditures. These forecasts are based on information on firm commitments and the foreign exchange component of anticipated expenditures. The cash requirements and revenue projections obtained from the agencies responsible for revenue collection are developed into a consolidated cash flow forecast by the *Ministry of Finance (MOF)*.

Once the budget is approved, the MOF has the task of controlling the release of funds, monitoring progress on budget implementation, and managing the cash resources of the government. From the start of the financial year, the MOF releases funds (warrants/cash allocations) periodically to the different sector agencies, keeping in view the approved budget, the sector agency cash requirements, and overall resource availability. As the fiscal year progresses, the sector agencies prepare monthly/quarterly requests for funds and submit actual expenditure/revenue statements for the previous month/quarter. Capital expenditure warrants are allocated to specific projects.

Warrants authorized by the MOF are sent to the treasury that is the supervisor of the *Consolidated Fund* (CF). The warrant either authorizes the treasury to make payments out of the CF or authorizes the treasury to make money available for payment by the responsible accounting officers of the sector agencies.

Budget Execution

Upon receipt of the warrant authority from the MOF and access to funds from the treasury, sector agencies begin implementing the approved programs and projects. The line agencies start using the appropriated funds by requisitioning, procuring, and paying for goods and services.

A typical sequence of administrative steps for the acquisition of goods and services is shown in Figure 1.

To ensure proper expenditure control, sector agencies are required to institute a system of commitment planning and control to ensure that expenditure does not exceed the sum approved by parliament for specific purposes and expenditure is within the warrant amounts. The latter element of expenditure control is often used by the MOF/Treasury to ensure that expenditures do not exceed actual resources (which may be less than estimated in the budget). When a receipt shortfall occurs, it is essential that the treasury be aware of the commitments (e.g., statutory payments such as public debt, staff salaries and allowances, unpaid bills and existing contractual obligations) for which cash is needed during the year.

Tax revenue from customs duties, income, excise, and land taxes is managed by the revenue collection agencies. These revenues are deposited in local commercial banks and remitted to the government's central account in the *Central Bank* (CB). The CB then sends a daily report to the treasury on inflows to this central account.

Non-tax revenue from fees, administrative charges, and product sales (e.g., products made in prisons) are also managed by the collection agencies and transferred to the CF.

Accounting

The basic processes involved in government accounting are:

- Maintaining records of spending authorizations at the appropriation and funds-release (warrant) levels;
- Processing transactions which includes recording the transactions as they occur, applying the requisite controls, posting to the appropriate account, and listing transactions and associated data for control and audit;
- Maintaining ledger accounts to monitor and control actual spending and receipts against budget and warrant controls;
- Reporting.

Key Characteristics of the Treasury Ledger System (TLS)

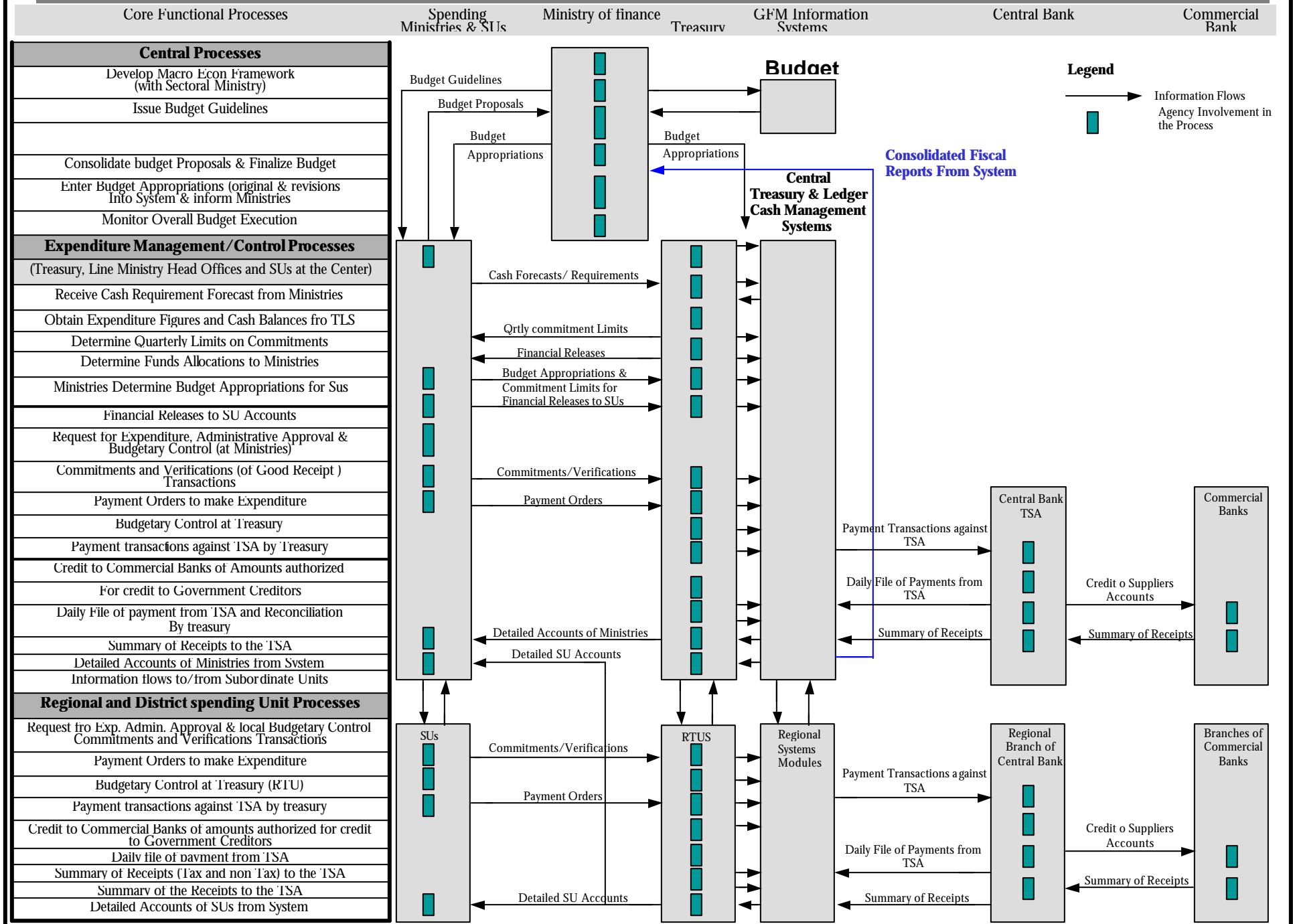
The core functional processes and information flows associated with the TLS are shown schematically in Figure 2. The TLS is normally implemented at the Treasury head offices and at each of the regional and district branches of the Treasury to process and control central government payments in their respective areas. Local government payments are not normally part of the system. Nevertheless, the implementation of the treasury system would not preclude the installation of a similar system for local governments.

The system encompasses the functional requirements for the budget implementation and accounting processes and would normally cover the appropriation, commitment, funds allocation, and payment processes for both the investment and current budgets. The details of the functionality of the TLS are given below.

The functional processes and information flows associated with the treasury system:

- Record initial budgets and distribute the budget appropriations, as approved by the legislature, to spending ministries, and keep a record of initial budgets, revised budgets, and budget transfers for a typical government spending unit.
- Distribute appropriation and commitment authorizations to spending units and record commitments incurred by a spending unit against the approved limits and the appropriation during the course of a year.
- Distribute funds allocations to spending units and keep a record of the amounts of funds allocations against the appropriations and any changes there to.
- Record expenditure against disbursements where there have been commitments and funds allocations (e.g. due to purchase orders or other payments). The system will have facilities to check availability of appropriation, commitment and funds allocation prior to payment approval.
- Print consolidated payment instructions for action by the banking system.
- Record revenue and other receipts against appropriate account heads.
- Consolidate data from all ministries and regional offices as necessary. The system will have good report writing facilities and support easy retrieval and reporting on data in the system databases in a variety of formats. The system would be able to produce commonly required accounting and management reports.

Figure 2. Core Government Fiscal Management Processes, Information systems and Information Flows



Information systems for budget execution, accounting and fiscal reporting

The Treasury Ledger System (TLS)

Information systems for budget execution, accounting and fiscal reporting form the centerpiece of the GFM systems network. They are the primary repository of financial data and serve as the basis of the government's *Financial Management Information System (FMIS)*. These systems are used to perform the processes associated with budget execution, monitoring and control to obtain the status of actual expenditures on ongoing projects. These systems also monitor and evaluate the overall budget implementation processes and produce the necessary fiscal reports. In addition, these systems would provide useful financial information to the line ministries, and spending units (in their respective areas) to enable them to better manage their work programs.

Systems support is focused on five main systems:

- Budget and Warrant control
- Accounts Payable
- Accounts Receivable
- The *Treasury Ledger System (TLS)* or the *Financial Ledger System (FLS)*.
- Fiscal reporting

Together these systems constitute the government's *Core Accounting System (CAS)*. The first of these is concerned with maintaining data on spending authority. These systems maintain data on approved budgeted appropriations (both capital and recurrent), sources of financing for programs and projects, budget transfers, and supplementary allocations, fund releases (warrants) against budgetary allocations over the course of the year. The second and third group of systems are used to process transactions as soon as possible after they occur, and record data on commitments and actual expenditures against budgeted allocations. The TLS/FLS is used for compilation of summary records for control and analysis. The term TLS is also used to refer collectively to the systems for budget execution, accounting and fiscal reporting.

The TLS would normally be used by:

- The Treasury and its regional offices to perform the basic accounting functions and to undertake budget implementation;
- The budget department of the MOF to obtain the status of actual expenditures and perform the processes associated with budget preparation and monitoring;
- The Treasury cash management department to provide the information it requires for cash management and implementation of cash limits;
- Line agencies to cater to their accounting and financial information needs;

- The Government auditing organization to access financial transaction data for auditing purposes.

In a fully automated accounting system as it exists in most developed countries and several middle-income countries, the basic accounting processes are automated and data captured only once as an accounting transaction progresses through the system. Such a system, introduced along with a modern budget classification system and an appropriate chart of accounts, enables expenditures and revenues to be recorded at a very detailed level and related to specific programs and projects. Data recorded at this level can be used directly for program and project management. These data also would be easily amenable to cross-classification in other ways as required for financial analyses. In the absence of an automated accounting system, data recording would not be accomplished at as detailed a level. More important, cross-classification of data to other schema would be very cumbersome and therefore seldom done. The introduction of an automated accounting system ensures completeness of data capture (that is, no transaction would be processed outside the system) and rigorous application of appropriate financial controls to all transactions processed by the system.

The information contained in the system databases would provide the MOF and other core financial agencies with comprehensive management information related to the country's financial resources. In addition, the system would provide useful financial information to the ministries and other spending units to enable them to better manage their work programs.

Budget Execution Using the Treasury Ledger System

Specific details regarding how the various government agencies involved in budget execution would use the related information systems in the performance of their duties as they relate to the execution of the budget are described in this section.

The various steps in the execution of budgetary expenditures are shown schematically in Figure 2. This figure lists in the first column the main processes performed by the central and line agencies involved. The diagram shows the major information flows that result as the different agencies involved in budget execution carry out the functional processes associated with budget execution.

Record Budget appropriations, apportionments and allotments: After Approval of the annual budget by the parliament, it is loaded into the system by the Budget Department of the MOF. The approved budget for spending ministries is then broken down to the detailed level of economic classifications and is apportioned over time (quarters months) and registered in the system by the MOF and communicated to the spending ministries. The Spending ministries, in turn, register the detailed budget for their subordinate spending units and communicate the allotments to the

spending units. These are the spending limits for the spending ministries and spending units by quarter/ month for the fiscal year.

Determine cash requirements and warrant amounts: Each year, financial plans detailing projected outlays and receipts are developed by spending units and ministries. As the year progresses, sector agencies prepare periodic requests for funds by economic category, which are also captured. The MOF then issues warrants to ministries for each category of spending. From these amounts the ministries issue sub – warrants for their spending units and advise the appropriate spending units. These processes take place periodically throughout the year. The warrant and sub – warrant amounts need to be within the amounts specified in the spending limits for these organizational units. The level of detail in the budget release need to be broken down is related to the authority delegated to the spending units to shift funds between items.

Record Commitment Transactions: throughout the year, sectoral ministries process requests for expenditure. After verifying the appropriateness of the expenditure and availability of budget appropriation and funds, Treasury registers the actual commitments in the system. If spending agencies have access to the system, they record the transactions themselves. In the case of *Spending Units (SUs)* located outside the center, the transactions are recorded through a *Regional Treasury Unit (RTU)*.

Verification of Receipt of Goods and Payment Orders: Following verification of a given expenditure, ministries directly linked to the system would record the corresponding payment order in the system. The system would automatically check that the order falls within the funds allocation limit set for that Ministry. The outlying spending units would process a payment order through the RTU, which also records all transactions on their behalf. Once all requirements for an obligation have been met, spending agencies should confirm that the commitment is ready for payment.

Payment Processing: The banking system must be advised at the same time as payment orders are registered in the TLS to effect payment. In a fully developed system this can be done automatically. Daily batches of the TLS transactions, which capture complete information on all payments, are sent to the Central Bank or by the RTUs to the regional Central Banks units. The applicable bank would transmit the relevant funds to each commercial bank to credit the appropriate account and debit the government account. The appropriate bank would confirm to the TLS (through the RTU) the debits in the Government account. Alternatively, the applicable accounting office could forward to the appropriate bank a consolidated listing of the registered payment orders requiring payment. Action by the banking system would be as described above, but confirmation to the accounting office would be manual.

Record Receipts: Government receipts such as taxes and duties are often paid into sub – accounts set up by the Treasury in the Central Bank. Taxpayers can direct their own Banks to

make transfers from their accounts into these special sub- accounts of the TSA set up for tax receipt purposes, or can make direct payments into these accounts. Periodic reports showing all details are sent by the Central Bank to the Treasury and the state tax authorities for recording and reconciliation.

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