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Good Financial Governance in Sector Ministries

Guidance Note and Tool

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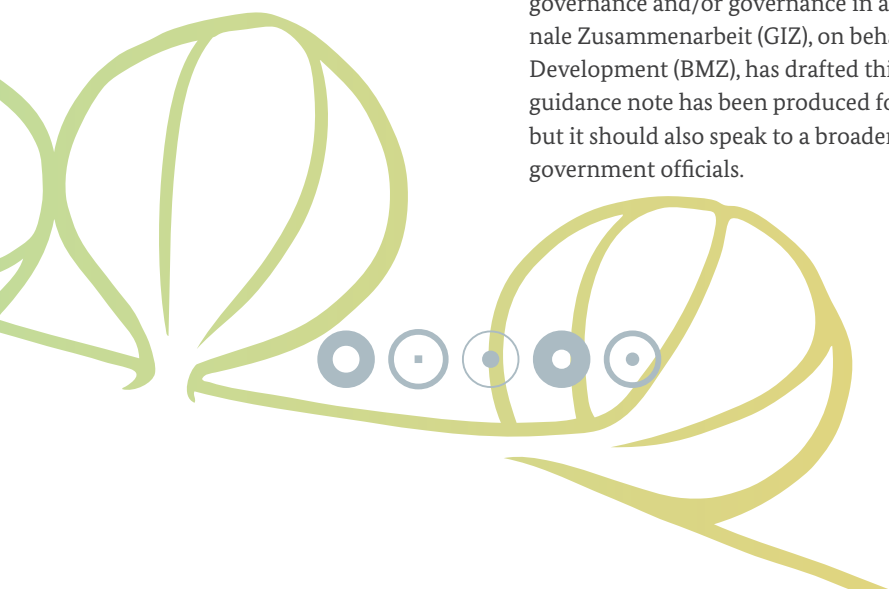
INTRODUCTION

Support for Good Financial Governance (GFG) is an important objective and a key strategic element of German Development Cooperation (GDC). GFG is a value-based, holistic and systemic approach, which integrates all subsystems and actors in the public finance arena. According to the GFG approach, support for public finance reforms should not only focus on strengthening ministries of finance, tax administrations, Parliamentary budget or public accounts committees and their secretariats and SAI. It must also take into account sector ministries, which play an important role in the budget process, in particular in the budget implementation.

At the same time, each sector ministry needs a budget in order to implement their respective sector strategies. Thus, sector ministries must be able to carry out budget planning in order to obtain the necessary funds and disburse funds in an efficient and development-oriented manner. In this context, the application of GFG within sectors takes on particular significance. Many challenges remain if sector reforms and service delivery are to be effective, such as communication with the Ministry of Finance, budget preparation, procurement, etc.

Against this background and taking into account the international discussion on sector governance and/or governance in and with sectors, the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), on behalf of the Federal Ministry for Economic Cooperation and Development (BMZ), has drafted this guidance note, entitled 'GFG in Sector Ministries'. This guidance note has been produced for development advisors working in sector ministries, but it should also speak to a broader audience of development cooperation professionals and government officials.

➤ *further reading:* BMZ Sector Strategy
Paper: [Good Financial Governance in German
Development Cooperation](#)



The guidance note is made up of four main sections

- **PART 1** describes the three dimensions of GFG: the normative dimension, the political economy aspects, and the main technical Public Financial Management (PFM) issues. The aim of Part 1 is to provide the reader with an overall understanding of GFG without being too exhaustive, in order to maintain the practical nature of the document.
- **PART 2** of the note provides more detailed guidance on how to analyse GFG in the sector ministries. It follows the stages of a typical budget cycle and will explain in non-specialist terms the different phases of the budgeting process. For each phase, the key actors and likely challenges for the sector ministries will be presented. Practical examples guide the reader towards a better understanding of these challenges.
- **PART 3** contains two case studies on GFG in sectors. They are the result of validation missions that were conducted to test the usefulness of this tool. Case Study 1 was carried out in December 2012 in Vietnam in collaboration with the biodiversity and forestry sector. Case Study 2 took place in Kenya in February 2013 and describes GFG in the Kenyan health sector.
- **PART 4** contains the tool on GFG by sector. It should serve as practical guidance for analysing GFG in any given sector by providing a set of key questions, some explanatory information and practical examples.

In order to assist advisors to identify bottlenecks in the management of public funds in any given sector, an analytical tool with questions and useful links is included in this guidance note. Furthermore, links to documents and studies for additional information are provided.

Finally, the intention of this note is not to turn a sector expert into a GFG expert. Rather, it will improve the general understanding of specific challenges that sectors might face in the public finance arena, provide a basic set of analytical questions and tools to assess the status quo, and hint at possible intervention areas. Should more detailed advice be required regarding this note and tool, members of the GIZ Sector Programme GFG team and Public Finance Planning experts can offer support.

HOW TO USE THIS GUIDANCE NOTE AND THE TOOLS?

As mentioned above, Part 1 of this guidance note serves as a general introduction to GFG and explains the three key dimensions that advisors or government officials should consider in any Public Finance Reform endeavour. Part 2 of the document is of a more practical nature and warrants a short explanation on how to treat and use the information contained therein. Part 2 follows the typical structure of the budget cycle explained in Part 1. At the end of each budget stage, a set of high-level analytical questions are provided. These should be seen as entry-point questions. It should be possible for an advisor working in the country or sector context to answer these questions almost intuitively without having to delve deeply into the country's GFG system. There are yes/no questions. The reader will also find a subset of more detailed questions pertaining to the high-level questions in tool 1 (Part 4). The detailed questions are structured according to the three GFG dimensions (see explanation in Part 1) and will allow for a more in-depth analysis of the perceived challenges. Tool 2 (Part 4) outlines some of the main effects of weak financial governance in sector ministries on public service delivery.

While there are public finance standards that can help to identify good or bad practices, it should be noted that not all of the questions will have definitive answers. GFG practices often depend on the country context and the capacity of the sector ministries and its divisions. When using the tool, it should always be questioned whether the human, financial and technical capacities are in place. Moreover, some practices might not be readily applicable to all countries due to the technical nature of some public finance areas (e.g. poor IT facilities) or to the lack of political will to pursue reforms (e.g. no commitment to improve transparency). Finally, please note that the tool is designed to pinpoint the challenges faced by the sector ministries. After pinpointing the challenges in the different stages of the budget cycle, more analytical assessment is needed to get to the root cause of the problem in one specific country context (e.g. capacity constraints, political will, lack of financial resources).

PART 01
HOW TO ASSES GFG?

01

The Normative Dimension
The Political Economy Dimension
The Technical Dimension



PART 01

HOW TO ASSESS GFG?

This section will briefly explain the GFG approach and its three dimensions that should be taken into account when advising on public finance matters. In the following sections, the technical dimensions of PFM will be explained, but light will also be shed on the role of various actors, in particular the sector ministries, their interests, incentives and powers in the budget process, as well as normative aspects shaping budgetary decisions. This part provides a general overview prior to a more detailed presentation of the specific challenges for sectors in the budget system.

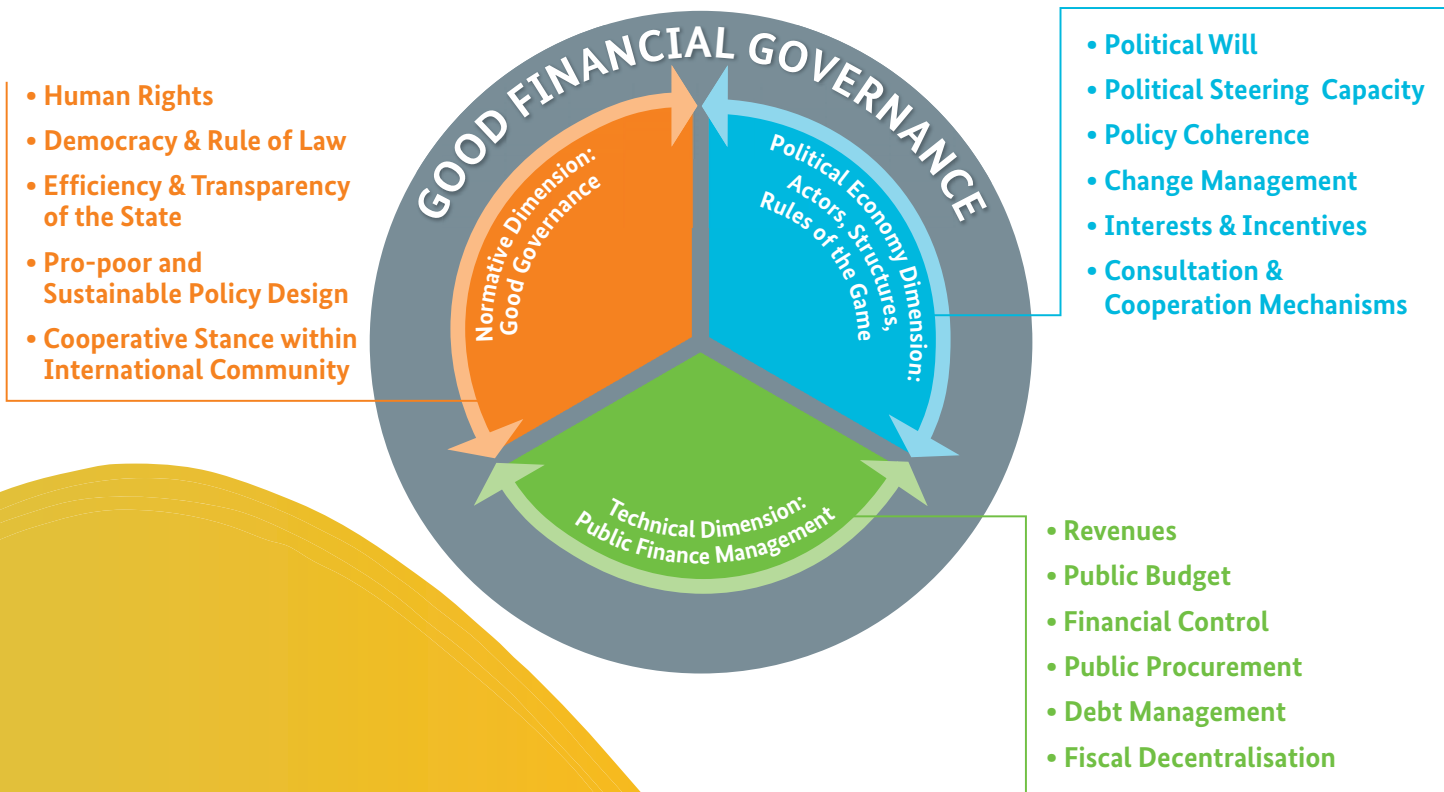
WHAT IS GFG?

GFG is the transparent, legitimate and development-oriented state action in the area of public finance, on the income and expenditure side, and it implies efficient and accountable state institutions and financial administration operating within the rule of law, efficient control institutions and politically and socially anchored oversight mechanisms.

GFG addresses three issues, namely

- Governance principles such as pro-poor and sustainable policy design, human rights, state effectiveness, accountability, participation and transparency through the normative dimension;
- Political economy dimensions such as formal and informal rules, power structures in and of organisations, incentives of actors in the system, resources, as well as processes and procedures of institutions;
- Technical issues, such as revenue and expenditure management, external control, etc. through its technical dimension.

Figure 1:
The three dimensions of GFG



WHAT IS A BUDGET?

The budget lists public revenues, expenditures and net lending/net borrowing figures. Yet it would be imprudent to regard public budgets simply as lists of facts and figures, or to view public budgeting or the drafting, enactment and auditing process purely in technical terms. In fact, quite the reverse is true: the public budget is an intrinsic part of a government's policy and the subject of intense political discussions, as it basically translates political priorities and policies into financial resource allocation.

- Budgets highlight a government's priorities in terms of policy, i.e. what it plans to do over a specific period of time, what these plans will cost and how it intends to finance this expenditure.
- Budgets also show what measures have been actually implemented by a government or public administration and how these measures were financed (e.g. through taxes, charges, user fees, public borrowing or donor funds).
- Public budgets are based on how political actors decide to spend other people's money. This creates constant tension between policy-makers, those who stand to benefit from government spending and those who foot the bill.
- Although the government sets the agenda and plays a key role in drafting and enacting the budget, it is the legislature that holds budgetary sovereignty in democratic states.
- Parliament, supported by SAI, needs to keep the government in check.



PART 01

THE NORMATIVE DIMENSION

GFG, and public budgets in particular, should contribute to the development of the country. A development-oriented public finance system is characterised by an orientation along governance principles, such as pro-poor and sustainable policy design, human rights, democracy and rule of law, state effectiveness and transparency¹.

The normative dimension of GFG

Pro-poor and sustainable policy design: stated Development Goals, in particular the progressive implementation of social and economic human rights, poverty reduction strategies and policy reform programmes, should correspond to the allocations in the budget.

Respect, protection and fulfilment of all human rights: the budget should serve as an instrument for the realisation of human rights, especially equal access to basic social services (education and health care) as well as economic and political resources (infrastructure).

Democracy and Rule of Law: in a functioning democracy, budget processes must be designed in a transparent and inclusive manner. Participation in the budget process strengthens civil society and increases the legitimacy of government action.

Efficiency and transparency of the state: the budget should ensure efficient and effective delivery of public services. Transparent processes throughout planning, implementation and reporting enable civil society and oversight institutions to monitor how money is spent. Finally, accountability provides the means for different actors to ensure that a budget is prepared and implemented according to the priorities of society.

¹ BMZ Strategy 178: *Promotion of Good Governance in German Development Policy*

PART 01

THE POLITICAL ECONOMY DIMENSION

When supporting reforms in public finances, it is very important to understand the political economy. Public finance reforms are very political and intervene in the power structures and the division of resources within a society. Consequently, one should consider actors, formal and informal rules, and structures. Political will, interests, incentives and capacities as well as change management issues play a particular role.

Actors in the budget process

The term 'actors' refers to 'all public or private groups within a society who are linked by their respective shared needs and values, and act publicly as organised groups to articulate and assert their interests by various means: in dialogue, in negotiations and alliances with other actors, in accordance with democratic principles, or by wielding power and authority.' (GIZ 2011: 75).

Any budget process will result in perceived winners and losers and can shift the balance between those who have gained and those who have lost out as a result of decisions in previous years. It is important to establish awareness of the actors involved in the budget process, their functions and their diverging interests. In general terms (variations per country are possible) the actors, institutions and functions that should be considered in the national PFM process are presented in the table below.

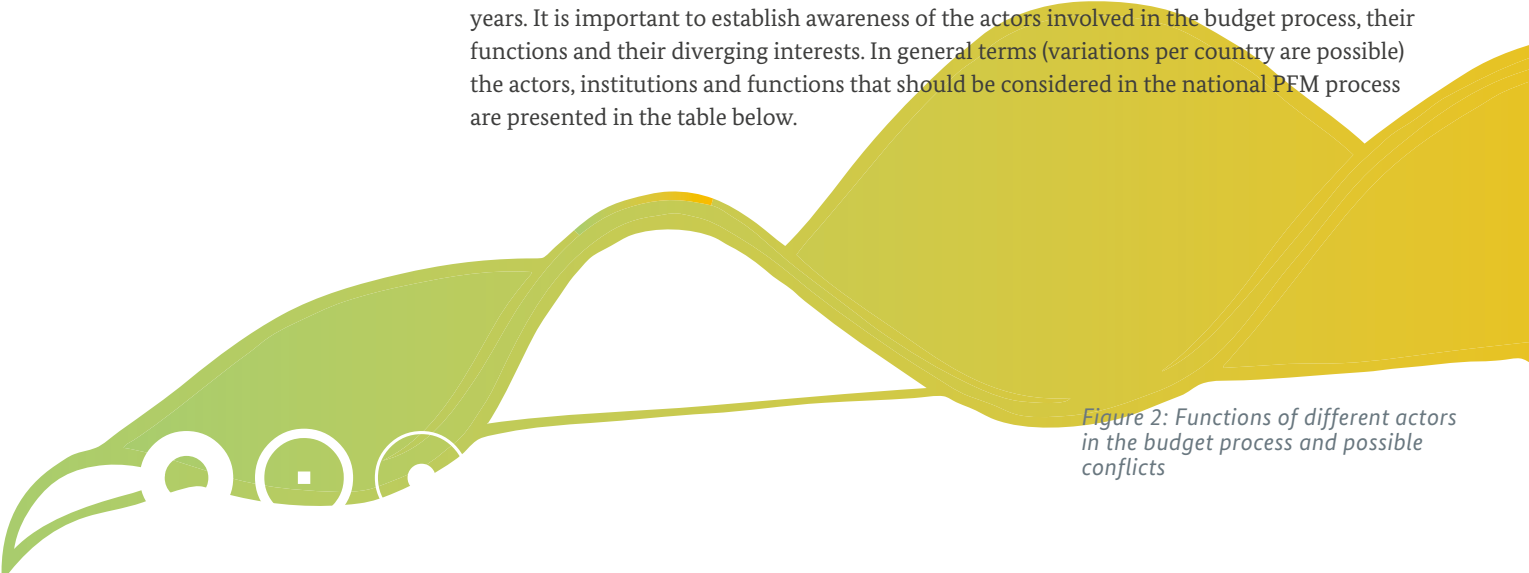


Figure 2: Functions of different actors in the budget process and possible conflicts

Institution

Functions

Possible Conflicts

Ministry of Finance

- Propose and manage expenditure, revenue and budgetary policy;
- Maintain aggregate fiscal discipline;
- Safeguard strategic, efficient and effective allocations;
- Manage government payments;
- Promote integrity and combat corruption.

- Facilitative role of MOF: must engage/negotiate with sector ministries to achieve policy goals;
- Conflicting interests with sector ministries: the latter requesting more resources while the former needs to maintain fiscal discipline;
- MOF might hold veto power in Cabinet and oppose spending proposals.

Ministry of Planning

- Steer the national development planning process (i.e. devise development strategy & PRSP);
- Monitor implementation of development strategies;
- Coordination of aid;
- Can be responsible for preparing and executing capital budget in the budget process.

- Existence of powerful planning ministry can weaken MOF or prevent MOF from becoming too powerful
- Fragmentation of ministries might be in the interest of political leadership.

Sector Ministries

- Set priorities (policy planning and contribution development plans) and allocate resources to programmes (including investments);
- Implementation of public policy;
- Service delivery;
- Effectiveness;
- Efficiency.

- MOFs and planning ministries are considered to set the agenda and are perceived to have the upper hand;
- Constant natural tension exists between MOFs' mandate to maintain fiscal balance and sector ministries' mandate to maximise service delivery.

Legislative

- Review of budget proposal and possible amendments;
- Budget appropriation;
- Promote openness, transparency, public accountability.

- Due the political nature of the institutions, scrutiny is often tainted by petty politics that do not promote developmental solutions.

Supreme Audit Institution

- Support legislative to:
 - Oversee use of public funds;
 - Ensure that public funds are managed properly and are used cost-effectively for the designated purpose.

- Excessive focus on compliance can sometimes limit innovation and responsiveness in government.

Donors

- The goals of donors depend on the strategic purpose of their involvement, namely humanitarian, political or commercial outcomes.

- Donors find themselves in gap-filling roles instead of supporting capacity building;
- Donors influence decision-making at times

Relation between the finance and/or planning ministry and the sector ministry

Due to their different functions and interests, communication and coordination between actors, in particular between sector ministries and the Ministry of Finance or planning ministry, is often poor.

- Tension may arise due to a perceived dominant role of the MOF in the budget process (top-down budgeting). Sector ministries might argue for a more bottom-up approach to allow them to present and defend their policy and funding needs.
- Influence on-budget (and policy) formulation within a government is not equally distributed. Stronger sector ministries may be more successful in seeking additional funds, which may lead to a perceived bias of the MOF.
- Conflicts may also arise because of dual budgeting. This implies separate processes for preparing the capital (or development) budget and the recurrent expenditures. In countries with both a MOF and a planning ministry, it may even be the case that the ministries issue their own budget circulars, the MOF being responsible for recurrent spending and the planning ministry for the capital budget. While capital and recurrent expenditures need to be clearly identified in the budget and thus presented separately, the budgeting process, for the sake of a better analysis of the overall government expenditures, should be integrated.

Sector Ministries and Dual Budgeting

“Line ministries have a strong incentive to prepare and defend separate budgets because they can use the opportunity of donor-negotiated projects to demand further complementary financing and to expand their operations without attention to the future cost implications. These projects may include either capital projects or specific and independent recurrent activities. For line ministries, dealing with two separate central ministries for defending their budgets is more advantageous than dealing with one unified central budget authority, because they can take advantage of the two central ministries’ lack of detailed information.”

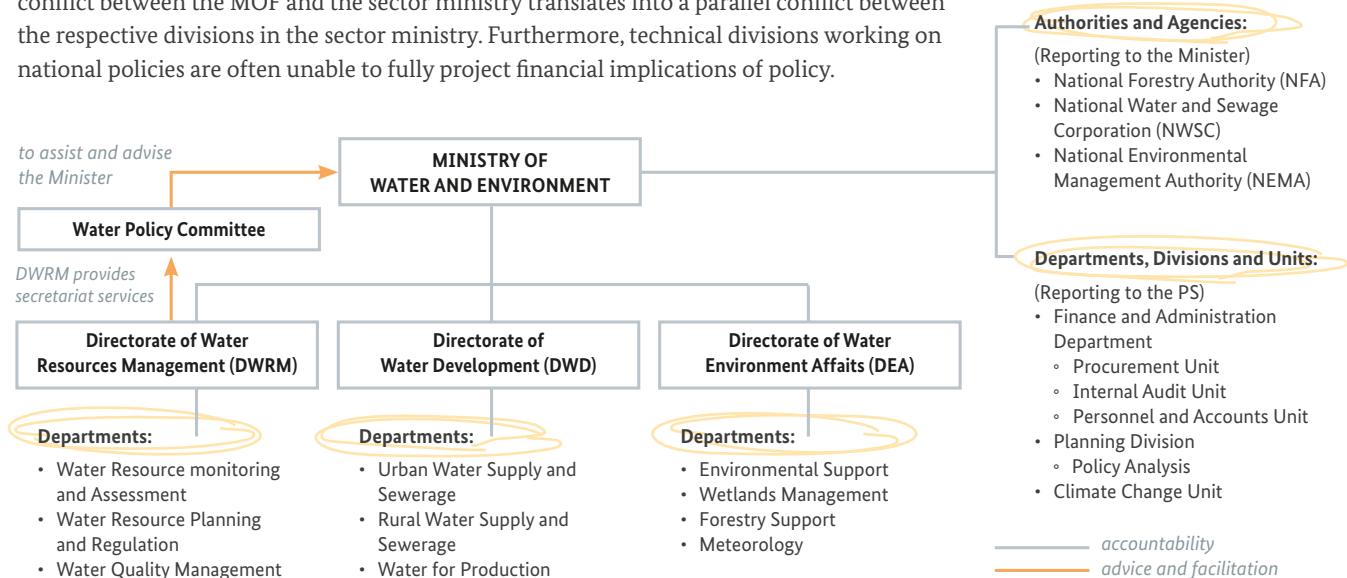
Source: FAD/IMF (2009)

Organisation of sectors and sector ministries

For various reasons, including political decisions, a sector can be split into several sector ministries (and parastatal entities). This has been the case in the Kenyan health sector, where two sector ministries were responsible for the implementation of the national health strategy. This can lead to difficulties in planning and coordination within the sector, in particular when they are competing for funds.

Moreover, weak communication within the sector ministries can hamper the provision of public services. In many instances, there is no functioning consultation mechanism between the administrative entities responsible for the budget's preparation and execution and the technical divisions working on national policies. Traditionally, preparing the budget has been considered to be the work of the finance department. As a consequence, the technical departments do not attach sufficient value to being involved. In this case, the above-mentioned conflict between the MOF and the sector ministry translates into a parallel conflict between the respective divisions in the sector ministry. Furthermore, technical divisions working on national policies are often unable to fully project financial implications of policy.

Figure 3: Example for a sector ministry structure – Uganda



PART 01

THE TECHNICAL PFM DIMENSION

THE BUDGET CYCLE

The budget is the core product of the budget process, which in turn is broken down into modular sub-processes, some of which overlap. The figure below shows the typical steps in the budget cycle. Within the budget system, sector ministries play a key role. Apart from spending the money allocated to them, they have to play an active part in planning, budgeting, monitoring and evaluation in order to be accorded the funds necessary to pursue national and sector policy objectives. Therefore, it is vital to understand the various stages of the budget cycle and the role of sectors within the national public finance system.

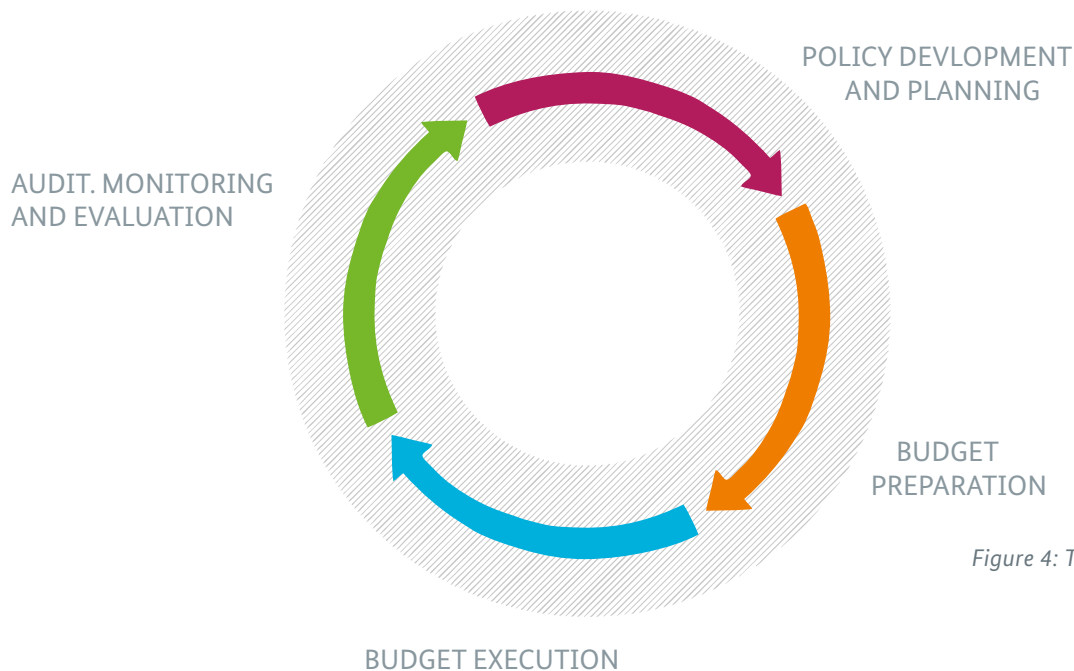


Figure 4: The budget cycle

Although the budget is usually prepared for one year, it often takes up to three years from the time the budget is prepared in year X to the time the recommendations of the SAI are approved. This means that the steps in the budget cycle run in parallel and overlap. A number of countries draft budgets that cover a period of several years. Even in these countries, however, the budget legislation is reviewed annually and the budget process is broken down into the different phases shown below.

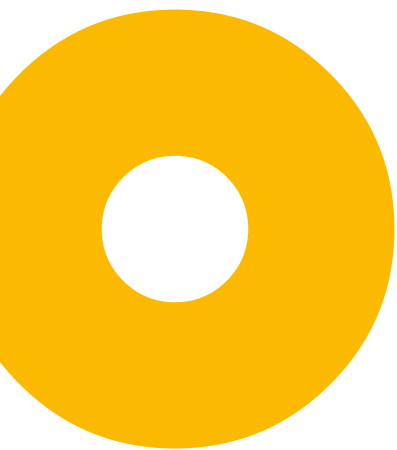
Key figures from the German Cabinet Budget Proposal, in €bn

	Actual 2012	2013 target	Key figures for 2014	Key figures for financial plan		
				2015	2016	2017
Expenditure under previous financial plan	-	-	302.9	303.3	309.9	-
Expenditure under new financial plan	306.8	302.2	296.9	299.2	303.4	306.8
Percentage change over previous year's target	-	-1.6	-1.7	+0.8	+1.4	+1.7
Annual average change from 2013 to 2017 in %	-			+0.54		
Tax revenue under new financial plan	256.1	260.6	269.0	+278.4	287.5	297.1
Other revenues under new financial plan	28.2	24.3	21.5	20.8	20.9	20.9
Net borrowing under new financial plan	22.5	17.1	6.4	0.0	-	-
Surplus	-	-	-	-	5.0	9.4
Structural deficit as % of GDP	0.31	0.34	0	-0.06	-0.20	-0.31
Net Borrowing (+)/surplus (-) under previous financial plan	-	-	13.1	4.7	-1.0	(-1.0)

Source: German Federal Ministry of Finance, March 2013

The typical central government budget structure

As shown in the diagram above, the aggregate central government budget usually summarises the departmental budgets and presents them in the budget overview. In the financing schedule, the net lending/net borrowing figures are juxtaposed, as are revenues from lending and capital repayments in the lending plan. The departmental budgets outline estimates for revenue, expenditure and commitment authorisations. To ensure that the use of public funds is transparent, details of the revenue and expenditure estimates are specified. The level of detail provided for revenue and expenditure in the overall and departmental budgets varies widely from country to country. The more detailed the estimates, the more information Parliament has to scrutinise in the budget. The budget is divided into capital (or development) expenditures, which cover the costs related to public investments such as the construction of roads, and recurrent expenditures, which cover recurrent costs such as personnel or maintenance costs.



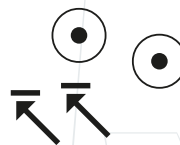
Budget Principles

To guarantee that the budget can be implemented in an efficient manner and allow for clear accountability, the content and structure of the budget should follow general budget principles.

According to the Public Expenditure and Financial Accountability Framework (PEFA), these dimensions encompass:

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

Germany defines twelve budgetary principles that can be found in the publication *The Budget System of the Federal Republic of Germany*. (cf. pp. 8-9)



CURRENT BUDGET REFORM TRENDS

In recent years and through the support of the donor community, most developing countries have started to introduce a set of key PFM reforms. These technical reforms impact directly on the management of public funds in sector ministries, and therefore deserve some consideration.

Towards multi-year planning through Medium-Term Expenditure Frameworks (MTEF)

The annual nature of public budgeting reflects the short-term priorities of political decision-makers. The MTEF allows for a longer-term planning approach to be adopted. It is very relevant for poverty-oriented budget policy and for ensuring coherence between budgets and strategic plans such as poverty reduction strategy papers. A number of countries have therefore successfully introduced the framework, with advice from GIZ and other organisations. In some countries, the establishment of the framework continues to be hampered by a lack of information, particularly from the sub-national level, due both to a lack of human resources and to external factors such as fluctuating resource prices or changes to budget support.

From line item to results-oriented budgeting

Although the budget as a whole outlines the government's policies and programmes, it does not necessarily reveal its political priorities. Against this backdrop, results-oriented budgeting focuses on clarifying these priorities by outlining the objectives to be achieved. The entities in sector ministries that manage funds receive extra managerial authority in two respects; (1) through a greater role in budget execution, and (2) through the transfer of responsibility for achieving the desired results. This means that results orientation goes hand-in-hand with the prerequisite of improving the efficiency and effectiveness of service provision by the administration, and of increasing the transparency and accountability of the use of state funds. The

➤ *further reading:* World Bank (2013): *Beyond the Annual Budget. Global Experience with Medium Term Expenditure Frameworks*

➤ *further reading:* GIZ Advisory approach GIZ (2012): *Results-oriented Budgeting & Check List*

achievement of these objectives clearly depends to a large degree on the performance capability of the public administration. Comparative studies of OECD and partner countries show that the latter frequently lack the required capacities to implement such a complex budget management system. This is no surprise, given that it often takes OECD countries over ten years to introduce results-oriented budgeting.

Programme-based and Performance-based Budgeting

PBB essentially group individual input items systematically into budget programmes and, where appropriate, formulate indicators for outputs and outcomes (i.e. results).

Performance-based budgeting refers to scenarios where performance indicators are formulated for the budget, and decisions related to the use of funds are made dependent on the degree to which these indicators are fulfilled.

Country Example: the Introduction of Programme Budgeting in Kenya

In 2006 Kenya initiated the process to move away from ‘basic line item budgeting’ to ‘advanced programme budgeting’. So far, four indicative PBB have been added to the classic input-based budget. The programme budget is to be put to the vote in Parliament together with the classic input-based budget.

Key actors of reform

It was the Budget Department in the Ministry of Finance that took the initiative to introduce programme budgeting. To coordinate the reform, a Secretariat was established. As for the legislature, the Budget Office in the National Assembly was involved in the reform and informed about the advantages of programme budgeting at an early stage. In 2007 a law was introduced entitling Parliament to request and receive an overview of programmes in a report detailing all planned expenditure.



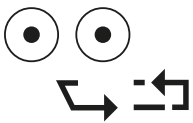
Objectives of the reform

The clearly laid out programme-based overview makes it easier for Parliament and other stakeholders to monitor the extent to which government services are being provided. It also facilitates other reform initiatives, such as gender-responsive budgeting and climate-sensitive budgeting, since it is easier to identify the groups benefiting from government services. That, in turn, also has advantages when it comes to analysing sector budgets in regard to the effectiveness of their pro-poor focus.

Challenges in the implementation of the reform

In 2009, it was specified in the Financial Management Act that the pre-budget paper must contain programmes for all sectors. The first indicative PBB was produced for 2008/9. Sector ministries received instructions through standing orders to produce programme budgets. In 2012, PBB became part of the new PFM Act. The Act stipulates that the national budget shall be appropriated along the lines of programmes from 2013/14. The counties are to follow suit from 2014/15. It remains to be seen whether the ambitious reform agenda can be implemented according to the set timelines. In order to move from indicative programme budgets, more capacity development, especially at line ministries and the newly established counties, will be required.

Source: Rosbach, Kristian (2012): Introducing programme budgeting in Kenya, GIZ.



Programme Outputs

Programme Title		Programme Components
P.0903 Children Services		
Outcome: To Safeguard the rights and welfare of all children in Kenya		
090301	Child Community Support Services	
Delivery Units	Children's Services Department, National Council for Children's Services (NCCS)	
09030101	Enhanced representation in the Districts	Number of districts offices operational
09030102	Successful rehabilitation of children	Number of children in rehabilitation and care programmes
09030103	Registration of children in the national children database	Number of children detailed
09030104	Establish an operational regional child help line	Number of calls
090302	Child Rehabilitation and Custody	
Delivery Units	Children's Remand Homes, Rehabilitation Schools, Street Children Rehabilitation Centre	
09030201	Establishment of rescue centres	Number of institutions fully operationalised
09030202	Running care and rehabilitation programmes for	Number of children benefiting from care and rehabilitation
...

Charts of Accounts

Key Performance Indicators

Extract from the Kenyan Programme Based Budget, Ministry of Gender Children and Social Development

Medium Term Expenditure Plans

PROGRAMME		Estimates 2012/13			Projected Estimates	
		Gross Expenditure	Appropriation in Aid	Net Expenditures	2013/14	2014/15
0903	Children Services	5,269,261,383	319,147,000	4,950,114,383	5,615,331,706	5,994,494,367
090301	Child Community Support Services	4,890,198,885	317,747,000	4,572,451,885	5,201,348,439	5,558,934,009
	Current Expenditure	962,113,285	-	962,113,285	1,127,639,139	1,265,437,189
2100000	Compensation Of Employees	217,808,028	-	217,808,028	220,740,046	222,473,293
2200000	Use Of Goods and Services	674,305,257	-	674,305,257	836,899,093	972,963,896
2600000	Grants And Other Transfers	70,000,000	-	70,000,000	70,000,000	70,000,000
	Capital Expenditure	3,928,085,600	-	3,928,085,600	4,073,709,300	4,293,496,820
2600000	Grants And Other Transfers	3,849,583,000	-	3,849,583,000	3,975,176,000	4,177,583,500
3100000	Acquisition Of Non-Financial Assets	78,502,600	-	78,502,600	98,533,300	115,913,320
	Appropriations In Aid	-	317,747,000	(317,747,000)	-	-
1300000	Grants	-	317,627,000	(317,627,000)	-	-
3500000	Receipts From The Sale Of Non-Financial	-	120,000	(120,000)	-	-

Current and Capital Expenditure are thought together!

Summary of Expenditure by Programme and Economic Classification (KSh.)

From cash to accrual accounting

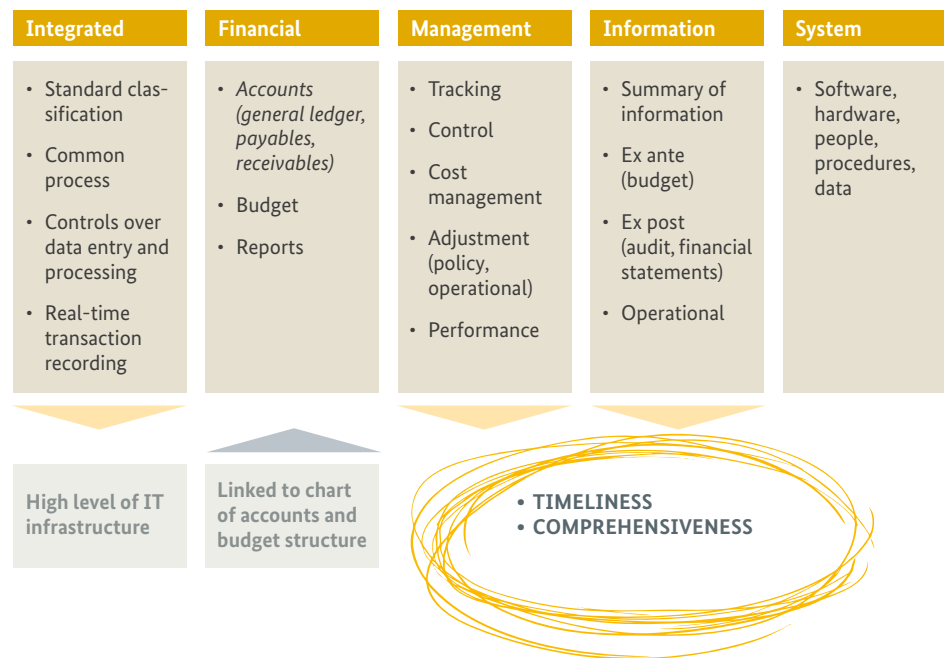
Accrual accounting records revenues and expenditures once they are incurred. It is irrelevant whether these revenues have already been received (i.e. appear on a government bank account) or whether expenditures have been paid. Accrual accounting has generally been used by the private sector. In recent years, international organisations such as the IMF and the OECD have advocated the move from cash (the traditional method of public accounting) to accrual accounting. Possible benefits, in addition to recording expenditures when they occur, include a better overview of future liabilities of social programmes, identification of payment arrears, and better asset management. However, accrual accounting is a complex system demanding stocktaking of all public assets, sound judgment and forward estimates. Due to its strong reliance on estimates, it is also prone to manipulation and might thus undermine the aim of accountability in the management of public funds. Whether the benefits of accrual accounting outweigh the high cost of its implementation is thus not always self-evident. Alternatively, it is possible to integrate some of the features of accrual accounting into a cash-based system. Especially for developing countries, accrual accounting poses technical and capacity-related challenges (Boothe, P. 2007).

Towards integrated financial management systems and accounting reforms

In recent years, integrated financial management information systems (IFMIS) have formed a core component of PFM reforms in many developing countries. An IFMIS is an information system that tracks financial transactions and summarises financial information. In the private sector, such systems provide critical support for management and budgetary decisions, fiduciary responsibilities, and the preparation of financial reports and statements. In government, IFMIS systems must be designed to support distinctly public sector functions. They must be able to handle and communicate all the financial movements for the complex structure of budget organisations. Moreover, they must be designed to ensure compliance with budget laws and public finance rules and restrictions. Integration is critical to the operation of an IFMIS, ensuring that every unit and every user adheres to common standards, rules, and procedures and helping safeguard against unauthorised or imprudent use of

budget funds. Integration also enables real-time reconciliation with bank accounts, allowing the government to manage its cash more efficiently while leaving a complete audit trail. Indeed, the potential information benefits can be tremendous (e.g. unified system for recording expenditures may reduce corruption).

Figure 5: Components of an Integrated Financial Management System



Source: Penrose 2005. In: World Bank 2007, *Budgeting and Budgetary Institutions*, S. 328 Note: Core IFMIS functions are in italics.

Towards treasury single accounts

Having a fragmented system of banking arrangements is considered a deficiency in the PFM system. Multiple bank accounts reduce government oversight of available cash, and may result in unnecessary borrowing. Fragmented banking arrangements thus come at a cost for governments. A Treasury Single Account (TSA) system is considered good practice. It can be defined as a 'unified structure of government bank accounts enabling consolidation and optimum utilization of government cash resources' (IMF, 2011). TSA is a single, or a set of linked, bank accounts through which the government can handle its transactions. The advantage is an enhanced oversight of daily cash balance. Additional advantages of a TSA system include, among others:

- Better cash management and planning;
- Maximised returns on liquid assets;
- Better control of budget execution (payments within budget allocations/limitations);
- Enhanced monitoring of collected revenues;
- Improved internal controls;
- Facilitated audit through government bank reconciliation.

Cash Management

Control of cash is a key element in budget and macroeconomic management. The primary goal of prudent cash management is the security of funds entrusted to the government, closely followed by liquidity (i.e. having those funds available when needed), which in turn contributes to budget efficiency. The third goal of cash management is to minimise the cost of government borrowing and maximise the return on any temporary cash surpluses. A TSA, built on the principal of centralising cash balances, is the most effective way to accomplish all three goals.

PART 02

THE BUDGET CYCLE AND THE ROLE OF SECTOR MINISTRIES

02

Policy Development and Planning
Budget Preparation
Budget Execution
Audit, Monitoring and Evaluation



PART02

POLICY DEVELOPMENT AND PLANNING

Sector policies set the general direction, overarching goals and priorities for a sector; they usually have a timespan of around 5-10 years. The sector policies need to be in line with the National Development Plan. The policy is operationalised into a strategic plan (including investment plans) that outlines tangible programmes that can be costed for a 3-5 year period and include contributions from national government and donors. In order to ensure opportunities for learning and adaptation in service delivery, results of evaluations of the effectiveness of government programmes should have an impact on policy development processes. An annual evaluation of the results achieved with public expenditure provides information for planning future measures. This may take the form of an annual Public Expenditure Review (PER), formal reports to Parliament in its legislative role, or it may be more ad hoc.

This phase of the cycle can generally be divided into three sub-stages including:

- Strategic planning whereby the vision, mission, values, outcomes and outputs of sector ministries are identified for monitoring purposes. It should also include cost-estimations.
- Programme formulation whereby sector experts design programmatic interventions that logically and plausibly contribute to the achievement of stated policy outcomes through the articulation of inputs, activities and outputs.
- Policy costing whereby programmes are designed which contribute to the progressive achievement of social objectives, ensuring at the same time affordability, responsibility and sustainability.

Key Actors in the Policy Development and Planning

The **ministry of planning** (where such a ministry exists) steers the national planning process and ensures that annual policy proposals are in line with national goals. Other actors could be the ministries of finance, public services and the Prime Minister's Office or Presidency including Cabinet. Their roles vary significantly from country to country, but typically all '**centre of government**' institutions play important roles in policy development and planning. Within the sector ministry, the **technical departments** formulate programmes based on national and sector policies and strategies. Cooperation with the administrative divisions in charge of financial planning and accounting is important in order to arrive at a realistic budget that reflects policy priorities with an eye to efficiency and effectiveness.

Challenges of Sector Ministries in the Policy Development and Planning

- Although a budget is usually drafted every year, it takes actors by surprise time and again. Internal procedures (e.g. budget calendar rules and responsibilities) are often lacking. Once the Budget Circular (including the budget calendar) has been issued, it is often too late to commence the policy review and planning process for the new fiscal year.
- Communication and cooperation between the sector ministry and the planning/finance ministry, as well as between the administrative and technical departments within the ministry, can inhibit the planning process. Moreover, if a sector is comprised of several ministries, coordination between the ministries may be a challenge.
- At times, there seems to be a discrepancy between local priorities (i.e. at the level of service providers and sub-national government) and the centrally set policy priorities. This can undermine ownership at the service provider level or lead to programmes being executed that do not meet the needs of the local population. Capacity constraints to develop strategic plans at local level also hamper the effectiveness of the planning process.

policy development and planning

1. Are medium or long-term sector policy objectives linked to the annual planning and budgeting process?
2. Does the sector ministry have fixed process/framework for planning and budgeting of programmes and projects?

Recommendations

- Sector ministries should strive to establish internal procedures on planning and budgeting, in order to make it easier for them to be actively involved right from the beginning of a new budget cycle.
- Clear internal procedures and guidelines, as well as consultation mechanisms with subsequent levels of government, will help sector ministries to anticipate the start of the budget cycle.
- Local authorities and service providers should be able to contribute to the policy planning process. A system should be in place that allows them to feed their priorities and lessons learned into the national planning process.

PART 02

 BUDGET PREPARATION

Budget preparation is usually coordinated by the Ministry of Finance (MOF) which initiates the process annually through the communication of a Budget Circular to all sector ministries. Within the parameters established by the MOF, sector ministries, as spending agencies, have to prepare their budget proposals. These budgets should present (a) the resources necessary to continue ongoing programmes, and (b) the amount required for new initiatives (Schiavo-Campo, S. 2007). The budgets should cover investment as well as recurrent costs. The budget formulation process should ensure prioritisation and equity in the allocation of resources to the most effective and efficient programmes in line with policy priorities.

The budget formulation process typically encompasses the following major activities within a sector ministry:

- Technical departments report monitoring and evaluation data of projects in progress and justify over/underspending, delays etc.;
- Budgeting unit in sector ministry receives circular and informs technical departments;
- Processes and draft allocations to technical departments are agreed;
- Technical departments provide inputs to budget of 'their programmes';
- Budget proposal is discussed among heads of departments;
- Budgeting unit needs should negotiate with technical units to maintain fiscal discipline;
- Sector ministry's budget proposal is sent to MOF;
- Budget negotiation between MOF and sector ministry may lead to adjustments in the budget of the sector ministry in order to safeguard aggregate fiscal discipline.

Key Actors in Budget Preparation

The MOF sets expenditure, revenue and deficit targets on the basis of macroeconomic projections, ideally over three to five years. This provides the building blocks of a MTEF which defines budget ceilings for sectors and ministries.

The MOF manages the budget formulation process and has the lead role in organising the budget negotiation process with the sector ministries. Some MOF fear that sector ministries have a tendency to undermine their authority and the principles of allocative efficiency and technical efficiency.



↘ *further reading:* Schiavo-Campo, S. and Tommasi, D. (1999) [Managing Government Expenditure](#).

The **Parliament/legislature** decide whether to approve the budget proposed by the government. However the role of parliaments varies considerably between countries. Their role can be minor or quite significant. Depending on the regulations in force in a particular country, the Parliament not only approves the budget but can also make amendments to the spending proposals (usually without changing the overall aggregate of the budget). The **Parliamentary Budget Committee** scrutinises the expenditure proposals of government and is responsible for deliberating on the budget each year.

The Role of Parliament in the Budget Preparation

To understand the influence of the Parliament in the budgeting preparation it is important to assess (1) the amount of time which Parliamentary committees are granted to review, discuss and approve the budget, (2) the level of detail of the annual budget which is approved by Parliament, and (3) the kind of changes (i.e. amendments) that Parliament is able to make in the budget tabled by the Executive, (4) the know-how, MP turnover rate and the financial and technical resources available.

The integration of **donor** contributions and related follow-on costs into state budgets is of particular relevance for sector ministries. A lack of knowledge of donor contributions, the intended results they aim to achieve and possible follow-on costs will result in a lack of coherence when drafting the budget. The development community has reiterated its commitment to building effective partner institutions through the use of country systems in the Busan Partnership for Effective Development Cooperation.

Yet, as country systems are often judged to be weak, development partners either choose to manage their funds off-budget (i.e. outside the national budget system) or to ring-fence their funds on-budget. While the latter is preferable over off-budget activities, it still presents a number of risks.



- First, donors often require that their funds are used for poverty reduction activities. While this is a legitimate condition, earmarking these funds reduces the incentive and does little to build the capacity of policy planners and budget managers to allocate national resources to poverty reduction programmes.
- Second, ring-fenced funds are often tightly managed by donors and external consultants. There is a danger of creating a 'budget within a budget' that withdraws capacity from the national process (Schiavo-Campo, S. 2007).

Using Country Systems for Aid Disbursement

Aid can be integrated within different phases of the national budget process.

Options for aid on plan and on-budget: full use of planning systems means that donor assistance is programmed using country planning institutions. Full use of country budgeting systems means that available resources for the assistance to objectives and activities are allocated using partner country procedures, ideally within the formal budget process. A supplemental form using country planning and budgeting systems entails the reflection of aid programmes in partner country planning and budget documentation and their integration in planning and budgeting processes.

Options for aid on treasury: using country treasury systems to the full means that development assistance flows are disbursed using the same treasury systems and banking arrangements used for disbursing government's own revenue. By definition, general and sector budget support modalities use country treasury systems fully. SWAps and basket funds are not on treasury.

Source: Using Country PFM Systems – A Practitioner's Guide; IDB, the World Bank and OECD (2011)

Challenges of Sector Ministries in Budget Preparation

- Given that the sectors are usually underfunded, an important challenge is to remain within the budgetary ceilings indicated by the MOF to arrive at a realistic budget proposal. It is also often difficult for sector ministries to influence the setting of sector budget ceilings.
- It is a challenge for sector ministries to prioritise and rationalise spending (e.g. value for money) based on policy priorities and programme experience (e.g. Have targets been met? Has the programme been effective?), taking into account decentralised entities and parastatals.
- Sector ministries might be reluctant to step up cooperation with the MOF if this is perceived as increased control over the sector. There might be a lack of cooperation and trust between the institutions (e.g. no focal point for each sector in MOF). The intergovernmental cooperation may be even more complicated if there is a ministry of planning in charge of the capital budget.
- Rules, procedures and responsibilities are not always clear. This is a precondition for a functioning budget system. For instance, if the administrative staff is seconded from the MOF and planning, it might adhere to different rules and procedures from the technical staff ministry.
- The sector ministry often has difficulties in integrating donor funds in its budget, because of lack of information on the donor side and/or due to lack of capacity in the sector ministry to coordinate and monitor donor funds.

Recommendations

- In order to arrive at a realistic budget proposal, zero-based budgeting should be avoided. Otherwise, the MOF must make the necessary cuts to maintain fiscal discipline or enter into a cumbersome bargaining process in which political power and affiliations decide on resource allocations. If the sector ministry wishes to influence the setting of the sector budget ceiling, it needs to engage early with the MOF in the preparation process and to have the capacity to rationally and factually argue for an increase in spending based on national policy goals (e.g. the minister needs to be properly briefed).
- Sectors (and the MOF) should also avoid an incremental approach to budgeting, in which only existing items are reviewed for cuts or increases without due regard to policy objectives and performance. Sector ministries have to take the spending proposals of decentralised entities and parastatals into consideration and collate them in their proposal to the MOF.
- Sector ministries need to cooperate with the MOF (their focal points) on a regular basis. Where capital and recurrent budgets are separated (in the case of dual budgeting), an effort should be made to integrate the budgets. If the two are treated separately, there is a danger of ignoring the recurrent costs of capital expenditure.
- Clear rules, procedures and responsibilities will help sector ministries to prepare the budget.
- In order to facilitate the incorporation of donor funds in the national budget, aid information management systems (AIMS), databases that record aid commitments, disbursements and activities, can be introduced. Regular updates of the system are a precondition for its utility.

TOOL TO ASSES BUDGET PREPARATION

budget preparation

1. Is the organization of the budget preparation process efficient/appropriate?
2. Does the Ministry of Finance issue budget ceilings for sector ministries?
3. Has results-based budgeting been introduced?
4. Does the budget provide comprehensive coverage of all fiscal matters (revenues, fiscal transfers, donor funds)?

Promoting Cooperation & Communication in the Budget Negotiation Phase

‘Several countries in Africa have evolved cooperative mechanisms to build a common understanding between finance and spending agencies of the policy choices and expenditure issues in each sector. A common variant is the institutionalisation of sector working groups that bring together finance and spending agency officials, together with external stakeholders, to review past spending effectiveness and forward objectives, spending programmes, trade-offs, allocations, and expected achievements. These working groups have the benefit of sharing the burdens of (a) developing an analytical framework that can be used to identify and quantify choices between finance and spending agencies and (b) calculating and creating cooperative forums within which information asymmetry can be addressed and consensus built. Experience with sector working groups in Kenya and Uganda points to the need to make the decisions of these groups count. In both countries, sector working groups form part of a strategic MTEF process that stands separately from the annual budget process. Ministries soon learn that the budgeting that results from appropriations (and which therefore really counts) still occurs, as always, in a subsequent detailed estimates process. Participants therefore quickly lose interest in the process and instead focus their attention on the preparation of the annual budget.’

Source: Alta Fölscher (2007)

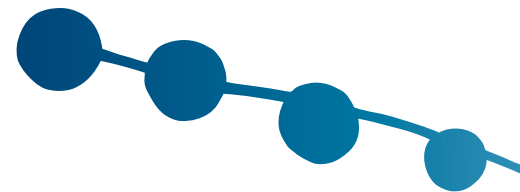
PART 02

 BUDGET EXECUTION

The approved budget and the budget legislation provide the legal basis for the use of funds at executive level. The process of managing ministerial budgets is guided first and foremost by the principle of economic efficiency and cost-effectiveness. The available funds are usually released to the responsible agencies in instalments, rather than paying out the full amount at the start of the year, in order to allow for unforeseen expenditure. Whereas the individual ministries are responsible for their specific budget appropriation, it is the MOF's job to monitor the overall budget and to intervene if budget execution veers away from the budget document. Among other things, the ministries must seek the approval of the MOF if it becomes evident that spending targets will not be met. In this context, it is important to bear in mind that many rules designed to make budget management more flexible aim to facilitate budget execution by ensuring that individual expenditure areas are able to cover their costs and by strengthening the ministries' autonomy and accountability in decision-making.

In order for the budget execution to be efficient, procurement rules and an accounting system need to be in place:

- An effective and transparent public procurement system, underpinned by sound legislation, institutional structure and organisational capacity, is the cornerstone for any public expenditure management framework. In general, three steps are important for public procurement: procurement planning and budgeting; procurement solicitation; and contract award and performance measurement.
- The accounting system is at the heart of a financial management system because here all financial transactions are recorded, classified and summarised (Overseas Development Institute (ODI), PFM Handbook: 16). In order to make informed decisions on (re-)allocation and expenditures, the accounting system must produce useful, timely and reliable data. A well-performing accounting system enables inputs to be tracked and costs to be attributed to specific government interventions.



↗ further reading: OECD CleanGovBiz
Procurement Good Practices

Key Actors in Budget Execution

The sector ministries as spending agencies play a crucial role in the implementation of the budget. The sector ministries allocate the funds to the subordinate units, which in turn are responsible for budget execution through the provision of goods and services.

The **procurement department** within the sector ministry is responsible for purchasing and procurement, as well as for the verification of received goods and services in order to request payment. Payment might be executed by the MOF, sector ministry or subordinate units depending on the system requirements.

The sector ministry, through the **accounting officers**, monitors spending in accordance with budgetary appropriations and reports the budget execution process to the MOF. Many countries have implemented IFMIS to facilitate more effective accounting and monitoring of budget execution.

It is furthermore the sector ministry's task to continuously monitor its programmes, and identify possible bottlenecks and appropriate solutions. This might involve the reallocation of resources within or between programmes. Depending on the national legislation, this will entail approval from MOF and/or Parliament.

The **MOF** safeguards the execution of the budget and monitors whether expenditures are executed as planned according to the Appropriation Act and whether deficit targets are met. The MOF releases funds to the spending agencies and monitors the flow of expenditures throughout the year. Moreover, the MOF is also involved in preparing major in year budget adjustments through supplementary budgets and submitting them to Parliament for approval. It prepares the in-year (monthly or quarterly, as well as mid-year) financial reports, which should be made public. Besides financial controls, the MOF should also follow policy implementation through the budget and if necessary propose reallocation of resources. In addition, **Parliament** should usually be involved in monitoring budget execution through the **Public Accounts Committee**.

Challenges of Sector Ministries in Budget Execution

- In-year budget cuts or reallocations by MOF due to unexpected events and non-existent or insufficient contingency planning. These cuts tend to fall heavily on non-staff operation, maintenance and capital expenditures, compounding the effect on service delivery.
- Delays in spending authorisations may result from insufficient funds available to the MOF or the Central Bank. This can also be the case with the capital (or development) budget that is often funded by donors with lengthy disbursement procedures.
- Non-adherence to budget classifications, using funds for purposes other than those authorised by Parliament. This will often be the case where expenditure items are under-costed in the approved budget. A balance needs to be struck in terms of budget flexibility/discretion and control, responsibility and accountability.
- Onerous requirements of government procurement procedures (e.g. if MOF plays an excessive role in pre-approving payments; or large number of staff involved in sign-off process) or capacity constraints in sector ministries to efficiently comply with procurement requirements.
- Weak procurement systems bear the risk of corruption and favouritism. Sector ministries' procurement divisions may lack accountability mechanisms or ethical standards and might be understaffed or insufficiently trained to curb corrupt activities. Moreover, nepotism might be culturally accepted.

Recommendations

- Accounting officers should in principle respect budget allocations as identified in the budget law. A sound accounting system should support the sector ministry in adhering to budget allocations. Accounting systems should therefore fulfil the following functions:
 - Providing information to managers for use in making informed decisions;
 - Substantiating financial transactions where necessary, based upon well-organised supporting documentation;

↘ *further reading:* OECD Procurement
Toolbox

TOOL TO ASSES BUDGET EXECUTION

budget execution

1. Is there a lack of compliance in expenditure management (i.e. budget not spent according to plan)?
2. Are annual cash requirements of the sector ministry realistic and affordable?
3. Is programme implementation and procurement generally effective and efficient?
4. Are the public accounts prepared on time?

- Reporting results in financial terms and, where performance data are maintained, to report costs;
- Permitting the control of current year budgetary execution as disbursements are made and preparation of future year budgets based upon actual expenditures;
- Providing periodic financial reporting and auditability, lending credibility to governmental operations and strengthening accountability.

- The transparent handling of funds safeguards the legitimacy of state action, helping to prevent corruption and unethical practices. Therefore, a procurement system should be guided by the principles of transparency, efficiency, economy, accountability and fairness. Public procurement should be scrutinised internally (e.g. internal control – see next section). The public, through civil society organisations, can also serve as a watchdog and monitor public expenditure.
- In order to curb corrupt behaviour, the establishment of an anti-corruption ‘roadmap’ for each sector ministry could be considered. This identifies priority issues and potentially vulnerable areas in internal and external budgetary control and auditing, and the rotation of employees responsible for procurement. Sector ministries must adopt balanced approaches to ensure that service delivery is not unduly compromised by inefficiencies introduced to combat corruption. Inter-ministerial dialogue can help to harmonise the use of these instruments and coordinate, plan and carry out the training measures required.

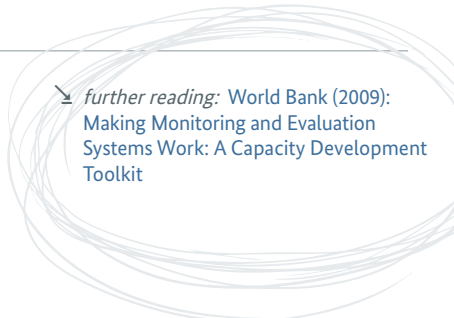
PART 02

 AUDIT, MONITORING AND EVALUATION

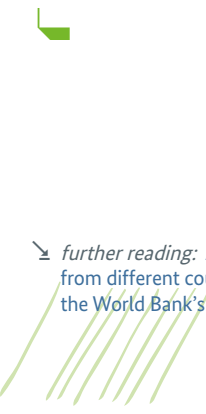
GFG assumes the integrity and political will of the government to serve citizens and to hold public officials accountable. Accountability requires that actions and decisions taken by public officials be subject to oversight. Therefore, it is essential to audit government expenditures (and performance) and to monitor and evaluate the achievement of intended results (outputs and outcomes) in government operations. Audit systems are closely interlinked to all public finance subsystems. A functioning and independent audit is a major contributing factor to ensuring the transparency of public funds reflected in the national budget – and thus improve control of government actions. The purpose of auditing is to provide assurance that public funds have been spent for the purposes for which they were designated.

A distinction can be made between internal and external audits.

- ◎ The purpose of internal audit is to improve the ministry's operations by reviewing accounting, financial, risk management and governance processes. In other words, internal audit ensures proper implementation of internal control mechanisms and is therefore essential in ensuring effective and orderly administration. A functioning internal audit provides external audit institutions with the appropriate data required for their external auditing of public funds. Internal audits are part of the internal control system, which ensures that ministerial entities comply with rules and regulations with regards to financial accounting and reporting, performance monitoring, asset management and procurement.
- ◎ External audits are conducted by SAI. External audit is the process by which an independent institution audits evidence regarding different aspects of an entity, and forms an opinion about the extent to which these aspects conform to set standards. The scope of auditing should be sufficiently broad. The objectives of an audit should include:
 - ◎ Compliance with budget appropriations;
 - ◎ Compliance with accounting standards for effective controls;
 - ◎ Whether public funds are used in an economical and efficient manner (i.e. value for money);
 - ◎ Whether public funds are aligned with performance targets (i.e. performance auditing).



➤ *further reading:* World Bank (2009):
Making Monitoring and Evaluation
Systems Work: A Capacity Development
Toolkit



➤ *further reading:* A collection of PER from different countries can be found on the World Bank's website.

Monitoring of programmes should be a regular process, informing the main stakeholders about the extent of progress and achievement of set objectives, as well as the progress in the use of allocated funds.

Evaluation is the systematic and objective assessment of an ongoing or completed programme/policy, including its design, implementation, outcomes and sustainability. Monitoring and evaluation reports are valuable sources for decision-making (i.e. policy planning and budgeting) for programme managers in sector ministries and ministries of finance and/or planning. Therefore, it is crucial that monitoring and evaluation systems generate credible and useful information (World Bank 2009: 2).

PER in Kenya

PERs are a tool to strengthen the linkages between policy goals and public spending. The objective of PERs is a critical assessment of public spending. Therefore PERs consider outputs and outcomes of public spending. Beyond that, PERs regard the management of public spending. Based on that, PERs generate information for future improvement of public spending.

PER has been an integral part of the MTEF budget process since the first PER in Kenya in 1997. The capacity for preparing PERs within Government remains a major challenge. In a first stage, a sector PER is undertaken. This PER informs about budget processes at Ministry, Department and Agency (MDA) level. Then a consolidated PER, which informs about the MTEF process and national budget, is developed. PER results are presented in a publicly accessible document, where both sector PERs and general findings on PFM are given.


Key Actors in Audit and Monitoring & Evaluation

Sector ministries often have **internal audit units**. Yet the roles, operations and powers of these units differ considerably. The Institute of Internal Auditors (IIA) defines internal auditing as an ‘independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes’ (IIA, 2013). Although roles and responsibilities may differ from country to country, tasks of audit units usually include (WB, 2005):

- Reviewing compliance with existing financial regulations, instructions, procedures;
- Evaluating the effectiveness of selected internal controls;
- Appraising the efficiency and effectiveness with which resources are used;
- Reviewing the reliability and integrity of record keeping and reporting;
- Verifying claims for reimbursement, expenses, revenues, goods received, etc.;
- Investigating irregularities;
- Ensuring that revenue is collected, deposited and correctly accounted for;
- Verifying inventory records and their relationship with physical inventory.

SAI play a central role in auditing. As external and independent bodies, their task is to audit the orderly and efficient use of public funds and report to Parliament. Their audit results are summarised in an annual report. They play an important role in the process of accountability and in achieving GFG. Although the mandate and objectives of external control are universal, it can be organised in many different ways and the levels of expertise can vary widely. In some contexts, SAIs can also serve as advisors in the budget process. Effective SAIs make important contributions to GFG as they:

- Promote an increase in the transparency of public finances;
- Minimise mismanagement and corruption, because government entities know that their financial transactions may be audited at any time;
- Contribute towards the more efficient use of funds and other resources, and thus increase the effectiveness of the public budget.



➤ *further reading:* For an insight into international auditing standards, see [International Organization of Supreme Audit Institutions \(INTOSAI\)](#) and [Committee of Sponsoring Organizations of the Treadway Commission \(COSO\)](#)

Country Example: The Yemeni Audit Court Checks the Water Sector

In Yemen, it is not only the shortage of water, but also pervasive corruption and the lack of a sound institutional framework that lead to a large number of challenges. In the water sector, weak administrative structures lead to mismanagement of the water resources and prevent a fair and efficient allocation of those resources.

From 2000 to 2011 GIZ, on behalf of BMZ, supported the Yemeni Audit Court, the Central Organisation for Control and Auditing (COCA), to reduce inefficiency and corruption by conducting regular inspections of public institutions in the water sector. Following training, the first efficiency audits in the water sector were conducted and draft reports were prepared.


These reports and their results should be critically and openly discussed, in both the Water Ministry and the Parliament, and recommendations should be implemented. This would improve accountability and transparency and also contribute to the sustainable and efficient water supply.

Source: GIZ, Managing water efficiently, Yemen's supreme audit institution audits the water sector, November 2011

The SAI's annual reports should be submitted to **Parliament** for scrutiny. In a democratic system Parliament plays a crucial role in demanding the adherence to and monitoring of the implementation of the SAI's recommendations.

The main actors involved in monitoring and evaluation are typically the **ministries of finance, public services and/or planning**. These institutions usually play important roles in defining the planning and other management frameworks for government as a whole. Usually sector ministries take their lead from guidance provided by these institutions. To fulfil their function of evaluators, **ministries of finance, public services and/or planning** either depend on information from the delivering agencies at central and local level or have to generate the required information themselves.

Challenges of Sector Ministries in Audit and Monitoring & Evaluation

- Internal audit is a part of the internal control system of a sector ministry. Its roles and functions are often not well understood, or the units lack the independence and organisational support to carry out their mandate. Common challenges include low status of internal auditors and limited independence from managers, absence of internal audit units at the sector ministries, and lack of risk assessment to plan and choose topics for audits.
 - In practice, monitoring and evaluation systems are often weak in government institutions. Timing of monitoring might not be synchronised with the planning and budgeting calendar. The quality of monitoring and evaluation systems varies. Feeding back lessons learned into the planning and budgeting process is a challenge.
 - External auditing faces many challenges in partnering countries and the role of SAIs to perform their function as public finance 'watchdogs' often remains limited. In many countries SAI lack the independence, resources and technical quality to carry out audits according to international standards.
 - SAIs and legislature often lack the capacity to ensure audit recommendations are followed up in the ministries. Sector ministries in turn might not be incentivised or might lack the will to act on SAI negative audit findings. Therefore, the same qualifications might reappear in future audits.
 - In many developing countries the limited capacity of parliamentarians to act upon the recommendations in the audit report to ensure follow-up by the executive branches undermines the effectiveness of auditing.
- 

➤ *further reading:* Jody Kusek/World Bank:
Assessing Country Readiness for M&E

TOOL TO ASSES AUDIT MONITORING AND PLANNING

audit and monitoring & evaluation

1. Is the ministry subject to external audits by Supreme Audit Institutions?
2. Are the requirements for internal audit within sector ministries?
3. Are results of programmes and performance monitored?
4. Does an evaluation system exist in the sector ministry to review effectiveness and efficiency of programmes against set objectives?

Recommendations

- The internal auditing department should be an independent function within a sector ministry to ensure objectivity. This implies for instance that the internal auditor reports to a level within the ministry that will allow him/her to execute the audit functions unfettered. If not existent, sector ministries should put in place and operationalise internal review processes.
- Budget systems are often not well aligned with a monitoring and evaluation system to measure policy and programme performance. Sector ministries should ensure that a manageable administrative performance reporting system is in place to ensure that a results-based management approach is applied to the delivery of public service. Monitoring systems should produce timely and reliable data and analyse performance. This requires that the technical, procedural and political capacities are developed to monitor, evaluate, learn and adapt to changing circumstances.
- There should be a mechanism within the ministries to ensure follow-up of audit recommendations. This could be within the responsibility of the internal audit unit. Additionally, Parliament should monitor the process at regular intervals.
- Engagement by and capacity building of Parliament and civil society to monitor government performance is crucial. This can contribute to and incentivise a results-based culture within the ministries.

GFG in the Kenyan Health Sector
GFG in the Vietnamese Forestry,
Climate Change and Environment Sector



PART 03

CASE STUDY 1: GFG IN THE KENYAN HEALTH SECTOR

INTRODUCTION

Kenya is at a crossroads. Following the violent clashes after the highly contested elections in 2007, the Government of Kenya (GOK) embarked on an ambitious reform effort. In August 2010 a new constitution designed to limit the powers of the President and devolve power to county level was approved by referendum. Reforms in the legal and regulatory framework for PFM have also been adopted, including the new Fiscal Management Act of 2009, the new Public Finance Management Act of 2012, and the Devolution Act of 2012. The reform agenda is likely to alter Kenya's political, regulatory and institutional landscape. Parliament has received more power and discretion in the budgetary process. Oversight functions have been reorganised or introduced, including the creation of the function of Controller of Budget. Fiscal devolution will enable county governments to decide on resource allocations received from central government. It is likely that the new institutions, functions and responsibilities will have to build their technical capacity to manage public funds efficiently and effectively. Political leadership at national and local level will be required to ensure transparency and accountability in the use of public funds in line with national development goals.



In spite of the many challenges ahead in implementing government reforms and the lingering threat of civil unrest, due to deeply entrenched ethnic divisions in Kenyan society, expectations among the population for a more inclusive development are high. The country experienced impressive economic growth in the pre-crisis years. After the election violence, GDP declined and is yet to recover to pre-2007 levels. From 2009 to 2010 it grew by 2.6% and 5.6% respectively. Growth decelerated again in 2011 with a 4% increase in GDP. The slowdown in economic growth, the Kenyan military response to the security threats posed by neighbouring Somalia, repeated droughts, food imports and high inflation (from 2005 until 2013, the inflation rate averaged 12.08%) stalled the country's development (UNDP, 2011; IndexMundi, 2013).

The goal of Kenya Vision 2030 is to 'provide equitable and affordable health care at the highest affordable standards' to the country's citizens. Meanwhile, unequal access to social services continues to be a challenge particularly for poor regions, such as North Eastern



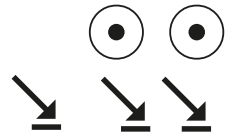
Province, Nyanza and Western Province. According to WHO statistics, health service provision and utilization are uneven between rural and urban areas, with markedly higher child mortality and fewer births being attended by skilled health workers in rural areas. In general, wealthier segments of Kenyan society are more likely to live healthy lives than are the poor (WHO, 2012). Expenditures on health as percentage of total government spending dropped from 7.69 in 2007 to 7.31 in 2009. In the same period, public health expenditure (% of GDP) declined from 1.61 in 2007 to 1.47 in 2009 while private contributions rose (WHO National Health Accounts Kenya). With almost one third of total expenditures, foreign aid is a major source of funding for Kenyan health care services. Some health programmes depend almost entirely on foreign contributions (e.g. HIV/Aids), which raises concerns about the sustainability of those interventions. Private payments continue to be the main source of health care financing. Out-of-pocket payments carry the risk of limiting access to care especially for the poor (USAID, 2010).

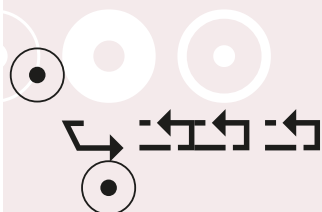
Providing equitable, quality care at affordable prices will depend to a significant degree on GFG of the health sector. This warrants a closer look at the institutional setting and incentives, the technical PFM capacity, and the normative underpinnings of managing public resources for health care provision.

THE BUDGET PROCESS IN THE KENYAN HEALTH SECTOR

Institutions and actors in the budget cycle

A number of institutions and actors are relevant for the management of public funds in the Kenyan health sector. They function within their pre-determined rules and procedures, but most likely have different incentives and varying degrees of influence in the budget process. Due to the recent reforms, roles have changed and new actors have entered the scene. Those regulatory changes have been introduced with the aim of achieving more openness and accountability, enhancing the equity of public spending and ensuring the prudent and responsible use of public funds (SID, 2012).





Kenya maintains a largely typical PFM cycle with the traditional processes and actors usually associated with Anglo-African country systems. The National Development Plan (Vision 2030) outlines long-term macro-policies. The Comprehensive National Policy Framework for Health 2011-2030 details the more specific strategic objectives for the sector. Based on those policy directions, the medium-term Kenya Health Sector Strategy Plan (five years) and annual plans are developed. The MTEF, the budgetary system in Kenya, links policy-making with the planning and implementation of budgeted programmes and projects in a three-year rolling framework. The annual preparation of the budget begins with a Budget Circular issued by the **MOF**. This defines the broad parameters of the budget and sets expenditure ceilings per sector. The Circular defines the budget calendar and associated responsibilities for the formulation of the budget.

Kenya's health sector is currently composed of two **sector ministries**, the **Ministry of Public Health and Sanitation (MOPHS)** and the **Ministry of Medical Services (MOMS)**. This was a result of the post-election violence. The split of the ministries made coordination more complex and led to the duplication of administrative functions for planning, budgeting and oversight (USAID, 2010). After the 2013 elections, the ministries will once again be merged. Other important actors are the **parastatal agencies**, of which the Kenya Medical Supplies Agency (KEMSA), responsible for procurement of medical supplies, and the National Health Insurance Fund (NHIF) are the most prominent actors. The sector ministries' functions include coordination of development plans, development of policy and investment plans, and monitoring the implementation of programmes. Their input to the budget preparation usually starts in September with a public expenditure and policy review (FY -1) that should in principle inform the Annual Operational Plan (AOP) for the next fiscal year (FY +1). The sector ministries consolidate the programme and budget proposals from the **counties** and reconcile them with the national sector strategy plan (Note: this process is due to change in 2013 with the establishment of new Counties and County governments). In the planning and budget preparation phase, the **policy & planning division** and **finance division** (in the administrative department) need to closely cooperate with the **technical planning department**. The administrative department and its divisions are usually staffed by personnel



seconded from the Ministry of Planning and the MOF, while the technical planning department is staffed by health professionals from the sector ministries.

The sector ministries submit their proposals to the MOF. Afterwards, sector negotiations for the allocation of resources commence within the **Health Sector Working Group** under the guidance of the **Sector Convenor for Health** from the MOF and these usually occur between September and February. Public hearings are an integral part of the budget negotiation phase. These give **civil society and interest groups** the opportunity to voice their opinion and be informed about the policy and budgetary plans. The new constitution aims to further strengthen participatory governance approaches. While the prime objective of the MOF is to safeguard aggregate fiscal discipline, ensure allocative efficiency and promote programme effectiveness, the sector ministries' aim is to mobilise and maximise resources to implement their strategies. This might in part explain why in the past health sector budget proposals have been grossly out of line with the MOFs estimated resource envelopes (i.e. budget ceilings) for the sector, although the main challenge is the disconnected processes for strategic planning and budgeting². In February, the Budget Policy Statement is issued containing estimates of revenue and expenditures for the next fiscal year.

The budget estimates (also known as the Executive Budget or Budget Proposal) are tabled in **Parliament**. Under the new constitution this should be done in April, two months prior to the start of the fiscal year (1 July – 30 June). The budget estimates should include funds provided to the health sector by **development partners** (Appropriations in Aid). However, a USAID-commissioned study from 2010 estimated that approximately 80% of Kenya's health expenditures financed through aid are off-budget (USAID, 2010). Many donors have introduced special purpose funds that are on-budget but these are usually ring-fenced and tightly controlled and often managed by donors or special units set up within the ministry. The **Parliamentary Budget Committee** assesses the budget estimates. Another important Parliamentary player is the **Departmental Committee on Health**. The new constitution grants considerably more power to Parliament to amend the budget, but without changing the overall aggregates. It may however cut spending to reduce the deficit. Since 2007, an

² Another incentive for the Sector Ministries to over-budget may be the 2001 Abuja Declaration of heads of state of African Union Countries. In the declaration a pledge was made to allocate at least 15% of their annual budget to improve the health sector.

independent **Parliamentary Budget Office (PBO)** has been in place, entrusted with the function 'to provide timely and objective information and analysis concerning the national budget and economy' (PBO, 2011).

Upon approval and the passing of the Finance and Appropriations Bills, the government is effectively authorised to raise revenue through taxes and to spend them in accordance with the approved estimates reflected in the budget. Budget implementation entails the disbursement of funds to Ministries, Departments and Agencies (MDAs). Budgetary resources are disbursed to MDAs through exchequer issuances (i.e. cash disbursements). The permanent secretaries are then granted authority to incur expenditure. The process also allows for commitment control and accountability. The **Controller of Budget**, a new function created under the Fiscal Management Act, exercises more oversight of allocative decisions and control over in-year cash disbursements. However, until now this function has been limited to approving the in-year allocations to the sector ministries and reporting on the budget implementation of the MDAs on a quarterly basis. Within the Ministries of Health the **accounting and procurement departments** (including KEMSA) are key actors in the budget execution phase. Kenya has also established a **Public Procurement Oversight Authority** to oversee the procurement system, although its capacity is a major constraint to its effectiveness.

Internal and external audit play important roles in validating controls both in-year and ex-post. Parliament also continues to exercise an oversight role, in particular by holding hearings on audit reports published by the **Auditor-General**.

KENYA'S PUBLIC FINANCE REFORM AND ITS IMPACT ON THE HEALTH SECTOR

In addition to introducing new functions and changing the responsibilities of certain actors (in particular of Parliament and the Controller of Budget as described above), the Public Finance Reform also introduces a number of significant changes in PFM processes and systems. Some of them, including PBB, have been adopted at an operational level in the last

few years. PBB will become the new norm of budgeting. As of 2013, it is envisaged to present the budget on programmes, to reduce the number of line items and thus enhance the managerial flexibility of department heads. It is not clear, however, whether in particular the sector ministries have the capacity to implement PBB or whether input-based budgeting will remain the practice for the time being. Other important reform efforts are the introduction of an IFMIS and the new Chart of Accounts. Another major innovation has been the distribution of essential medicines and medical supplies, where a demand-driven 'PULL' system was implemented to ensure more efficient distribution of supplies to healthcare facilities throughout the country. The aim is to reduce wastage and ensure that the correct supplies are available where and when needed.



GFG IN THE KENYAN HEALTH SECTOR: STRENGTHS AND CHALLENGES

The country context, the institutional setting and reform efforts outlined above influence the management of public funds in the Kenyan health sector. The following overview provides a summary of GFG challenges and strengths in the Kenyan health sector for each phase of the budget cycle. It takes into consideration the application of normative dimensions (e.g. rule of law, transparency, and development-orientation) and the technical PFM capacity, as well as the role and power of actors involved in Public Financial Management. For each budget stage one major issue, of several, has been identified on the basis of possible quick gains if addressed first. Other issues are explained in less detail.

Policy development and budget preparation

Failure to link policy, planning, budgeting and evaluation may be the single most important factor contributing to poor budgeting outcomes at a macro, strategic and operational level in developing countries. The most significant challenge from a GFG perspective in this phase of the budget cycle is the difficulty faced by the health sector and the MOF of following a process that matches needs and resource availability dynamically in the short, medium and long-term. In the Kenyan health system there is a significant shortfall in the health infra-

structure, human resource development and administrative capacity necessary to address the real service delivery needs of Kenyans. The resources needed to bridge the service delivery gap that has built up over decades of deferred spending and capacity building, are considerable. As a result, there is often a mismatch between the AOP devised by the sector ministries and the actual available resources. The practice of zero-based budgeting can cause planning fatigue in the health sector. Moreover, the health sector planning process does not provide full information of the resource bidding process (i.e. early negotiations with MOF for sector aggregates), which can lead to lower budget ceilings for the sector. While Kenya has deployed good practice through implementing the sector-based budget mechanism, there seems to be limited attention to properly costing the full needs for adequate health service provision to the nation, in order to make over-time progressive attainment of those needs a possibility. This might in part be due to insufficient cooperation and coordination among the various departments and divisions involved in policy planning and budgeting at the ministries. The technical departments are staffed with health professionals, while the administrative unit employees are seconded from MOF or the Ministry of Planning. This means that they might have different directives and incentives and do not necessarily speak the same language.

Recommendation:

A rational process needs to be established whereby long-term (i.e. 10-15-year) needs are identified and costed, and medium- and short-term plans are defined and fully funded to allow for the progressive realisation of healthcare objectives in line with available resources (including borrowing linked to sustainable debt management). The move towards PBB offers a possibility to prioritise and cost programmes in the medium term. Well-designed programmes with proper justifications and realistic costing have better chances of consideration within the budget preparation phase. Next to a more substantiated engagement with MOF, the health ministries should consider engaging at an early stage with the Parliamentary Committee for Health and, depending on the entry points, with the Budget and National Accounts Committees. This seems particularly important in the light of the new budgetary powers conferred on Parliament by the new constitution. Engaging constructively with

both the MOF and the Parliamentary Committees could increase the resources allocated to the sector. Moreover, it will be important to strengthen and engage early on with the new County Legislatures, who will receive substantial authority over public finance at the sub-national level in line with the new constitution. This will help address the fundamental conflict that has arisen in the Kenyan health sector between two critical GFG dimensions namely, financial control versus poverty-oriented and sustainable policy design. Finally, the sector needs an internal planning and budgeting procedure that allows it to engage more effectively and proactively in the budget process. A proposal by Stephen Muchiri of the Futures Group should be reviewed by the sector to consider if it is feasible to put in place an extended internal budget calendar for the sector. It is vital that the relevant technical and administrative departments cooperate in this process.

Other Issues

- There is a high prevalence of off-budget funds in the health sector which can contribute to the significant uncertainty regarding funding needs and reduce the government's ability to plan effectively. Off-budget funds lead to several problems: 1. the expenditure cannot be audited by the external audit; 2. it opens the door for other GOK funds to account for the same expenditures; and 3. it leads to poor coordination among the Ministries and Agencies. There is also the risk that off-budget donor funded activities are not in line with national health objectives.
- Donor involvement in setting up and managing certain ring-fenced funds such as the Health Sector Services Fund (HSSF) could diminish national ownership and responsibility. While it is understood that this approach is better than donors making use of off-budget mechanisms, it is less desirable than on-budget use of country systems. Moreover, ring-fenced donor funds may reduce the incentive for the health ministries for progressive, development-oriented budgeting as this task is taken over by donor funded mechanisms. If donor funding were to stop, significant reallocations of national revenues would have to be made to continue to meet the needs of the poor, as national revenues are currently primarily destined to finance national hospitals and services in urban areas.



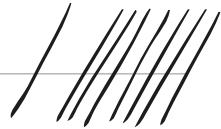


Budget execution

Poor budget execution practices are a major cause of poor programme and project implementation, including a failure to translate strategic priorities into results on the ground and inefficient resource use. A major concern in the Kenyan health sector is the inefficient procurement system. Kenya has developed an extensive framework of laws, regulations and oversight institutions to oversee and regulate government procurement procedures and functions. The legal framework is generally considered to be sound and it is good practice to have standard tender documents in place. However, implementation is weak due to understaffing and underfunding of procurement functions within the health ministries. In addition, unrecorded commitments from the previous fiscal year cause arrears (i.e. unpaid pending bills) to accrue and roll over from one financial year to the next, resulting in the health ministries beginning the year with fewer funds than anticipated once bills from the previous year have been paid. There are also possible disincentives in the system, favouring a weak procurement system, as well as limited oversight mechanisms (e.g. insufficient procurement audits, no follow-up to general audit findings).

Recommendation

The sector should make use of documents and evaluations, for instance those produced by the Controller of Budget, Audit Reports and Public Accounts Committee, to assess where the major budget implementation problems lie, from a technical and financial point of view. Moreover, the procurement practice should be evaluated against existing procurement legislation. This will identify bottlenecks in the procurement processes, and should also include a critical assessment of the capacities and reporting requirement of the procurement officers in the Ministries of Health. Finally, the roll-out of the re-engineered IFMIS should provide for better monitoring of expenditures and procurement commitments.



Other Issues

- The new PFM Act limits the flexibility of permanent secretaries to shift funds between programmes and between sub-votes³. They are required to seek pre-approval from MOF for any reallocation. This new rule introduces more budgetary control, as it was previously possible to make larger in-year changes with ex-post legitimisation, leading to shifts of resources not always justified in terms of national priorities. However, the new law might excessively limit the managerial flexibility to respond to changing needs within the year.

Accounting & audit

Accounting lies at the heart of a financial management system because other systems depend upon it for useful, timely and reliable data for decision-making. Auditing will provide assurance that public funds have been spent for the purposes for which they were designated. One concern related to this budget phase in Kenya is the apparent lack of follow-up. There seems little political pressure on ministers and permanent secretaries to address poor audit outcomes. It seems that audit findings repeat themselves in certain departments year after year without the systemic root causes being tackled. This is in contrast to other developing countries where Auditor-General opinions on department financial statements are widely publicised and Cabinet requires permanent secretaries to develop, implement and report back on remedial plans that are tabled in Parliament, to counter systemic weaknesses. This would address the key GFG dimensions of ensuring effective institutions through the improvement of financial management capacity, improved asset management and enhanced procurement practices, since audit findings typically emerge from these areas.

Recommendations

The Cabinet should institute a process whereby it scrutinises all Auditor-General opinions on department financial statements and ensures that permanent secretaries act on remedial plans that are tabled in Parliament to address systemic weaknesses identified in the auditor's report. Audit Committees should be strengthened, as they can provide the link between

³ The PFM Act does not define sub-vote.

the External Audit, Parliamentary Accounts Committee, and the management of the health ministries. In the PFM Act and the subsequent regulations, they have a very strong role and will be constituted from ministerial staff as well as outsiders.

Other Issues

- There seems to be a lack of audience orientation in the Auditor-General's reports. A "citizens' audit report" may be considered in Kenya to ensure that the audit reports are accessible and utilized by the public and civil society organisation to apply pressure on the health ministries to improve financial governance.

Programme monitoring and evaluation

Monitoring of performance and evaluation of outcomes are critical functions within any government department. The processes and procedures for implementing and maintaining a workable performance management system are generally weak in the Kenyan health sector. Close monitoring complemented by evaluation could provide valuable information for decision-making on the expansion, modification or termination of programmes. A particular concern in the sector is the lack of information available on service delivery and spending trends at facility level. In the absence of reliable information of this kind, decisions on allocations to expand, modify or contract services are unnecessarily fraught and risky. This lack of cost-benefit information exacerbates the political economy challenges prominent in GFG that have resulted in the skewed distribution of resources between primary, secondary and tertiary care in Kenya. Political interference significantly reduces the ability of officials in the health sector to resolve this policy challenge.

Recommendations

In order to mitigate interference of this nature (which is always present to some degree in the delivery of public services) the development of technical, procedural and political capacity for programme performance monitoring and evaluation is crucial. This is a first step towards

making evidence-based policy and budgeting decisions. To solve the problem of service delivery and policy decisions based on political expediency, it is also important to provide factual data and cost-benefit analyses to the citizens, so that they can hold the health service providers and the health ministries to account.

Other Issues

While the Kenyan health sector follows the good practice of carrying out annual expenditure reviews, this information does not seem to influence the upcoming policy and budget preparation phase.

FINAL REMARKS

Kenya's health sector faces a number of significant GFG challenges. Some of these challenges are directly related to the on-going, ambitious reform agenda of the GOK, which will entail a large amount of institutional and procedural changes. The two health ministries will be merged again, which might on the one hand lead to efficiency gains but is also likely to cause redundancies. Powers will be redistributed, which rarely happens without resistance. Once fully operational, the new PFM Act will introduce new procedures and rules of the game that still need to be fully understood and internalised by the staff concerned. One of the major changes that will materialise in the near future is the mandatory PBB. It has become clear that the health ministries are not sufficiently prepared to implement this reform. Other important construction sights are the procurement system and the planning and budgeting based on actual needs, performance and available resources. Thus, while a lot of the elements for a modern public finance system are provided in the new constitution and Acts, much remains to be done to facilitate proper implementation by MOF and sector ministries alike. For the health sector to become a more effective player in the budget process, capacity development in the GFG areas outlined above is crucial. The health sector will thus be enabled to make the best use of available national resources to provide equitable and affordable health care at the highest affordable standards to the citizens.



Disclaimer: This case study is based on a literature review and a field study visit to Kenya from 11-15 February 2013. We are grateful to the Kenyan authorities, development partners and GIZ colleagues who provided the research team with valuable insight into GFG in the Kenyan health sector.

PART 03

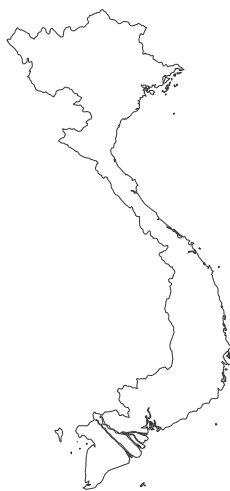
CASE STUDY 2: GFG IN THE VIETNAMESE FORESTRY,
CLIMATE CHANGE AND ENVIRONMENT SECTOR

INTRODUCTION

The Socialist Republic of Vietnam is a middle-income country. It has experienced a significant GDP growth per capita since 1991, increasing from USD118 to USD1,200, while in the same period of time the poverty rate fell from 60% to less than 10% in 2010. In Vietnam, the government plays a key role in financing services and investment projects. Government spending accounts for almost 30% of GDP. Relatively speaking, Vietnam is less dependent on foreign aid than other countries in the region. In 2011, Official Development Assistance (ODA) constituted less than 0.5% of GDP. It is therefore the budget process that plays the most important role in weighing up political priorities and underpinning these with concrete decisions on the allocation of funds.

The Financial Development Strategy for the period up to 2020 summarises current challenges in PFM and includes measures to address them. General aims in this context are improved accounting, auditing and statistics, simplified tax collection and an increased use of information technology in delivering and managing public services. Currently, the State Budget Law is under review. An important objective of this process is to add provisions to better control inflation and react flexibly to changes in the global economic climate, making the budget more transparent and allowing for resource allocation based on the performance of the spending units.

To promote sustainable development, a number of strategies including the National Environment Protection Strategy (2003), Vietnam's Forestry Development Strategy 2006-2010, National Target Programme to Respond to Climate Change (2008) and Climate Change Strategy (launched 2012) and appropriate action plans have been approved in Vietnam. Beyond technical measures, the raising of awareness within and training for the population are established targets. Different actors, including the government but also civil society organisations, are working on the implementation. Beyond budget resources, Foreign Direct Investments and also ODA are being used to finance the strategies.



THE BUDGET PROCESS IN THE VIETNAMESE FORESTRY, CLIMATE CHANGE AND ENVIRONMENT SECTOR

Institutions and actors in the budget cycle

There are a number of institutions and actors relevant for the management of public funds in the Vietnamese forestry, climate change and environment sector. Responsibility for forestry, climate change and environment policy lies with the **Ministry of Agriculture and Rural Development (MARD)** and **Ministry for Natural Resources and Environment (MONRE)**. Since it is aimed to mainstream climate change, other sector ministries are also responsible for climate change topics. Subordinate authorities such as the Department of Agriculture and Rural Development (DARD) are responsible for implementation at provincial level. It is important for the sector authorities to play a proactive role in the national budget process, in order to acquire more funding for the sector, to implement more realistic and sustainable programmes by improving planning processes and to provide an incentive for the more efficient use of funds.

Officially, the **MOF** is responsible for the budgeting process. Responsibilities are shared however between the MOF, which is in charge of recurrent spending, and the **Ministry of Planning and Investment**, which is in charge of capital or investment spending. The intra-ministerial budgeting process mirrors this division of tasks. The Planning Department at **MARD** is responsible for drafting the investment budget, with the recurrent budget being drafted by the finance department. The process steps for formulating the budget draft are established in the budget calendar. In May, the **MOF** sends the Budget Circular, on the basis of which ministries and sub-national governments need to prepare their budget proposal for the draft budget, within only 7 weeks. At the end of October, the draft budget is submitted to the **National Assembly (NA)**. Coordinating the recurrent and the investment budget is made more difficult by the fact that MARD's Planning Department is now introducing PBB on a pilot basis.

The NA then has a few weeks to review the draft budget. The annual budget law is based on a very rough classification of expenditure into administrative budget items – i.e. according to ministry and authority – and economic budget items, including recurring, investment and development costs. Parliament decides on the amount of overall funding available to each ministry and on the breakdown of this expenditure into very general economic categories. It also determines which programmes and construction projects are important at the national level and decides how much funding will be made available to the provinces. During the budgeting process, Parliament is also informed about plans regarding the purpose of state expenditure, with details of objectives and key programmes.

VIETNAMESE PUBLIC FINANCE SITUATION AND ITS IMPACT ON THE FORESTRY, CLIMATE CHANGE AND ENVIRONMENT SECTORS

Given that **MARD** is the recipient of one of the largest investment budgets, and against the backdrop of increasingly scarce funds, the budget process is crucial for the ministry. Overall investment expenditure has dropped significantly as a result of the restrictive fiscal policy adopted in response to the financial crisis in recent years. In order to boost domestic demand and maintain economic momentum, the wages and salaries of the 1.6 million or so public servants in Vietnam have been increased. Redeploying funds in this way from the investment budget into boosting consumption has further restricted scope for investment in forestry, climate change and the environment. Measures to improve the fiscal situation are also planned on the revenue side in areas that will impact on sector objectives. For example, the introduction of a resource tax is being considered.

GFG IN THE VIETNAMESE FORESTRY, CLIMATE CHANGE AND ENVIRONMENT SECTOR

The following overview provides a summary of GFG challenges and strengths, for each phase of the budget cycle, in the Vietnamese forestry, climate change and environment sector, in

particular **MARD**, which is the recipient of one of the largest investment budgets. It takes into consideration the application of normative dimensions (e.g. rule of law, transparency, and development-orientation), the technical PFM capacity, as well as the role and power of actors involved in public financial management.

Policy development and planning

Strategic planning plays a key role in the Socialist Republic of Vietnam. Despite the economic reforms implemented since 1986 as part of Vietnam's shift to a market economy, policy steering in Vietnam is still based on national and more detailed provincial five-year socio-economic development plans (SEDPs), keeping the tradition of a centrally planned economy. The targets and priorities outlined in the SEDP form the general basis for the annual budget plan. Despite the importance of planning in the socialist system, the lack of provision for implementing these plans and ultimately their relevance for budgeting are criticised. The SEDPs set macroeconomic targets and outline policy priorities and indicators for key tasks, without actually specifying the measures to be implemented or putting a figure on the cost. Given the weak prioritisation abilities and uncertain costing and funding sources, the SEDPs are difficult to translate into realistic annual budget plans. The question therefore arises of how to integrate mainstream action plans such as the Climate Change Adaptation Action Plan into the SEDPs. A lack of integration of these plans into the general budget planning contributes to their underfunding. For example, the Climate Change Adaptation Action Plan is thought to be 98% underfunded.

Budget preparation

In addition to the five-year plans, three-year medium-term fiscal/budget frameworks are being implemented on a pilot basis. The pilot programme initially covered six ministries and four provinces and will now be expanded to cover the entire budget. 'Top-down' macro-economic parameters and policies determined by the ministries of finance and of planning and investment, as well as 'bottom-up' expenditure planning, need to be incorporated into the budgets. The extent to which this incorporation takes place and the relevance of these

parameters for sector ministries will need to be examined. Theoretically, medium-term planning could help build capabilities among the lower administrative levels in the budgeting process, if policies were binding and if decisions about how departmental budgets are broken down were made at the corresponding lowest level. In many countries however, it is the case that the introduction of medium-term financial plans is not binding, and frequently only translates into a linear updating of existing budget items because there is a shortfall in planning and costing expertise. As a result, plans lack relevance for the actual allocation of funds. Medium-term planning may however send some signals to the sector ministries and provinces in term of available money and future allocations and consequently help them in preparing more realistic budgets.

MARD is piloting the introduction of PBB in the drafting of its annual investment budget. The Finance Department of **MARD** is not covered by the pilot programme, only the Planning Department. All investment projects in **MARD**'s business area are being structured into large-scale programmes, such as the forest rehabilitation programme. However, these large-scale programmes are not yet reflected in the budget sent to the **NA** for adoption. However, there is some degree of coordination between the administrative units involved, which must provide an explanation to the next-highest level if programme goals are not met. This provides an incentive for efficient administration, which facilitates policy steering.

Programme monitoring and evaluation

One of the challenges faced in the context of the introduction of programme budgeting, is that it is difficult to draw up indicators for the programmes. **MARD**'s Administration of Forestry (VNFOREST) is responsible, for example, for managing six national parks and a forestry institute. As part of these responsibilities, VNFOREST must fulfil 13 sub-indicators that have been agreed with the **Ministry of Planning and Investment** and with **MARD**'s Planning Department. However, the responsible administration does not yet have the capacities/ means to monitor the selected indicators. Costing models are also not very well drafted and offer little incentive for the efficient use of funds. One of the problems is that costing standards, such as the rehabilitation cost per hectare, are unrealistic. However, the fact that the introduction of the programmes has instigated results-based discussion on the allocation

of funds is to be welcomed. To date however, a general legal basis is still lacking for budget regulations, as are guidelines from the ministries of finance and of planning and investment on how to draft PBB and indicators. At the same time, this does give MARD scope to draft an effective steering model without set parameters from ‘above’.

No planning framework for provinces

The administration of the Socialist Republic of Vietnam is broken down into 59 provinces and five municipalities. The provinces have relatively comprehensive decision-making powers and scope for action. At the same time, they are almost fully dependent on funds allocated from the central budget and – unlike the national budget – by donors. Allocations from the central budget are distributed based on a scale that is kept constant over three to five years, so they bear only a limited relation to the provinces’ actual needs. ‘Bottom-up’ planning processes therefore play a minor role and provide little incentive for the efficient and results-oriented use of funds. Provinces could improve expenditure planning if clearer parameters such as binding spending caps were to be provided at central level. Such parameters would pave the way for greater results orientation, the more efficient use of funds and ultimately for a more target-oriented environmental and climate change policy at provincial level.

FINAL REMARKS

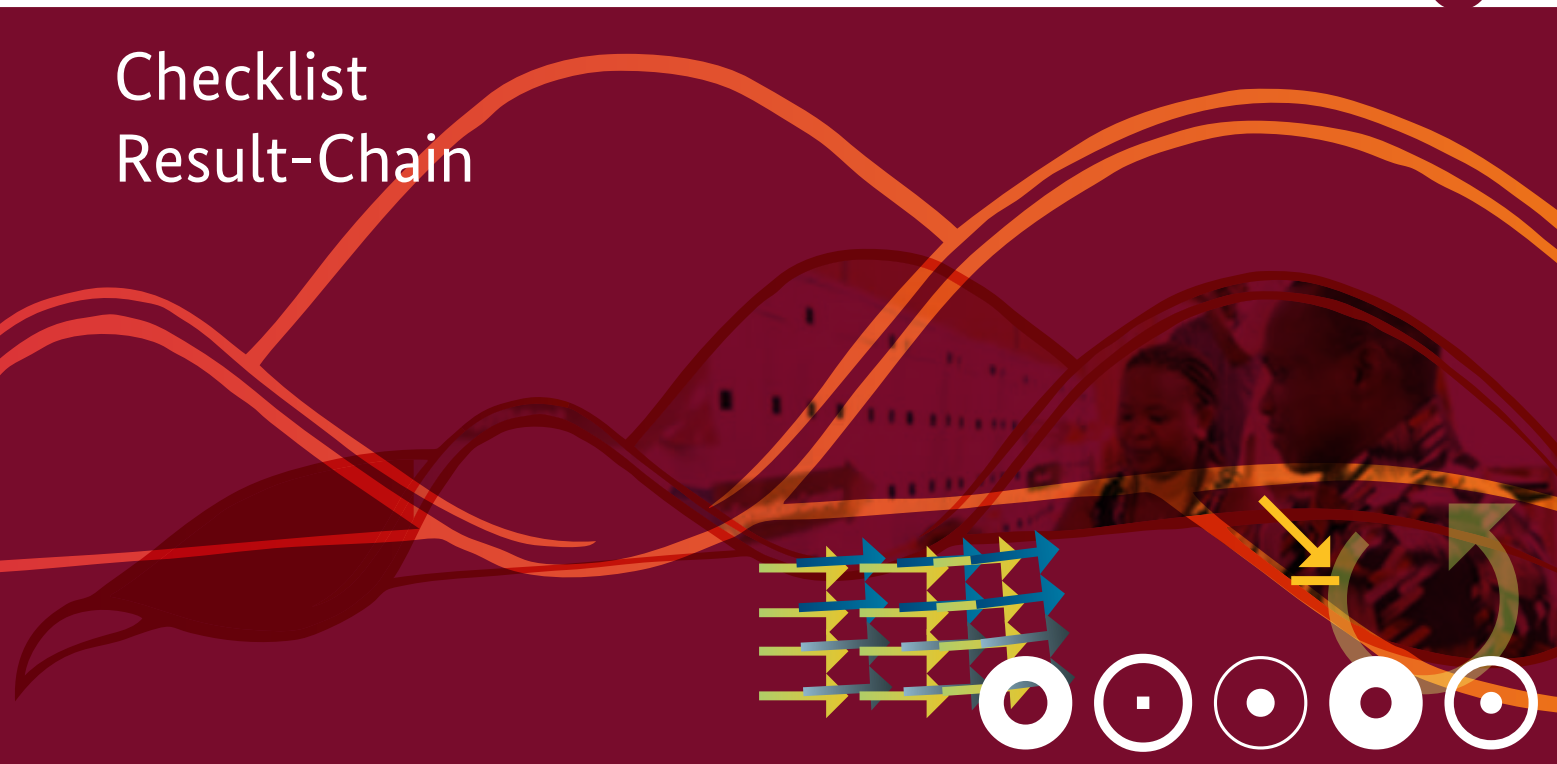
- Strategic planning and budgeting are not sufficiently coherent. The fact that the ministries of finance and of planning and investment share responsibility for budgeting makes coordination more difficult. Sector planning processes frequently lack a sound basis, as the actual amount of medium-term funding is not clear.
- The introduction of PBB into **MARD**’s investment budget is a good entry point for stepping up results orientation in the forestry, environment and climate change sector and for improving policy steering at subordinate and provincial authority levels by MARD. Sound programmes and indicators could also provide a guideline for developing standards for sector-specific services.



- There is a greater 'disconnect' between expenditure planning and available funding at provincial level than at national level. Funds need to be planned and allocated based on binding parameters, to enable environmental and climate change policy to become more objectives-oriented at the provincial level. Based on this increased planning certainty, steps should then be taken to improve results orientation at the administrative level.

Disclaimer: The case study is based on a literature review and a field study visit to Vietnam from 3-6 December 2012. We are grateful to the Vietnamese authorities, development partners and GIZ colleagues who provided the research team with valuable insight into GFG in the Vietnamese forestry, climate change and environment.

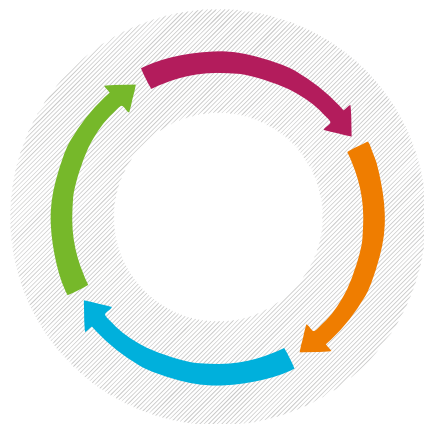
Checklist
Result-Chain



PART 04

TOOL 1: CHECKLIST

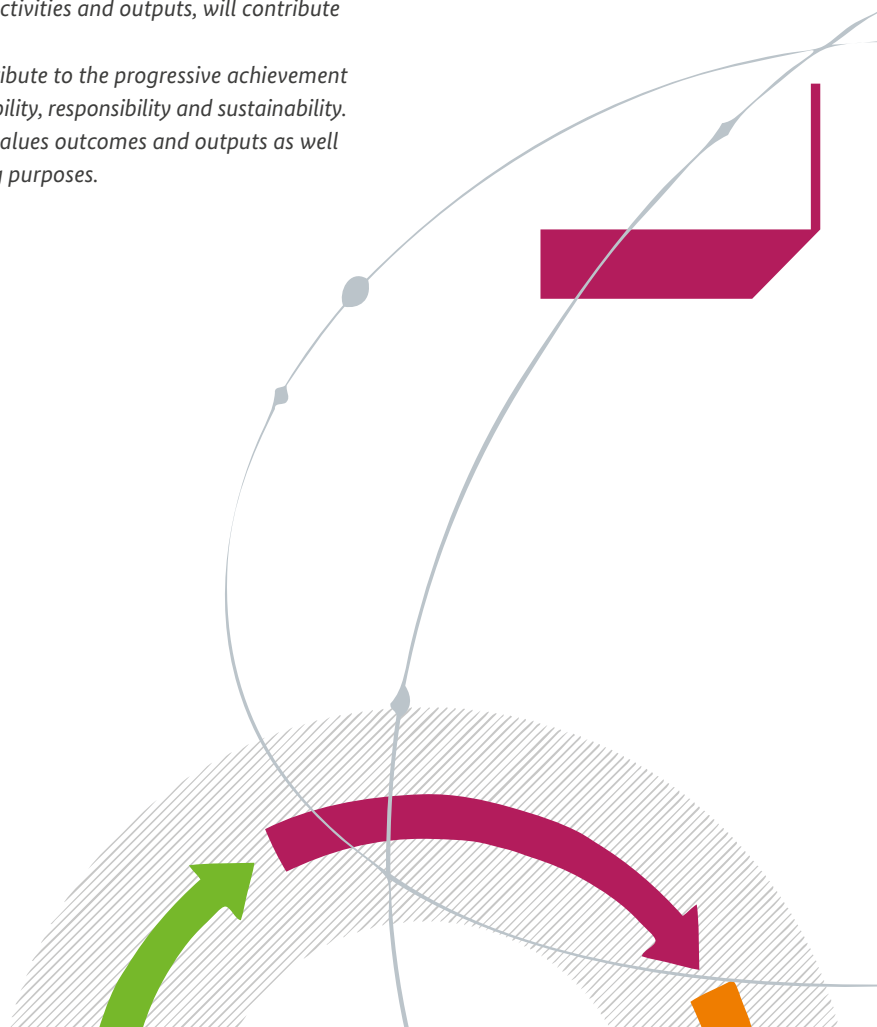
The checklist serves to analyse weaknesses of financial governance in sector ministries. It can be used as a guide for structured interviews with counterparts at the respective sector ministry. The checklist is made up of four parts reflecting the generic stages of the budget process. For each stage a short explanation of the budgetary phase is provided. For more in-depth explanations please consult the corresponding sections in Part II of the guidance note. Each budgetary phase contains a set of high-level questions. Should the answer to the high-level question reveal no weakness, you can continue on to the next high-level question or to the next budget phase. Should the answer to the high-level question point to a weakness, please continue on with the more detailed questions. These questions are structured according to the three GFG dimensions (see Part 1 for an explanation of GFG). Although the distinctions between the dimensions might not always be straightforward, structuring your analysis in this way will help you pinpoint the nature of the underlying problem, e.g. whether there are technical shortcomings or rather institutional challenges. The tool does not provide standard answers to the questions as there is mostly no one-size-fits-all solution. However, it does provide a short description of negative effects if certain financial governance elements are not adhered to. For more detailed guidance, please consult the description of the budget phases in Part II or seek assistance from a GFG expert to help you analyse the responses to the questions.



Policy Development and Planning

can generally be divided into three substages including:

1. *Programme formulation whereby sector experts design programmatic interventions that logically and plausibly through the articulation of inputs, activities and outputs, will contribute to the achievement of stated policy outcomes*
2. *Policy costing is an effort to design programmes that contribute to the progressive achievement of social objectives while at the same time ensuring affordability, responsibility and sustainability.*
3. *Strategic planning whereby line ministries vision, mission, values outcomes and outputs as well as costed performance targets are identified for monitoring purposes.*



1

policy development and planning

Are medium or long-term sector policy objectives linked to the annual planning and budgeting process?

Normative Dimension

- Is there a sector strategy that reflects development goals?
- Does the strategy contain policy, performance (in terms of outcomes and output quality, efficiency, quantity) and financial information for a medium-term?

Political Economy Dimension

- Who sets the framework for sector ministry planning? Prime Minister's Office? Planning Ministry/Commission? MoF? Other?
- What is the role of the finance and planning ministries, civil society and private sector in influencing sector strategies?
- Are policy and planning processes within a sector informed by national policy initiatives such as those articulated in the national development plan?

Technical Dimension

- How does the sector strategy inform the annual budget preparation process?
- Are resource constraints taken into consideration when drafting annual policy / strategy goals?
- How is the balance between real needs and constrained availability of resources managed?
- Is the policy and planning process informed by evaluations that assess the effectiveness or efficiency of government programmes?

Failure to link policy, planning and budgeting may be the single most important factor contributing to poor budgeting outcomes at a macro, strategic and operational level in developing countries.

policy development and planning

Does the sector ministry have a fixed process/framework for planning and budgeting of programmes and projects?

Political Economy Dimension

- Who are the key players in the planning phase? How do technical and administrative departments interact when drafting the annual policy plans?
- Are sub-national entities consulted in time to influence the policy and budgeting phase?
- Are programmes formulated by sector experts who aim to achieve stated policy goals (through the articulation of inputs, activities, outputs and outcomes)?

Technical Dimension

- Is there a timeline for policy review and design?
- Are there guidelines on programme/budget design and are these guidelines known, understood and applied by the parties involved? Are constraints taken into consideration when drafting annual policy/strategy goals? Is an effort made to forecast the costs associated with implementing policy?

2

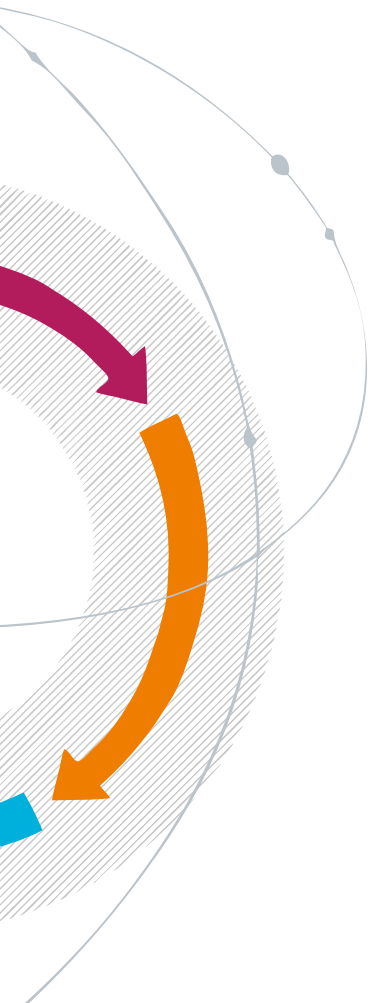
To grasp the relevance and nature of the planning process it is essential to understand whether planning is a top-down or a bottom-up exercise.

Beyond the organisational integration of different strategies and plans, it is important that sustainability issues are carefully considered, for example, impact of vulnerable groups and environmental consequences are taken into account.

Budget preparation

is usually coordinated by the MoF which initiates the process annually through the communication of a budget circular to all sector ministries. The process encompasses the following activities:

1. *Strategic (medium-term) planning:*
Expenditure and deficit targets are set on the basis of macroeconomic projections, ideally over three to five years.
This provides the building blocks of a medium-term expenditure framework, which will be briefly discussed at a later stage.
2. *Budget formulation: Managing the budget formulation process within the ministry to ensure prioritisation in the allocation of resource to the most effective programme and policy priorities, including managing the interface between MoF and Parliament; validating programme costing to promote efficiency and re-prioritisation between or within programmes and consolidating and allocating the expenditure estimates through the chart of accounts*



budget preparation

Is the organization of the budget preparation process efficient/appropriate?

1

Normative Dimension

- Are relevant issues, information and stakeholder perspectives available to decision makers in order for the budget preparation to be transparent?

Political Economy Dimension

- What is Parliament's role in the budget process?
- Has the Executive established practical and accessible mechanisms to identify the public's perspective on budget priorities?
- When does the Executive release a Pre-Budget Statement to the public?

Technical Dimension

- Is there a fixed budget calendar that makes the budget process predictable for all actors?
- Is there a well-defined process for considering new policy proposals?
- Is the budget circular communicated in a timely manner to the sector ministries?
- Does the circular provide clear guidance in terms of timeframes and sequence?

It is important that the sector ministries have the technical capacities to prepare the budget. However, it is equally important that the rules, procedures and responsibilities are clear. That is the cornerstone for good communication between the various institutions and actors.

On the normative side, sector ministry staff should allocate the often scarce resources in a development-oriented way.

2

budget preparation

Does the Ministry of Finance issue budget ceilings for sector ministries?

Normative Dimension

- Are the macroeconomic projections and revenue forecasts realistic?
- Are changes in spending ceilings compared to last year explained/made transparent?

Political Economy Dimension

- Can ministries present medium-term budget estimates before MOF/Cabinet sets ceilings?
- Once the ceilings are finalised, do sector ministries have reasonable discretion to allocate funds to programmes or to projects and line items?
- Are the ceilings communicated prior to the preparation of the sector budget submissions?
- Do sector ministries adhere to budget ceilings?

Technical Dimension

- Do ceilings cover both recurrent and capital components of the budget, reflecting total costs of projects?
- Are ceilings set for multiple years (e.g. 3 years) and are the ceilings binding or indicative?

To ensure a credible budget it is important that sector ministries try to remain within the budgetary ceilings indicated by the MOF to arrive at a realistic budget proposal. Ministries should be able to issue spending projections prior to the MOF or Cabinet fixing the budget ceilings.

budget preparation

Has results-based budgeting been introduced?

3

Normative Dimension

- Do the programmes in the budget reflect national development policy?

Political Economy Dimension

- Is the programme budget informed by the sector ministry?
- Is there a leading unit within in a sector ministry for each budget programme?

Technical Dimension

- Is there a manual for describing the design and implementation of programme budgets?

Most countries that have achieved basic control and can account for spending are in a position to introduce a basic results-orientation within the budget and accounting system through a budget classification. Budget programmes should represent policy outcome while sub-programmes should represent major activities or outputs.

4

budget preparation

Does the budget provide comprehensive coverage of all fiscal matters (revenues, fiscal transfers, donor funds)?

Normative Dimension

- Is the budget documentation available and accessible to the public to increase transparency and accountability?

Technical Dimension

- Are the assets and liabilities of parastatals and sub-national government entities that receive fiscal transfers (e.g. subsidies) clearly reflected in the budget?
- Are revenues collected by sector ministries such as user fees reflected in the budget?
- How are donor funds reflected in the budget?
- Are separate arrangements (typical of ring-fencing) made for providing aid agencies with progress reports and statements on expenditure incurred by government?

The budget documentation must cover all budgetary and extra-budgetary operations of government, as well as the activities of parastatal entities and donor funding. It should include detailed information on all public expenditures and revenues to enable an informed debate of the tradeoffs between different policy options.

Budget execution

should follow the approved budget and the budget legislation. The available funds are usually released to the responsible agencies in installments, rather than paying out the full amount at the start of the year, in order to allow for unforeseen expenditure. Whereas the individual ministries are responsible for their specific budget appropriation, it is the finance ministry's job to monitor the overall budget and to intervene if necessary. The budget funds must also be managed in such a way that all expenditure is covered. Appropriate procurement systems, underpinned by sound legislation, institutional structure and organisational capacity, ensure that the available budget funds are used cost-effectively, in line with the purpose designated by Parliament. Every financial transaction should be documented in the accounting system by the governmental or local institution that undertakes it.



1

While adjustments such as virements and shifting of funds between programmes and line item economic classes is normal, allocation of additional aggregate funds reflects poorly on the credibility of the budgeting preparation process. Sector ministries should have some discretion in shifting funds (with certain limitations such as restrictions on shifting between capital and compensation economic classes) without prior approval from MOF. Typically a threshold for this responsibility is 8-10%.

budget execution

Is there a lack of compliance in expenditure management (i.e. budget not spent according to plan)?

Normative Dimension

- Is the public and Parliament enabled to monitor budget execution through the release of timely and reliable in-year reports?

Political Economy Dimension

- Are budget adjustments above a certain threshold or adjustments that change the total amount of budget authorised via a supplementary budget approved by Parliament throughout the fiscal year and how often do in-year budget revision occur?
- Does the MOF have the authority to change allocations to sector ministries during the year in exceptional circumstances?
- What is the discretion of sector ministries to reallocate funds within or between programmes/to shift between line items or functions?
- Do unauthorised expenditures occur?

Technical Dimension

- Are authorisations to spend in line with appropriated budget?
- Is information on actual expenditure available timely and in-year for monitoring purposes so that it can provide an early warning of over- or under-spending?
- Are arrears (which typically result from over or unauthorised spending) significant in proportion to total expenditure?

budget execution

Are annual cash requirements of the sector ministry realistic and affordable?

2

Political Economy Dimension

- Are there efficiency incentives in budget execution, such as allowing agencies to carry over unused appropriations (e.g. from savings)?

Technical Dimension

- Are spending agents provided with the funds needed to implement the budget in a timely manner?
- Are collected revenues processed promptly and made available for disbursement?
- Are cash plans/cash projections in place to ensure timely and reliable cash outflows?

Government cash flow management should be as efficient as possible with timely cash disbursements to departments on at least a monthly basis.

3

budget execution

Is programme implementation and procurement generally effective and efficient?

Normative Dimension

- Are procurement processes transparent?
- Do you witness connivance of officials and/or suppliers?
- Is there a clear modern legal framework for government procurement?

Political Economy Dimension

- Does the sector ministry hold the discretion to implement programmes as appropriated in the budget or do controls carried out by the MOF interfere with programme implementation? Are roles and responsibilities for programme implementation clearly defined between the MOF, sector ministry, departments and subordinate agencies?
- Is there a central oversight agency or unit with the MOF that provides guidance on best practice and supports sector ministries through capacity building?

Technical Dimension

- Does the sector ministry experience irregularities and delays in the procurement system?
- Are procurement processes efficient and do they ensure competition, value-for-money and proper control?
- Are procurement plans used as a tool to manage the pipeline of large procurements? Are tender boards used and do they meet with sufficient regularity and are they respected?

Procurement Units within sector ministries need to have sufficient capacity to carry out their function. The Head of Procurement should be a senior manager equivalent in status to heads of other branches and Chief Finance Officer. Control and compliance are important as well as efficiency and effectiveness.

budget execution

Are the public accounts prepared on time?

4

Normative Dimension

- Are expenditure statements frequently distributed to stakeholders and do they cover total expenditures?

Technical Dimension

- Are there manuals setting out the procedures and regulations for the accounting system?
- Is there a stable standard chart of accounts?
- Does the accounting system capture appropriations (incl. increases and decreases), apportionment, spending commitments, stage of verification and payment?
- Are monthly reports on the budget execution produced throughout the fiscal year?
- Is a comprehensive mid-term review produced to identify any challenges with programme implementation?
- Is a computerised information system used to support expenditure management activities?

In terms of accounting, the main role of sector ministries is to ensure systems are in place to account for spending according to generally accepted accounting principles and to maintain internal controls to safeguard public resources.

Usually the position of Accountant-General (different from Auditor-General) will exist in the MOF and is normally responsible for setting public accounting policy.

Audit and Monitoring & Evaluation

The focus of auditing is to provide assurance that public funds have been spent for the purposes for which they were designated. A distinction can be made between internal audits – conducted within the sector ministries and external audits – conducted by Supreme Audit Institutions (SAI) and legislative oversight.

While evaluations should focus on outcomes, impact and sustainability, a monitoring system should assess the realisation of outputs and the programme process. These are important parameters to establish whether the program is delivering the assumed outputs and outcomes. Usually the ministries of finance and/or planning establish the guidance for the monitoring and evaluation system. Who conducts the monitoring and evaluation itself – sector ministries, delivering institutions or ministries of finance and/or planning depends on the particular system.



audit and monitoring & evaluation

Is the ministry subject to external audits by Supreme Audit Institutions?

1

Normative Dimension

- Are reports of the SAI made public and used for informing reform efforts?

Political Economy Dimension

- Are audit findings followed up by the sector ministries?
- Does Parliament follow up the SAI findings?

Technical Dimension

- Do audits include performance or value-for-money audits?
- Are the annual audited accounts statements prepared in a timely manner?

Regular financial audit by an independent audit institution helps to ensure value for money of public spending and to curb corruption.

Performance audits, which are a more sophisticated audit tool, can support sector ministries to improve service delivery and value for money against a specific policy target.

2

audit and monitoring & evaluation

Are there requirements for internal audit within sector ministries?

Political Economy Dimension

- Are audit queries responded to swiftly?
- When SAI issues an adverse report, is appropriate action taken?
- Does internal audit report directly to the head of the sector ministry?

Technical Dimension

- Are annual financial statements produced and do they appear shortly after the end of the fiscal year?
- Are internal audit reports accurate in recording expenditure and do they show where outcomes differ from budget estimates?

Internal audit ensures proper implementation of internal control mechanisms and is therefore essential in ensuring effective and orderly administration.

A functioning internal audit provides external audit institutions with appropriate data required for their external auditing of public funds.

In many countries AG opinions on sector ministry financial statements are widely published and Cabinet requires heads of sector ministries to develop remedial plans that are tabled in Parliament to address systemic weaknesses.

audit and monitoring & evaluation

Are results of programmes and performance monitored?

3

Normative Dimension

- Does government foster an environment that supports and demands results?

Political Economy Dimension

- Are performance targets of programmes linked to the performance management system of the organization? Are programme results data used for management purposes?

Technical Dimension

- Are performance indicators defined to measure the performance of organisations?
Is there a systematic collection, analysis and reporting of performance information to verify compliance with strategic goals and to provide a sound basis for future policy making and implementation?

The system should provide just enough information for management purposes and not so much information that the burden of collecting and managing data becomes excessive and inefficient. Also the system should not be overwhelmed but information on issues of minutiae.

4

audit and monitoring & evaluation

Does an evaluation system exist in the sector ministry to review effectiveness and efficiency of programmes against set objectives?

Normative Dimension

- Are results of evaluations published?
- Does the sector ministry foster a culture of learning?

Political Economy Dimension

- Are there incentives in the resource allocation and budgetary system for sector ministries to undertake evaluation of existing policies?

Technical Dimension

- Are client surveys routinely and frequently carried out as part of these evaluations?
- Is there a requirement that new policy proposals be accompanied by evaluation strategy?
- Are results of evaluations used for decision-making and resource allocation?

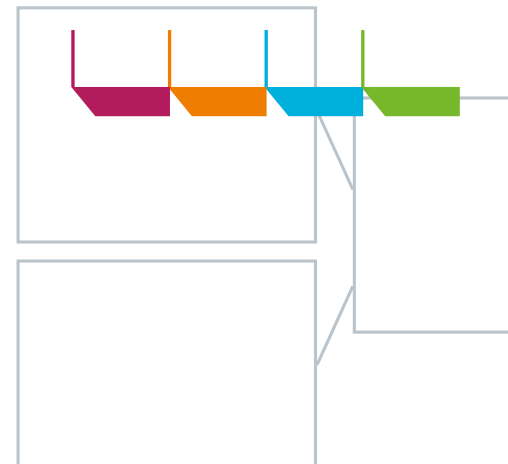
Sector ministries must ensure that the technical capacity, procedural capacity and political capacity are in place to utilize the results of evaluations for effective decision-making.

The MOF should have an expenditure review capacity that creates a demand for high-quality evaluations that can inform budget allocations.

PART 04

TOOL 2: RESULTS-CHAIN

This tool outlines some of the main effects of weak financial governance in sector ministries on public service delivery. It draws on the results-chain developed in by the World Bank's Governance and Public Sector Management Unit in the context of the Review of Indicators for the Strength of Public Management Systems (World Bank, 2013). It has been extended and modified to the particular challenges of GFG in sector ministries. The Results-Chain serves to identify the linkages between GFG and service delivery and how failures in public finance management can negatively impact on service delivery outcomes. It can be an aid in identifying key areas of intervention. At times, sector experts might notice deficiencies in service provision (e.g. the disruption of service). Read backwards (from right to left), the Results-Chain can point to some core dysfunctions in financial governance that might be the cause of such deficiencies (e.g. problems in cash flow management). To analyse the problem the Checklist (Tool 1) can be used. Conversely, by using the Checklist financial governance challenges might be detected in the sector ministry but the link between these challenges and service provision might not be that obvious. In that case, read forward (from left to right) the Results-Chain can provide a better understanding of those linkages and serve as an entry point for discussions on improving financial governance to enhance service delivery.



policy development and planning

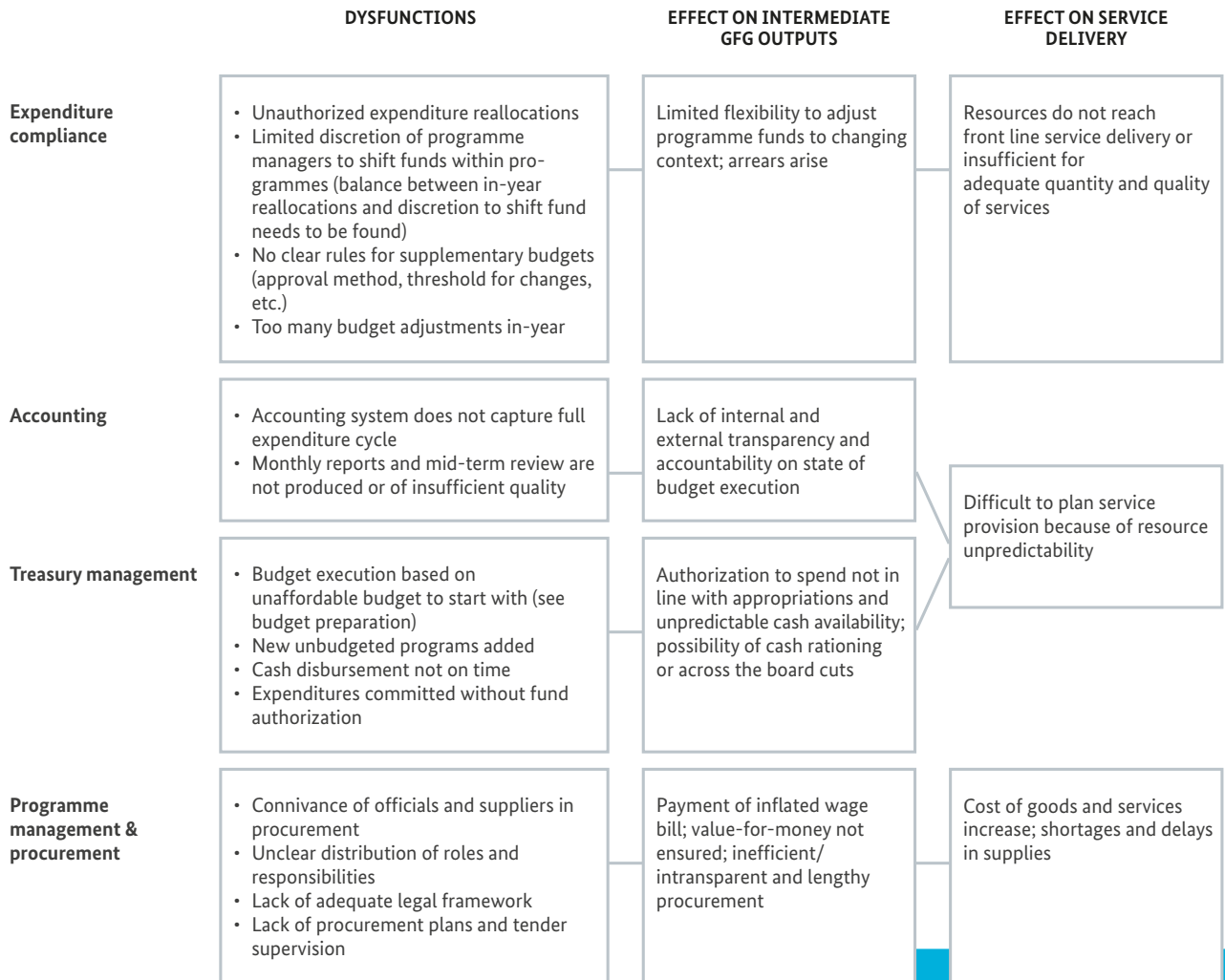
	DYSFUNCTIONS	EFFECT ON INTERMEDIATE GFG OUTPUTS	EFFECT ON SERVICE DELIVERY
Link annual planning & budgeting	<ul style="list-style-type: none"> Monitoring and evaluations results not produced on time to feed into planning process Weak link between multi-year sector strategy, annual operational plans and budgets Sector strategy not taking into account available resources 	<p>Sector budget proposals based on unrealistic resource expectations</p>	<p>Planning fatigue at sector ministries and service providers as cuts to proposed budget become unavoidable</p>
Link annual planning & budgeting	<ul style="list-style-type: none"> Unclear process, rules and responsibilities for strategic and annual planning No formal process to incorporate results in policy development and planning Room for improvement in cooperation between sector ministries, MOF and/or planning ministry, as well as local administration and service providers Limited involvement of civil society 	<p>Sectors are not well prepared to engage in budget negotiations early on; budgeting process not sufficiently informed by policy review and planning</p>	<p>Budget does not reflect sector priorities and resource needs of service providers</p>



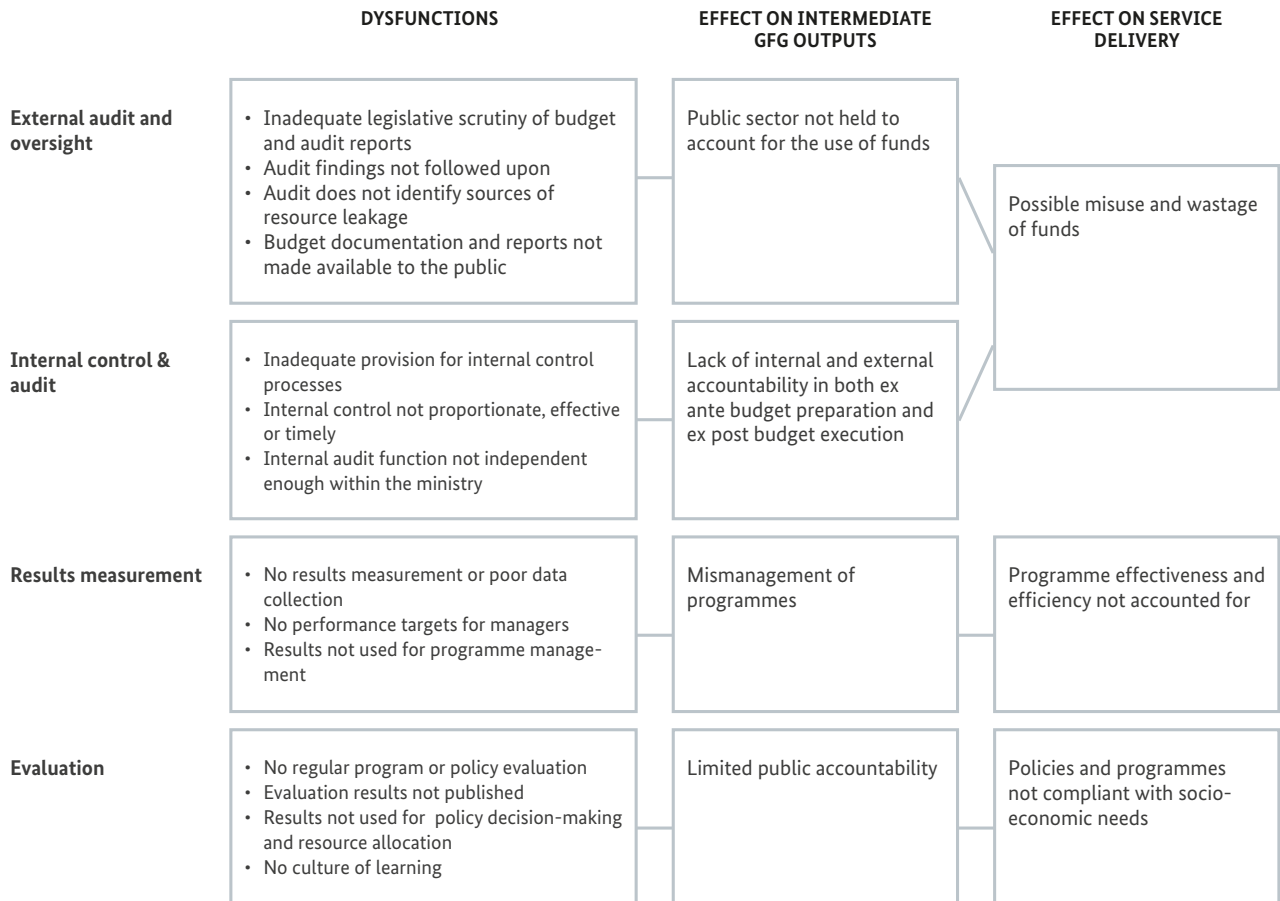
budget preparation

	DYSFUNCTIONS	EFFECT ON INTERMEDIATE GFG OUTPUTS	EFFECT ON SERVICE DELIVERY
Budget preparation process	<ul style="list-style-type: none"> • Weak communication among stakeholders & incomplete information on budget formulation process • Weak role of parliament and limited involvement of public • No fixed budget calendar • Untimely distribution of budget circular 	<p>Limited understanding of and for budget preparation and scrutiny by sector ministry staff, parliament and civil society</p>	<p>Budget allocations not in line with policy priorities; insufficient allocations for planned service</p>
Fiscal discipline	<ul style="list-style-type: none"> • Over-optimistic projections of growth and revenues • Budget ceilings set without input from ministries • Changes in ceilings not explained • Sector ministries do not adhere to ceilings • Unrealistic costing and overloaded budget 	<p>Ceilings not in line with spending needs; unrealistic fiscal aggregates; sector proposal not aligned to available resources; budget not credible</p>	<p>Annual budget appropriation is unaffordable; “arbitrary” cuts to budget become necessary affecting service provision</p>
Results-oriented budgeting	<ul style="list-style-type: none"> • Limited understanding of results-oriented budgeting • Weak involvement of sector ministries and unclear responsibilities • Budgetary programmes not well defined • No performance orientation 	<p>Budget programmes not in line with policy; weak management of budgetary programmes within the sector ministry, no performance measurement of programmes</p>	<p>Service delivery not in line with national policy; funds not efficiently used for service delivery</p>
Budget comprehensiveness	<ul style="list-style-type: none"> • Not all fiscal matters captured on budget (e.g. user fees, revenues of parastatals, donor funds) • Incomplete budget information made public 	<p>Underestimation of funds; inefficient budget allocation and possible duplication with aid programme; lack of transparency</p>	<p>Public oversight and informed debate on policy options and trade-offs hampered; risk of mismanagement of funds affecting service delivery</p>

budget execution



audit, monitoring & evaluation



ANNEX

ABBREVIATIONS:

AIMS	Aid Information Management System
AOP	Annual Operational Plan
BMZ	Federal Ministry for Economic Cooperation and Development
COCA	Central Organisation for Control and Auditing
DARD	Department of Agriculture and Rural Development (Vietnam)
GDC	German Development Cooperation
GDP	Gross Domestic Product
GFG	Good Financial Governance
GIZ	Deutsche Gesellschaft für internationale Zusammenarbeit
GOK	Government of Kenya
HSSF	Health Sector Service Fund (Kenya)
IFMIS	Integrated Financial Management Information System
IIA	Institute of Internal Auditors
ISPMS	Indicators of the Strength of Public Sector Management Systems
KEMSA	Kenya Medical Supplies Agency
MARD	Ministry of Agriculture and Rural Development (Vietnam)
MDA	Ministries, Departments and Agencies
MOF	Ministry of Finance
MOMS	Ministry of Medical Services (Kenya)
MONRE	Ministry for Natural Resources and Environment (Vietnam)
MOPHS	Ministry of Public Health and Sanitation (Kenya)
MTEF	Medium-Term Expenditure Framework
NA	National Assembly
NHIF	National Health Insurance Fund (Kenya)
ODA	Official Development Assistance
OECD	Organisation for Economic Cooperation and Development
PBB	Programme-based budget
PBO	Parliamentary Budget Office
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PFM	Public Financial Management
PRSP	Poverty Reduction Strategy Paper
SAI	Supreme Audit Institution
SEDP	Socio-Economic Development Plan (Vietnam)
TSA	Treasury Single Accounts
VNFOREST	Vietnam Administration of Forestry

GLOSSARY

Accountability: Accountability requires that actions and decisions taken by public officials be subject to oversight.

Accounting: Accounting is the practice of recording, classifying and summarising financial transactions. It is a means of assuring compliance with budget rules and demonstrating that public funds are being used for their intended purposes (ODI Handbook).

Accrual Accounting: Accrual accounting records revenues and expenditures once they are incurred. It is not relevant whether these revenues have already been received (i.e. appear on a government bank account) or whether expenditures have been paid. Accrual accounting covers assets and liabilities.

AIMS (Aid Information Management System): Database that records aid commitments, disbursements and activities.

Asset: Assets are what an organisation owns or is owed (cash, accounts receivable, equipment, notes receivable, buildings, inventory, and bonds).

Audit: The purpose of auditing is to provide assurance that public funds have been spent for the purposes for which they were designed. A distinction can be made between internal and external audits.

Audit (external): External audit is the process whereby an independent institution audits evidence regarding different aspects of an entity, and forms an opinion about the extent to which these aspects conform to set standards.

Audit (internal): The purpose of internal audit is to improve the ministries' operations by reviewing accounting, financial, risk management and governance processes.

Budget: A government's forecast of revenue and planned expenditure is laid out in its budget, usually produced on an annual basis. The budget is enacted into law by the legislature, which authorises the government to spend funds in accordance with a set of appropriations. Usually, a collection of PFM laws and regulations further regulate how the approved budget should be executed (ODI Handbook).

Budget Circular or Call: The Budget Circular stipulates the guidelines for the formulation of the annual budget by the various ministries and government entities. It usually includes the initial budget ceilings, budget formats to be submitted to the MOF and the budget calendar (see below).

Budget Calendar: Indicates the dates in the process of preparing and approving the national budget. These usually include (but this can vary according to country) the period for discussing budget estimates with the ministries and departments, the date the executive budget has to be submitted to Parliament, the parliamentary review process and the final budget approval session.

Capital budget and/or expenditure (or development budget): Capital budget and/or expenditure covers the costs related to public investments, such as the construction of roads.

Controller of Budget: The Controller of Budget is an independent office established with the Kenyan Constitution, that oversees the implementation of the national and county budgets and can authorise withdrawals from public funds. It reports to Parliament on the implementation of the budgets on a regular basis.

Dual budgeting: Dual budgeting implies that there are two separate processes for preparing the capital (or development) budget and the recurrent budget.

Good Financial Governance: GFG is the transparent, legitimate and development-oriented state action in the area of public finance, on the income and expenditure side, and implies efficient and accountable state institutions and financial administration that operate within the rule of law and efficient control institutions as well as politically and socially anchored oversight mechanisms.

Incremental budgeting: Incremental Budgeting uses a budget prepared using a previous period's budget or actual performance as a base, with incremental amounts added for the new budget period.

IFMIS (Integrated Financial Management Information System): An IFMIS is an information system that tracks financial transactions and summarises financial information.

Liability: Liabilities are the debts of the organisation or what is owed.

MTEF (Medium-Term Expenditure Framework): MTEFs translate macrofiscal objectives and constraints into broad budget aggregates and detailed expenditure priorities. An MTEF requires budget preparation to go beyond the annual budget, to take account of the medium term.

Parliamentary Budget Committee: Most parliaments (except the UK and some former colonies) have a parliamentary budget committee which scrutinises the executive budget proposal. In some countries it may be tasked to review audit reports (in other cases this might be the task of the Public Accounts Committee).

Parliamentary Budget Office: The Parliamentary Budget Office is an oversight body which provides independent non-partisan analysis to Parliament of fiscal policy and the financial implications of proposals. The most comprehensive and independent budget office can be found in the US (Congressional Budget Office). It prepares its own economic and budgetary forecasts and re-estimates the costs of the president's budget, as well as any proposal by congressional officials.

Performance-based budget: Performance-based budgets are a form of results-oriented budgeting. Performance-based budgeting refers to scenarios where performance indicators are formulated for the budget, and decisions related to the use of funds are made dependent on the degree to which these indicators are fulfilled.

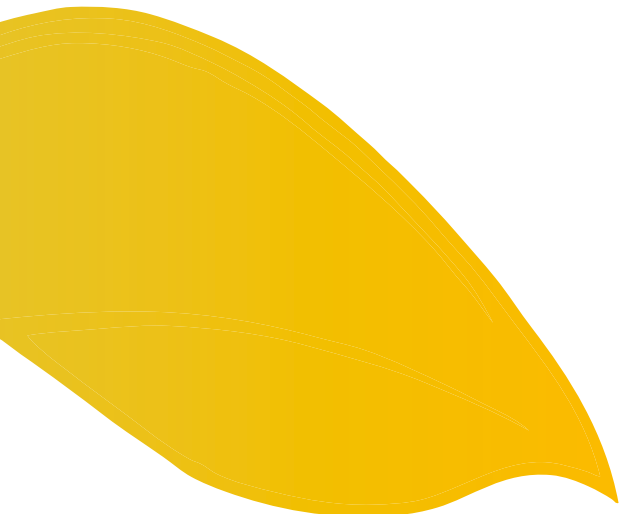
Programme-based budget: Programme-based budgets are a form of results-oriented budgeting. They essentially systematically group individual input items into budget programmes and, where appropriate, formulate indicators for outputs and outcomes (i.e. results).

Recurrent budget and/or expenditures: The recurrent budget and/or expenditures cover the recurrent costs, such as personnel or maintenance costs.

Results-Oriented Budgeting: The results-oriented budgeting concept is the introduction of results-orientation in the preparation and execution of the government's budgets. It aims to link the planning and budgeting processes more closely, by reflecting public policy priorities and targets in budgets.

Treasury Single Account: Unified structure of government bank accounts enabling consolidation and optimum utilisation of government cash resources (IMF, 2011).

Zero-based budgeting: In a "pure" ZBB system, a 1970s era reform, instead of concentrating on budgetary changes at the margin, all programmes are evaluated each year. The process of arriving at a budget is literally to start from scratch (Public Expenditure Management Handbook, World Bank).



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