

Public Financial Management and the PFM International Architecture – A Whole System Approach

**CONSULTATION DRAFT
31 JULY 2009**

REQUEST FOR COMMENTS

CIPFA welcomes comments on the proposals and issues addressed in this Consultation Paper. Please submit your comments, preferably by e-mail, so that they will be received by 30 November 2009. All comments may be considered a matter of public record. Comments should be addressed to:

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Foreword

Over recent years there has been a growing consensus about the importance of public financial management (PFM) for both developed and developing economies. Not surprisingly there has also been a parallel debate about the detailed definition of PFM, its principal components and the levers by which it can be successfully improved and developed.

CIPFA has developed its thinking about a whole system approach to PFM as a contribution to the international debate and with a view to assisting the improvement of PFM and public service delivery across the world. Our work has been carried out with the assistance of funding from DFID, the UK's Department for International Development, for which we are extremely grateful.

Whatever the level of development or economic circumstances in a country, citizens will rightly keep raising the bar with regard to their expectations about public service delivery. As pressures on national budgets increase and additional demands are made by the global financial crisis, there is unprecedented need to better understand the components of PFM and how the full set of institutions and processes relate to each other. We believe that only by taking a holistic view and highlighting special characteristics of the public sphere, will we be able to properly focus thinking on how to better leverage improved service delivery, transparency and accountability, and where to prioritise efforts. Governments are under pressure to respond and CIPFA takes very seriously its role in leading new thinking and developing practical solutions with our partners in the public services.

This paper builds on the concepts developed in CIPFA's ground-breaking Financial Management Model now widely used as a PFM assessment and performance improvement tool in the United Kingdom. It provides a strategic definition and whole system context that includes the international sponsors and enabling framework within which PFM underpins the delivery of public services and helps achieve sustainable social outcomes. The focus on PFM and the service delivery chain is deliberate and overt: our thinking is not narrowly focused on the fiscal or macro-economic attributes of PFM, budgeting or accountancy.

One of the most important facets of the paper is the delineation of the whole system of PFM processes notable for the inclusion of the 'learning and growing' element. This aspect of PFM has tended to be overlooked or only partially addressed in international development programmes. However, a number of international sponsors now recognise the importance of professionalisation, its key role in developing self sustaining approaches and the benefit of developing public sector professionals at the heart of the PFM international architecture.

At the July 2009 International Federation of Accountants (IFAC) G20 Summit in London, the World Bank highlighted the urgent need to develop and strengthen the profession in developing and emerging economies as a key step in achieving financial stability. This paper provides a framework upon which to build that thinking, based on practical experiences and tested methodologies.

The intention of the mapping of the global, regional and national PFM bodies is to assist all interested parties in avoiding duplication of effort, waste of resources and placing undue burdens on partner governments. These aims are in line with the 2005 Paris Declaration on Aid Effectiveness that emphasises the use of country systems, something CIPFA strongly endorses and actively supports.

We thank DFID for its support of this work under our Accountable Grant Agreement.

This consultation draft has been prepared to facilitate comments and contributions from the widest international community of practice in public financial management. We hope you will find it stimulating, useful and worthy of response. We look forward to hearing from you.

Roger Latham

President

Steve Freer

Chief Executive

Executive Summary

Purpose of the paper

- S1 CIPFA believes that using public money well can make a significant improvement to the lives of people everywhere. In the international context it can change the lives of very poor people. This paper is about Public Financial Management (PFM): driving the performance of public services across the world through the effective and efficient use of public money.
- S2 This paper has two important purposes. The first is to propose a universal definition of PFM and to describe the model system of processes that enable it to function, together with a supportive institutional and social context. The second purpose applies that system to the existing pattern of PFM institutions and their regional distribution, and considers the implications and requirements for strengthening financial management systems in developing countries through aid programmes. This second objective also forms part of a much wider debate about strengthening developing country systems for reducing poverty.
- S3 Financial management is only one of the factors that make for success in public sector expenditure programmes. It sits alongside other contextual aspects, such as leadership, transparency and accountability, levels of resources and staff capacity, and is influenced by many aspects of the social, political and economic environment. However CIPFA believes that good financial management generates vital information for better decision making, better services, and better value for money if resources are managed and controlled transparently and effectively. So PFM is worth doing well.
- S4 The paper describes CIPFA's whole system approach to financial management in the public sector context and draws out 'hypotheses' about its performance in the international development context. This consultation draft has been prepared to facilitate comments and contributions on the definition of Public Financial Management and its elements and components; the descriptions of the international PFM institutions; the hypotheses about PFM's effectiveness in the development context and other issues that can be raised in seeking to better leverage the contribution that PFM can make to improving public services at country level.
- S5 Throughout the paper a series of charts summarise or illustrate the arguments. It is recommended that these are viewed when reading this summary.

Chapter 1: Introduction

- S6 It is widely understood that sound PFM is fundamental to achieving development objectives and reducing poverty. It enables aid funds to be managed and spent efficiently and with integrity and it helps to give donors necessary confidence against their own fiduciary risk. It is a lever to broader country development, to raising revenues effectively, planning and executing budget decisions reliably and transparently, and to building trust for donors and investors. The recognition that development should be led by countries if it is to have lasting transformative impact requires greater international reliance on country PFM systems.

S7 Understanding and analysing the whole system picture of the PFM international architecture should facilitate better designed support for the development of country systems, targeting interventions at the appropriate level in the architecture and allowing donors collectively to allocate resources more efficiently. Strengthening country systems and the capacity to operate them should encourage the use of country systems.

S8 This paper therefore proposes a new whole system model of the PFM international architecture. Its purpose is:

- to gain agreement on the essential processes, institutions and enablers in the PFM architecture that influence effective financial management in the public sector, and provide a basis for joint action
- to stimulate analysis of the architecture's performance, identifying significant gaps, duplications, weaknesses and barriers, and imbalances across the system
- to support the international development community, especially country partners in improving the functioning and legacy impact of aid initiatives, to the benefit of poor people.

S9 In pursuit of these aims, the paper sets out for consultation:

- a new definition of Public Financial Management
- a description of a Whole System Approach to PFM
- a model of the PFM process architecture, with a description of the elements and components that contribute to the whole system operating successfully, including its execution and its checks and balances
- a model of the institutional framework of the PFM International Architecture, the key bodies that currently operate at global, regional and national level
- maps of the current regional architecture: showing the institutions in each geographic region
- initial analysis and findings, by applying these architectures as conceptual tools to identify gaps in the overall system, with comments on possible implications for reform programmes and donor activity.

Chapter 2: Public Financial Management – A Definition

S10 Although PFM has been regarded as essential to effective development programmes there has been no clear definition of what it is. In the development community it is often defined in terms of stages of the budget cycle. CIPFA proposes a definition that parallels the world of corporate governance, emphasises system implications and stresses the outcome focus of PFM.

'Public financial management is the system by which the financial aspects of the public services' business are directed, controlled and influenced, to support the delivery of the sector's goals.'

S11 The P in PFM draws attention to the features that are distinctive about financial management in the public sector, particularly the heightened expectations of transparency and accountability, the constrained resources in the face of demand levels that are not primarily controlled by price, and the political environment. Resolving competing demands for resources is a value driven process rather than a technocratic solution. There is also a set of

processes that are specific to the public sector, such as tax administration. Financial management in the public sector is qualitatively different from its private sector counterpart, even though there are some common professional standards and techniques. Financial management is much more than accounting.

- S12 There are currently different interpretations of the boundaries of PFM, for instance in relation to procurement processes or other resource strategies. CIPFA's model is based on the principle of including only processes that are part of the checks and balances of a whole public finance system and which operate directly on public finances. For example financial risk management is included, but risk management itself is recognised as a wider topic.

Chapter 3: CIPFA's Whole System Approach

- S13 CIPFA's process model for PFM sits within a social, political and economic context that includes institutions, enablers and a governance framework. That context, including other factors such as macro-economic stability and cultural norms condition its effectiveness. PFM is also closely related to the sphere of effective public management more generally, including leadership, performance management, transparency and accountability; and to cross cutting themes such as sustainability, efficiency and ethical standards.
- S14 The whole system approach of this paper is based on a proposed model set of processes that, acting together, can gear up PFM effectiveness. Single improvements can generate progress but this may be limited if there are no mechanisms to optimise total output rather than the performance of individual PFM elements.

Chapter 4: The PFM Process Architecture

- S15 The proposed model of financial management processes again stresses the whole system perspective with its processes for operations, monitoring, balancing and regulating, its formal and informal feedback systems for learning and adapting and its generative processes for growth. Understanding the whole system picture can suggest areas of leverage in developing and sustaining good practice over the longer term and can identify gaps or imbalances in the system, assisting with the important issue of prioritising PFM improvements.
- S16 The proposed model system of processes is described in progressive levels of detail:
- PFM Elements: a grouping of PFM components each of which performs a different function in the PFM architecture
 - PFM Components: encapsulating the high level processes that actualize each element, and that are illustrated on a one page chart
 - PFM Descriptors: a brief description of each of the processes and the role it plays in the broader system.
- S17 The individual processes are grouped under the following elements:
- Legislation and Regulation: the mandatory requirements and powers for public financial management

- Standards and Codes: established principles or rules that govern the actions or behaviour of a group of like professionals or organisations to common standards
- Execution - Strategy and Planning: the activities that set the direction for financial management
- Execution - Operations: the principal financial operations that need to be carried out in order to deliver services and achieve the desired results
- Execution - Monitoring and Control: a cluster of processes designed to maintain the organisation on track to realise its objectives, to limit risk and to prompt corrective action if forecast results deviate from plans
- Assurance: independent formal processes to give assurance to stakeholders about a body's standards and effectiveness
- Scrutiny: scrutiny processes, outside executive responsibility, can oversee, influence or challenge the allocation of resources and the administration of public sector finances. They create a demand for transparency and accountability that can build pressure for a more open, honest and effective public sector
- Learning and Growing: a theme that infuses professionalisation into all other PFM elements, learning and growing processes enable public service organisations, individually and collectively, to reflect and learn from best practice, from partners and peers, and from their own experiences, in order to develop their knowledge and capabilities. Public service organisations also need to draw inspiration through involving service users.

S18 The development community is concerned that its efforts to improve public financial management have not had a clear effect on the quality of public services. Applying 'whole system' analysis, CIPFA argues that greater consideration could be given to directing reforms at the elements of PFM that exercise greatest leverage on service outcomes and public benefit. Reforms can target those PFM elements and components that have most direct impact on services, such as integrating policy and financial planning, budget management, expertise for finance staff in financial analysis and information for decision making and addressing corruption. Some reforms such as developing audit and accounting expertise are critical but take longer to demonstrate impact.

S19 Finance staff do not have control of large operational budgets and do not have responsibility for delivering services, so reforms that focus on finance staff will be successful only if their skills are directed to supporting managers who do deliver services. Designing reform with the explicit intention of improving services should start with the outcome – more effective services - and work backwards through the process chain, considering all the processes that add most value to the end result. CIPFA argues that relatively little attention has been paid to this kind of methodology. Nor has there been sufficient attention to financial literacy for service managers and to financial management skills for organisations within countries that have significant spending responsibilities, such as line ministries and local authorities. On the contrary, donors' justifiable concerns with their fiduciary risk – that aid will not be used as intended – often leads them to stress compliance and control aspects of PFM at the expense of resource management and other aspects of the system that focus on its sustainability.

S20 Without a whole system perspective reforms may also not be focused on the wider or longer term consequences of projects, for example the maintenance requirements physical investment. As a PFM technique, whole life cost

assessment may not seem to be one of the first generation PFM reforms, but in fact its relevance appears early in many development programmes.

S21 CIPFA further argues that a lack of technical understanding of what PFM involves and how it connects to service delivery undermines donor strategies for improving development effectiveness and its legacy impact. Without that technical understanding of key linkages, reforms risk proceeding with limited impact. Professionalisation and other related components of the 'Learning and Growing' element have been under supported, and the challenge of weak capacity at country level not appropriately addressed. Reforms are at risk therefore of underperforming in terms of speed, effectiveness, quality and sustainability.

Chapter 5: The PFM International Architecture: Institutional Framework

S22 The institutional architecture is modelled, representing the structure of agencies and organisations that are involved directly in promulgating, operating, developing and overseeing PFM standards and practices. The institutional PFM system is described through:

- Levels: that distinguish the reach of the institution - international, regional, national and sub-national
- Types: distinguished by principal function.

S23 CIPFA proposes a broad taxonomy of institutions as a basis for understanding and analysing the existing state of the PFM architecture. This covers funding institutions such as Development Banks, international standard setting institutions, regional umbrella bodies set up to promote the accountancy and audit professions, associations of peers, training providers and country level organisations, such as the Ministry of Finance and accountancy bodies that award professional qualifications.

S24 Applying the whole system perspective to existing institutional arrangements, CIPFA proposes a number of hypotheses that it believes should improve the effectiveness of donor strategies and PFM interventions:

- that sub national PFM capability, close to service delivery points, needs to complement country level PFM reform, to create a sustainable legacy
- that creating a ground up capability calls for a programme of professionalisation that encourages its members to pursue excellence in public financial management and equips them with the skills and tools to do so
- that donors could overcome the difficulty of trying to engage with multifarious sub regional organisations, through a programme of professionalisation for practitioners involved with service delivery within countries. This would encourage them to take responsibility for PFM leadership locally and would also help to embed PFM reforms in a more sustainable way. A supportive environment that recognises and uses personal development is a necessary adjunct for this to be successful
- that financial accounting and auditing interests, often with private sector backgrounds, are prevalent in the institutional architecture. This should be balanced by institutional support for financial management expertise in the context of the particular challenges for public services
- that the drive to global convergence of accounting standards should recognise the gulf between the technical sophistication of those engaged in setting international accounting and auditing standards and the fragile

capacity of some countries expected to implement them. These relative imbalances need to be taken into account in donors' expectations, and the path to compliance must be well supported

- that the donor community should be cautious of relying over much on organisations that have been set up to regulate standards for a primarily private sector accountancy profession, for the promotion of public financial management in countries.

Chapter 6: The Regional Mapping

S25 The paper maps the existing institutions in each of the major geographical regions, as the basis for development partners to consider how best to target and route PFM reform projects.

S26 It is clear that this architecture grows out of a long history but not out of system logic; the proliferation of bodies says nothing about quality and institutional specialisation tends to fragment PFM topics rather than to pull them together. It is also striking how much capacity is absorbed in an institutional superstructure that sits above the front line country initiatives, and the general paucity of institutions dedicated to PFM as opposed to accountancy with a private sector focus. To add value for PFM, it must be well used by the international development community, and gaps in its effectiveness identified and addressed so that it can support rather than strain resources importantly needed for national service priorities.

S27 CIPFA believes that mapping and analysing the regional architecture can inform donors' decisions and hence the effectiveness of aid, by assisting technical understanding of the structure, purpose and role of the PFM architecture. It can help them to decide the right institution in terms of function and position to meet their purposes, and to counter the risk that donors may bypass existing organisations because they are unaware of their existence or role. It helps to surface issues about the completeness of the arrangements in each region to support PFM and suggests where gaps may need to be addressed. It opens up discussion about what functions are best performed at regional level and which at country or sub national level. A striking feature of the maps is the general paucity of institutions dedicated to PFM as opposed to accountancy with a private sector focus.

Chapter 7: Request for Comments

S28 CIPFA wishes to test the concepts it has developed in this paper and to seek views about the hypotheses it has drawn from examining the whole system of Public Financial Management. It also seeks views from others working in this field about the issues that they identify, using this perspective. CIPFA welcomes general feedback and also responses on a set of specific questions brought together in the final chapter of the paper.

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1 Introduction

- 1.1 Public Financial Management (PFM) is about ensuring that public money is used well, and is made to stretch as far as possible. It provides leaders and managers with information to make decisions and to know if they are using resources effectively. Managing finances in the public sector is about much more than accountancy – it is an integral part of bringing services to people.
- 1.2 The relevance of this message is clear for the UK and the developed world. Its importance can be even sharper in the developing world. Much thinking about PFM and its significance for improving service delivery has taken place in the international development arena. DFID (the UK Department for International Development) has provided strategic funding to support production of this paper, together with a catalogue of some 700 PFM institutions around the world. The purpose of DFID's funding was to support CIPFA in analysing and contributing to the strengthening of the PFM International Architecture, in the interest of improving PFM and PFM reforms at country level. Throughout the text therefore, there is a significant focus on the international development community and on less developed country circumstances. The resultant enhanced version of the CIPFA Whole System Approach brings together the PFM perspectives of both developed and developing countries.
- 1.3 It is now widely understood that sound PFM is fundamental to achieving development objectives and reducing poverty. It enables aid funds to be managed and spent efficiently and with integrity and it helps to give donors necessary confidence against their own fiduciary risk. It is a lever to broader country development, to raising revenues effectively, planning and executing budget decisions reliably and to building trust for donors and investors.
- 1.4 The recognition that development should be led by countries if it is to have lasting transformative impact implies greater international reliance on country PFM systems.

“Effective financial management of public resources is essential to achieve the objectives of development programmes. It also promotes accountability within developing countries and provides donors with assurance on the use of their funds. Good financial management systems in partner countries are required for all forms of aid, but are particularly important for budget support, where donor funds are not allocated to finance specific expenditures”.

- 1.5 At a time of global economic turbulence, when the need for aid is as great if not greater than ever, there is also a risk that donors may become more inward looking. Against that background, attention focuses on the factors that enable every cent to make a difference, and this is reflected in current work to strengthen the impact of the 2005 Paris Declaration on Aid Effectiveness and to test how PFM reform can uplift government results. This paper seeks to contribute to current programmes of work, for example through the new OECD PFM Task Force, by setting out a whole system approach to Public

¹ OECD/DAC Guidelines *Harmonizing Donor Practices for Effective Aid Delivery* (2003)

Financial Management that can be used to test, formulate and improve PFM design and strengthen interventions.

- 1.6 Good financial management is not enough by itself for success in delivering results for public services. It sits in a wider global context of governance and accountability, consultation and citizen involvement, performance management and leadership. It will be influenced by its social context, cultural norms and political environment. However without effective financial management, services cannot deliver good value for citizens.
- 1.7 CIPFA's whole system approach aims to provide a better definition and understanding of PFM, based on the definition which underpins CIPFA's Financial Management Model developed in 2004. It seeks to represent in a holistic model the processes that need to work together within the PFM International Architecture, for development aid to lead to lasting results and to depict the institutional players whose responsibility is to bring this about. It is concerned not only with the relationship between countries and international funding institutions, but with building the ground-up infrastructure that will help to sustain development even after individual projects come to an end.
- 1.8 The effectiveness of the PFM system in any country depends on a network of interlocking processes, within a framework of institutions at global, regional, national and sub-national level. The quality of PFM depends on how well the individual institutions work, the quality of inputs provided to the system, the feedback and control mechanisms that ensure a focus on objectives, and on how well the system functions as a whole. It is influenced by factors such as culture, people skills, the political economy, leadership, environmental and systems related issues.
- 1.9 A PFM reform programme based on individual or uncoordinated initiatives risks underperforming since there may be no process to assess interactions or optimise total results across the whole PFM system. Some examples of sub optimal outcomes can be illustrated by reference to weakness in the process or the institutional architectures:
- assessing the performance of individual PFM components rather than optimising the outputs of the whole system
 - individual institutions underperforming: for example, local training providers may be lacking in technical skills or in other resources to play their role, leading to inadequate training that leaves no lasting impact
 - absence of some institutions e.g. accountancy bodies, in certain countries, or where present they may represent only the private sector
 - insufficient coordination and knowledge sharing, particularly at regional and country levels, that fails to lever the benefit of development inputs
 - absence of a region-wide perspective, leading to fragmented and uncoordinated solutions by individual countries.
- 1.10 Understanding the whole system picture of the PFM international architecture should bring a range of benefits, enabling participants to be involved in a planned and systematic way, supporting the use of country systems, and informing the design and prioritisation of donor support and development programmes. It should allow donors collectively to allocate resources more efficiently and to support countries more effectively.

- 1.11 This paper proposes a new whole system approach, with a modelling and analysis of the PFM international architecture. Its purpose is:
- to gain consensus amongst key stakeholders of the whole system picture – the essential elements, components, processes, institutions and enablers of the PFM international architecture that influence the effectiveness of financial management in the public sector, that can be a basis for joint action
 - to stimulate analysis of the performance of the architecture, identifying significant gaps, duplications, weaknesses and barriers, and imbalances across the system
 - to support the sector in identifying and designing initiatives that improve its functioning and legacy impact, to the benefit of poor people.
- 1.12 In pursuit of these aims, this paper sets out for consultation:
- a better definition and understanding of PFM that goes beyond the existing tendency in the development community to focus on aspects of the budget cycle, to embrace the whole system whereby financial management contributes to successful conduct of the public sector's business
 - a proposed model of the PFM Process Architecture, with a description of the elements and components that contribute to the whole system operating successfully, including its execution and its checks and balances. It also draws attention to the distinctive aspects of financial management in the public sphere
 - a model of the existing Institutional Framework of the PFM International Architecture: the key bodies that operate at global, regional, country and sub-national level
 - maps of the principal existing institutions in the Regional Architecture. (700 PFM Institutions have been catalogued).
 - comments on some initial issues that arise from applying the proposed models as tools to identify gaps in the overall system, and comments on possible implications for the development community and practitioners.
- 1.13 Through this open consultation, CIPFA is seeking a wider dialogue to test and refine the concepts, and to build a greater understanding of the issues that arise. We are seeking to validate the approach and models, while recognising that models involve a degree of simplification, and will not fit perfectly against the huge variability world-wide.
- 1.14 CIPFA has been supported in this work by DFID, based on a shared conviction that strengthening the PFM architecture contributes to effective development, and ultimately, to reducing poverty. The methodology draws on desk top research and experience in the field to chart the PFM system, and on helpful discussion with CIPFA's International Strategy Board, DFID, the World Bank and groups of accountants based in developing countries. CIPFA now wishes to test the issues and proposals in a broader arena.
- 1.15 It is easy for a PFM model to appear technocratic, when what is really important about money is what it buys. It is also easy for dialogue to remain in a closed specialist world, when the role of professionals in PFM should be as much about leadership as technical expertise. Focusing on financial processes can obscure the fact that it is service ministries and sub national organisations of varying autonomy that actually spend the money and for partners in

international aid, it is poor people who should benefit. The PFM descriptors used in the model try to maintain a sense of that presence: the people struggling to administer aid programmes in difficult environments and the people in poverty who need help.

- 1.16 International PFM concerns are at the heart of this paper, particularly the contribution financial management can make to good services and how an understanding of the PFM system can gear up effectiveness. However it also speculates on the application of the process architecture to design and model systems of financial management in new areas or where systems have broken down. It is also very relevant during 2009's economic disturbance which is prompting numerous governments to put public money into private sector financial institutions, bringing them into an unfamiliar and demanding institutional space. With that have come new demands for accountability, regulation, ethical codes of behaviour, operational priorities, public scrutiny and assurance. Welcome to PFM.

2 Public Financial Management – A Definition

What is Public Financial Management?

2.1 The foreword to the report on the use of country systems prepared for the Accra Forum in July 2008 by the Joint Venture (JV) on Public Financial Management², begins: "The development community has long understood that a robust public financial management (PFM) system is vital to a country's development efforts and to the effectiveness of the aid funds that support those efforts". The World Bank agrees that "A good PFM reform plan shows that interventions in processes interact to achieve final goals".³ And yet the concept of PFM, what is included in it and what is outside, is far from clearly defined. The Paris Declaration lists it merely as one of the elements of the financial infrastructure, separate from audit and accounting⁴: Its edges are fuzzy – is procurement in or out?⁵ The JV calls PFM multidimensional – and liable to differ between countries.

2.2 The JV offers a definition to take the discussion forward:

"Although the exact definition of Public Financial Management (PFM) may differ from donor to donor and from one partner country to another, PFM, as generally understood, includes all components of a country's budget process – both upstream (including strategic planning, medium term expenditure framework, annual budgeting) and downstream (including revenue management, procurement, control, accounting, reporting, monitoring and evaluation, audit and oversight). Sound PFM supports aggregate control, prioritization, accountability and efficiency in the management of public resources and delivery of services, which are critical to the achievement of public policy objectives such as the MDGs." ⁶

2.3 The term PFM has therefore come to mean a cluster of core financial activities. The World Bank too describes PFM in terms of its component parts:

"For countries, financial management refers to the budgeting, accounting, internal control, funds flow, financial reporting, and

² Report on the Use of Country Systems: report of the Joint Venture on Public Finance Management (JV on PFM) to the Accra High Level Forum on Aid Effectiveness July 2008

³ Background and Summary of an Integrated PFM Model

http://www.siteresources.worldbank.org/INTPRSI/Resources/383606-1119904390686/bbl121905_background.pdf

⁴ "Country systems and procedures typically include, but are not restricted to, national arrangements and procedures for public financial management, accounting, auditing, procurement, results frameworks and monitoring." (Paris Declaration 2005, Paragraph 17)

⁵ The differing interpretations are acknowledged in Report on the Use of Country Systems: report of the Joint Venture on Public Finance Management (JV on PFM) to the Accra High Level Forum on Aid Effectiveness July 2008 chapter 1.

⁶ Ibid P10

auditing arrangements by which they receive funds, allocate them and record their use.”⁷

2.4 And other definitions tend to cluster around the budget as the central theme.⁸ PFM has perhaps become most potently described by the content of the PEFA assessment, which relates principally to central government.

2.5 For many purposes, this diversity of approach to definition may be satisfactory. It enables a direct engagement with individual countries on a collaborative basis. But it does need care to avoid misunderstandings about what it means to use a country's PFM system⁹. It tends to underplay the importance of knowledge transfer and learning from the stock of existing experience, rather than repeating the mistakes inevitable in a learning by doing process. Professionalisation and the Learning and Growing element of CIPFA's PFM definition is the subject of a separate CIPFA paper. The current international development approach runs the risk that what gets measured gets done and that operational effort at country level is targeted on moving up the PEFA ladder rather than on outcomes and changing people's lives. It risks privileging technical expertise when leadership and practical financial management is much needed from financial practitioners in an increasingly decentralised donor approach.

2.6 CIPFA's definition for PFM is therefore deliberately broader. It explicitly parallels the world of corporate governance, and emphasises the importance of the interactions between system components in creating a legacy.

“Public financial management is the system by which the financial aspects of the public services' business are directed, controlled and influenced, to support the delivery of the sector's goals.”

2.7 This definition focuses on financial management for a purpose that is explicitly oriented towards the public service. It also embraces the point that PFM is about more than control, probity and compliance. It is also directed to supporting resource management and value for money, and to enabling the sector to progress and adapt to new challenges.

⁷ World Bank Home/Projects/Financial Management <http://go.worldbank.org/OHI4ODL60>

⁸ For example, [IMF Survey: Low-Income Countries Need Upgrades](http://www.imf.org/external/pubs/ft/survey/so/2007/POL0720A.htm) Richard Allen and Duncan Last IMF Fiscal Affairs Department July 19, 2007 *“Public financial management comprises the institutional framework, systems, and procedures that govern the preparation, execution, and reporting of the budget.”* <http://www.imf.org/external/pubs/ft/survey/so/2007/POL0720A.htm>.

See also *“Public Financial Management includes all phases of the budget cycle, including the preparation of the budget, internal control and audit, procurement, monitoring and reporting arrangements, and external audit.”* Harmonizing Donor Practices for Effective Aid Delivery – Good Practice Papers –A DAC Reference Document, OECD, 2003, quoted in Public Expenditure Working Group, Strengthened Approach to Public Financial Management Reform, World Bank, 2008

⁹ “Only a few donors have adopted a definition of the use of country PFM systems and these definitions tend to differ.” Report on the Use of Country Systems in Public Financial Management – Joint Venture on Public Financial Management, July 2008 P37

The P in PFM

2.8 Although PFM has many features in common with other FM environments it has its own distinctive concerns:

- a taxpayer relationship with citizens and customers, rather than one defined principally by consumer interests and choice. This relationship calls for high standards of governance, probity, sound financial administration, stewardship of public resources and overt compliance with regulatory standards
- a heightened expectation of integrity, transparency and accountability to the public
- a culture of cost centres rather than profit centres. Efficiency and value for money drivers may need to be internally generated, rather than result from market forces
- inelastic resources – there is competition for resources between service demands that can always consume more funds, and that may be beyond direct control, such as demographic change. Funding envelopes may be determined independently of expenditure pressures, or the relationship may be inverse, for example when a recession increases demand whilst reducing tax base and income sources
- dependency on external funding sources of variable reliability, that can create instability in planning and implementing expenditure programmes
- management of demand levels that are constrained not by price, but by other techniques, that may involve difficult choices like queuing and rationing
- a political environment that imposes pressures and risks that may be calibrated differently from business risks. For example, the risks of ceasing a service feel much greater for a politically driven organisation. Electoral timetables can influence the timing of decisions. Prioritisation and resolution of the competing demands for resources is essentially a 'political' and value driven process rather than a technocratic solution
- there is an endemic risk that policy and financial planning take place independently
- service delivery may take place in a system of devolved financial responsibility, that increases the complexity and risks to understanding financial implications
- a balance to be continuously negotiated between the objectives of funders, whether government or external donors, and more locally driven priorities
- a set of administrative processes that is characteristic of the public sector, such as tax administration or concessionary charging. These typically involve a politically judged tension between social outcomes (e.g. anti poverty policies) and administrative efficiency (e.g. maximising income collection).

2.9 These are distinctive features of PFM. They pose particular challenges if regulation, codified good practice, advice, support, and capacity development have to rely on generic professional institutions that do not have a specific background in these issues.

Definitional Boundaries

- 2.10 CIPFA's definition of PFM relates to the management of public sector finances, but not to national roles in ensuring overall management of the economy, such as banking regulation or taxation policy. It does include national and local financial processes such as debt management and taxation administration.
- 2.11 Even so, its whole system approach is not immune from the debate about what is in or out of PFM. There are a range of environmental factors that have an important influence on PFM's effectiveness, and that are therefore particularly relevant for PFM reform. These include social organisations, cultural norms, political stability, and the level of managerial capacity. It can be particularly important to address these contextual issues alongside projects for improving PFM processes themselves.
- 2.12 Institutions are included in the PFM architecture by virtue of the specific functions they perform in relation to managing public finances. Both institutional and process elements are brought into CIPFA's PFM model where they operate directly on the management of public finances, and where they form part of the checks and balances that are needed to ensure a healthy PFM contribution to policy results. They sit outside where they act principally to create the climate within which PFM can be effective in bringing about lasting results¹⁰, when they are treated as framing issues.
- 2.13 Thus procurement rules are included, in so far as they are key to sound decision making involving financial commitment, probity and value for money, but procurement is also recognised as a discipline in its own right. The Central Bank is included because it may have functions including debt management, and paymaster administration, rather than because of its activities in relation to economic regulation, inflation control or money supply management.
- 2.14 Similarly, there is a cluster of resource related disciplines that are closely linked to making money go further through productivity and efficiency: risk management, IT strategy, asset management, knowledge management, procurement and commissioning, workforce planning and natural resource management. Again these are included in the PFM 'whole system' discussed in this paper only to the extent that they relate directly to financial effectiveness.

Issue 1: PFM Definition

- 2.15 There is currently no single accepted definition of PFM, but it is often narrowly expressed in terms of the stages of the budget cycle. This paper defines PFM as a system of financial management directed towards realising the goals of the public services.
- 2.16 "Public financial management is the system by which the financial aspects of the public services' business are directed, controlled and influenced, to support the delivery of the sector's goals."
- 2.17 Do you agree with CIPFA's proposed definition of PFM?

¹⁰ By analogy there are a number of complementary diagnostics to the PEFA assessment, including the World Bank's Country Policy and Institutional Assessment, reference the Joint Venture of Public Financial Management Working Party on Aid Effectiveness July 2008 P42.

- 2.18 The definition, like the traditional focus on budgetary processes, is concerned with managing finances in the public services. It is a broader definition than that generally adopted. However, it does not include broader management of the economy or fiscal policy. It recognises relationships with other management processes, and with other resource management strategies - such as procurement and risk - and with forces like the influence of the media, but they are included as part of PFM only if they are directly related to financial management.
- 2.19 Do you agree with the approach to the boundaries of the definition?

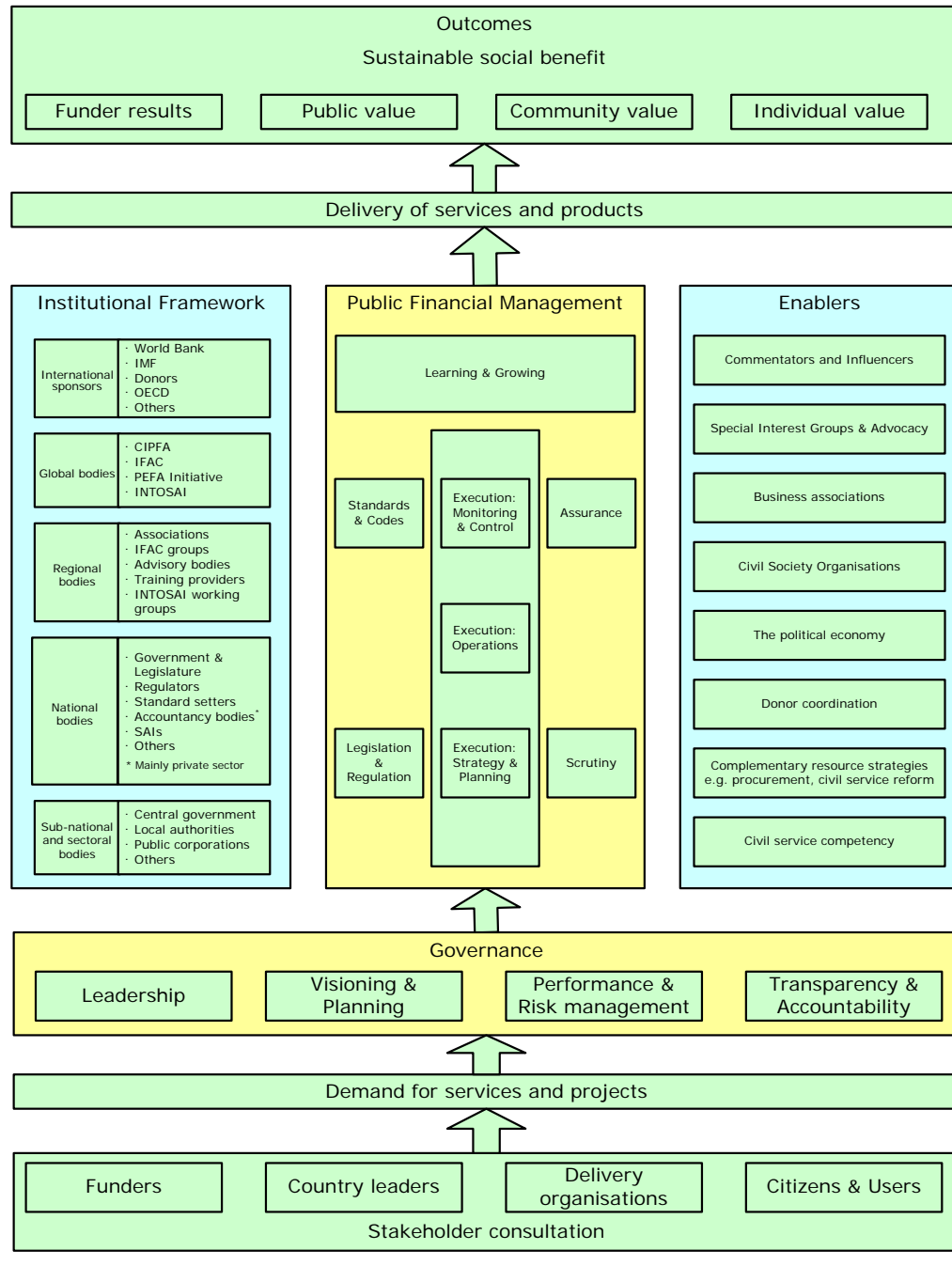
3 CIPFA's Whole System Approach to PFM

- 3.1 The territory of development effectiveness is densely occupied, and new initiatives continue to close gaps and intensify the linkages between programmes.¹¹ CIPFA's proposed model draws back from this close focus to propose an equally significant and strategic helicopter vision of the principal players and processes in PFM.
- 3.2 The PFM system is naturally powered by its complex environment: the quality of leadership; the objectives of stakeholders; the political economy; the influence of civil society; the work of national and international institutions setting the terms of financial and economic stability¹² and the catalyst of think tanks, academia and research. It connects with the cross cutting themes of ethics, diversity, sustainability, anti-corruption, efficiency and partnerships.
- 3.3 PFM also relates to an overarching universe concerned with effectiveness in public management, stressing leadership, governance and performance management, transparency and accountability. These are not part of PFM but they need to be acknowledged as significant contributors to PFM effectiveness, even though they are much wider issues. The chart below proposes a high level delineation of the PFM architecture, framed by these enabling and institutional elements.
- 3.4 Following our proposed definition of PFM the whole system chart stresses the significance of the link to service delivery, as the means of transmission from money to social benefit, whether this accrues to individuals, communities or to the public at large, with results that meet donor objectives. It also emphasises the need for collaboration and coordination of stakeholder interests in originating expenditure programmes. This includes the citizens and service users, the country's priorities and the delivery organisation, and the donors.
- 3.5 The whole system described in this paper is a model of checks and balances which, acting together, can gear up PFM effectiveness. Its purpose is to consider whether PFM elements and components are operating together and are mutually supportive and to suggest where there may be practical gaps and weaknesses in the support that the major institutions offer to less developed countries. The model is intended as an objective base for analysis and improvement, complementing existing assessment tools rather than creating additional ones.

¹¹ As a recent example, the suggested platform for South led peer exchange in Sub Saharan Africa: Memorandum on the Capacity Development Alliance and how it might link up with the WP-EFF – DCD/DAC/EFF (2008) P34

¹² See the World Bank's Reports on the Observance of Standards and Codes and their relevance for the international financial architecture http://www.worldbank.org/ifa/rosca_aa_overview.pdf

CIPFA's Whole System Approach to PFM



- 3.6 Single PFM interventions can generate progress, but this may be limited by other parts of the system, possibly in ways that emerge only after a time delay. A systems model's stress on interconnectedness can help to indicate where failure or even short term success may bring consequences elsewhere, since it looks for mechanisms to optimise total output rather than the performance of individual elements. The idea that the individual aspects of reform are vitally connected is by no means new¹³ but a whole system approach aims to emphasise the concept of interdependence and to keep the big picture in the frame.

Issue 2: Relationship between PFM and contextual factors

- 3.7 The PFM system is powered by contextual factors, such as the political economy and the influence of civil society. In the whole system approach proposed here these are treated as framing elements that influence the effectiveness of PFM, but are not an intrinsic part of PFM processes. The chart on page 22 locates PFM in its overall context.
- 3.8 Do you agree with the approach to the contextual factors of PFM?
- 3.9 Do you agree with the categorisation of the institutional framework?
- 3.10 Do you agree with the categorisation of enablers in the framework?

¹³ For example, *"Reforms in external audit are unlikely to have a sustained impact unless parliamentary committees, such as Public Accounts Committees are able to provide effective legislative scrutiny of audit reports."*- Report on the Use of Country Systems in Public Financial Management July 2008 P23 Joint Venture of Public Financial Management Working Party on Aid Effectiveness.

For example: *"Reforms of PFM systems are more effective if they are part of a broader public sector reform of the civil service, governance and transparency, and of the legal framework."* [IMF Survey: Low-Income Countries Need Upgrades](#), Richard Allen and Duncan Last, IMF Fiscal Affairs Department July 19, 2007

See also Background and Summary of an Integrated PFM model
http://siteresources.worldbank.org/INTPRSI/Resources/383606-1119904390686/bbl120905_background.pdf

4 The PFM Process Architecture

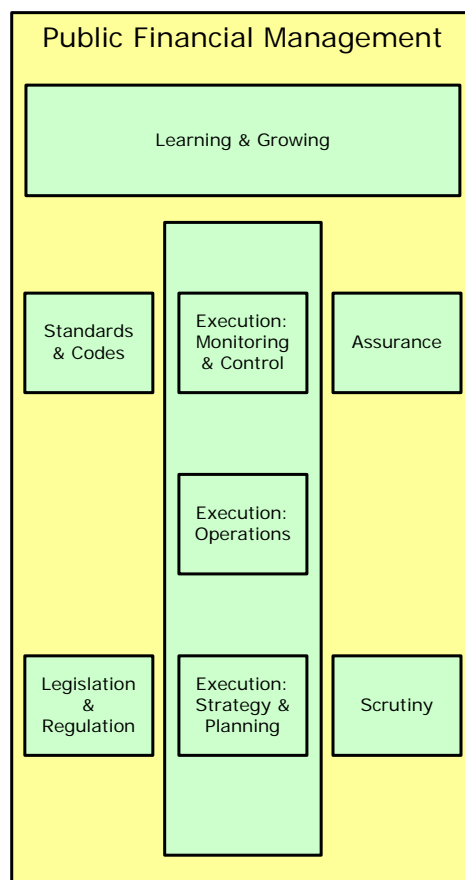
- 4.1 Starting from the proposed definition of PFM, CIPFA's Whole System Process Architecture is wider than the frequent emphasis on budget cycles. The structural skeleton of PFM comes from the major institutions and central governments involved. But the whole system also comprises the set of processes that animate them: a circulatory system of funding flows, processes for monitoring, balancing and regulating, formal and informal feedback systems for learning and adapting, and generative processes for growth. All these elements need to operate together if development inputs are to reinforce virtuous cycles of improvement and to be self-sustaining for the longer term.
- 4.2 An emphasis on the whole system argues that the effectiveness and sustainability of aid intervention depends on a healthy balance across the PFM components. This is not to advocate a rigid implementation of every element - there should be room for what the Overseas Development Institute (ODI) calls 'astute and opportunistic PFM interventions'¹⁴ - but to insist that these aspects of real politik should be located in the big picture and mindful of their system effects and possible unintended consequences.
- 4.3 A whole system picture can suggest areas of leverage in developing and sustaining good practice over the longer term. Codifying standards and creating common concepts across the PFM architecture enables information to be aggregated, exchanged, devolved, compared and interpreted, and increases transparency¹⁵. A whole system approach embraces standard techniques of capacity building such as training, but also how countries can take responsibility for growing professionalisation through their own associations. It helps to show where reinforcement processes can strengthen and embed an improvement trajectory, for example through peer networks. It can help to identify gaps, or imbalance, in the PFM international architecture, and so assist with the important issue of sequencing PFM improvements.
- 4.4 CIPFA recognises that countries will bring their own administrative traditions to PFM, for example francophone countries may approach the boundaries of what is regulated and prescribed differently from the English speaking tradition. The test of the PFM process architecture described here is whether there is general consistency and agreement about the elements of PFM.
- 4.5 The whole system of processes outlined here is described in progressive levels of detail:
- PFM Elements: a grouping of PFM processes, each of which performs a different function in the overall PFM architecture
 - PFM Components: the high level processes that actualise each element
 - PFM Descriptors: a brief description of the individual processes and the role they play in the broader system

¹⁴ Overseas Development Institute: CAPE Public Finance Conference – Concept Note 'Reforming for Results: Can PFM reform uplift government performance?' November 2008 P2

¹⁵ For example, IPSASB's objective for high quality accounting standards, *"This will enhance the quality and transparency of public sector financial reporting and strengthen public confidence in public sector financial management."* – An Overview of IPSASB's role and standard setting process – website <http://www.ipsasb.org>

The PFM Process Elements

- 4.6 The model distinguishes a number of different process elements, pictured in the chart below, and then described in summary. Our proposition is that each of these elements needs to be nurtured, but equally none is sufficient without the others.



- 4.7 **Legislation and Regulation:** the regulatory framework for PFM, determining the powers and mandatory requirements within which public sector agencies spend money and receive income. Regulation should be transparent and its application predictable, so that it can be consistently administered and can be navigated by civil society.
- 4.8 **Standards and Codes:** the system of established principles or rules common to a group of like organisations or professionals that is intended to govern their actions and behaviour to achieve compliance with a common set of non-statutory requirements. Observation of standards and codes is likely to be on a 'comply or explain' basis, and unjustified breaches can attract sanctions. Standards and Codes may be developed internationally by bodies such as the International Federation of Accountants (IFAC) and CIPFA, by national Governments and professional bodies or on a sectoral basis within a jurisdiction.
- 4.9 **Execution – Strategy and Planning:** the processes that set the direction for the activities which require financial management, in the short, medium

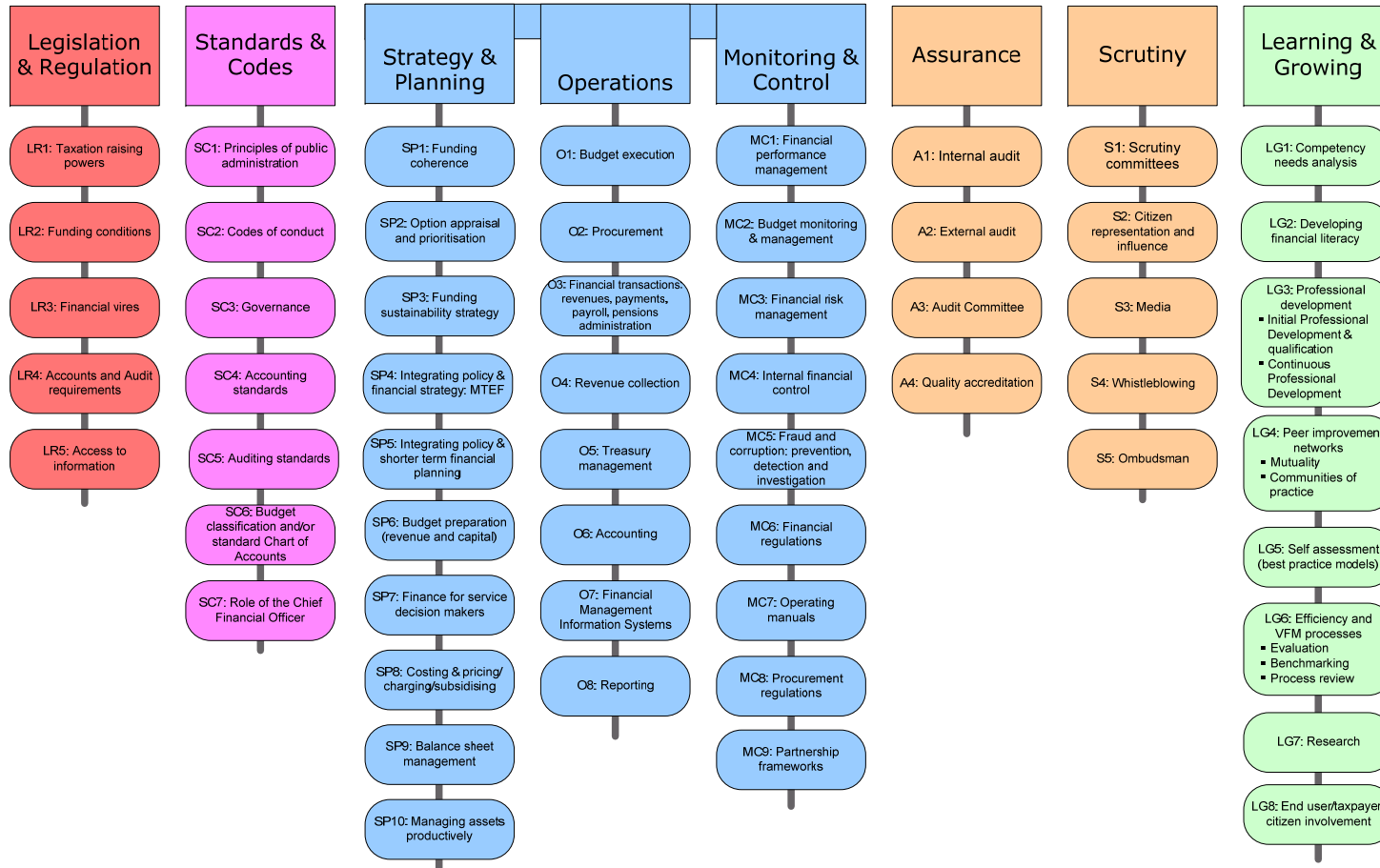
and longer term, and the financial performance frameworks within which overall performance is managed.

- 4.10 **Execution - Operations:** the principal financial operations that need to be carried out in order to deliver services and achieve the desired outcomes. Monitoring of the Paris Declaration's commitment to using country systems focuses on national budgeting and accounting systems in this area. In practice, while central governments may set the framework for spending, it will often be line ministries and local administrations who carry it out. It is important to consider the whole range of operations and the level at which they are undertaken, in order to plan and create capacity building initiatives.
- 4.11 **Execution - Monitoring and Control:** a cluster of processes, complementary to operations, designed to maintain the organisation on track to realise its objectives. They constitute a framework for activity that manages risk and prompts corrective action if forecast results deviate from plans. Internal controls aim to ensure that resources are directed towards planned purposes with as little leakage as possible. Internal controls need to be designed into organisational processes – and are therefore distinct from internal audit, which aims to provide assurance that processes are effective, efficient and economical. Monitoring of performance and related financial transactions together allows organisations to understand their financial position and their progress towards service goals, and to make adjustments if they believe variations prejudice results or financial sustainability.
- 4.12 **Assurance:** formal processes to give assurance to stakeholders about the organisation's standards and effectiveness, carried out at arms length from the operations they examine. The rigour, professionalism and independence of these processes, and of the bodies that carry them out, is important because it contributes to public trust and the resilience of the taxpayer relationship.
- 4.13 **Scrutiny:** scrutiny processes, outside executive responsibility, can oversee, influence or and challenge the allocation of resources and the administration of public sector finances. They create a demand for transparency and improve accountability. Their influence can help to build pressure for a more open, honest and effective public sector. Scrutiny processes can be formal, such as a Parliamentary Public Accounts Committee, or informal, including civil society groups and the media. Viewed as a whole system, scrutiny processes and bodies are an important part of overall checks and balances and a way of ensuring that the citizen voice is heard by executive authority. In the context of the developing world citizen and media scrutiny may be extremely important in generating pressure for reform.
- 4.14 **Learning and Growing:** processes that enable public service organisations, individually and collectively, to reflect and learn from best practice, from partners, mentors and peers and from their own experiences, in order to develop their knowledge and capabilities. Public service organisations can be supported by capacity building initiatives, but they also need to draw inspiration through their roots by involving service users. Processes for learning and growing enable organisations to become more effective and to achieve better results more efficiently, but also enable organisations to sustain improvements and take responsibility for their future development.

The PFM Process Components

- 4.15 The chart on page 28 gives an overview of the whole system components, illustrating the important checks and balances, as well as the softer processes that help to bind them together. For PFM to drive better services and make more effective use of aid it needs to operate at country level and to match the level of decentralisation and country programme implementation design, including aid modalities. The whole system should be considered for appropriate application in line ministries and devolved administrations as well as in Ministries of Finance.

PFM Process Architecture: Elements and Components



The PFM Process Descriptors

- 4.16 The processes that make up the PFM system, illustrated in the Elements and Components chart, are described below.

Legislation and Regulation

- 4.17 **LR1 Taxation raising powers:** the national government's definition of the powers to raise taxation to fund public expenditure. The taxes available to each level of administration may differ, for example between national, regional or local government. There may also be a variety of taxation sources available, e.g. assigned or hypothecated taxation revenues, or a mixture of property taxes, sales taxes, tourism taxes, vehicle registration charges. The powers to levy local taxes may also be limited by national or regional government.
- 4.18 **LR2 Funding conditions:** the terms on which funds may be received and applied, whether external aid or, within a country, specific subsidy. These are binding in that spending that falls outside these terms is liable to be repaid.
- 4.19 **LR3 Financial vires:** the powers and limits of operation granted by statute.
- 4.20 **LR4 Accounts and Audit requirements:** the government's process for prescribing essential elements of accounting and auditing in the public sector – for example, the duty to maintain a system of internal control and internal audit, to maintain accounting records, and the content, approval and publication of the accounts, the rights of the public in relation to the accounts and the external auditor's report. Regulations may also prescribe the individual duties of statutory posts and the professional standards to be adhered to.
- 4.21 **LR5 Access to information:** requirements that define public rights to access information held by public sector organisations. Such rights and protocols support openness, accountability and equity. Information about high level budgets, outturn, financial statements and major contracts lay the foundation for civil scrutiny and can sustain its demand.

Standards and Codes

- 4.22 **SC1 Principles of public administration:** principles that set out the standards expected of public officials help to underpin the effectiveness of organisations and will also bear on their financial management. Principles may relate to behaviour (e.g. integrity, objectivity, accountability, openness, honesty, leadership by example), to management practice and accountability, or to the professionalism and pay of the civil service itself.
- 4.23 **SC2 Codes of Conduct:** within the general principles of public life there are likely to be specific codes governing the conduct of public sector employees, elected office holders and professionals.
- 4.24 **SC3 Governance:** good governance in the public service requires a focus on the organisation's purpose and its intended social outcomes. It also carries a specific obligation to citizens, taxpayers and service users to make best use of resources and ensure value for money. Financial management is therefore a core corporate discipline, that should be reflected in a corporate governance framework, covering all the entity's activities (financial and non-financial),

along with the duty of public service leaders to determine the allocation of resources, to manage resource use and performance objectives, to maintain a system of controls, to assess and manage risk, to uphold high standards of behaviour, to take informed and transparent decisions which are subject to scrutiny, to develop capacity and capability across the organisation and to engage with stakeholders to ensure public accountability.

- 4.25 **SC4 Accounting standards:** accounting standards help to ensure consistency and comparability, and improve the reliability of financial information for its users. These include users within a country as well as the international aid community, such as the World Bank. The International Public Sector Accounting Standards Board (IPSASB) promulgates accounting standards for the public sector. Its goals are "to serve the public interest by developing high quality accounting standards for use by the public sector entities around the world in the preparation of general purpose financial statements. This will enhance the quality and transparency of public sector financial reporting and strengthen public confidence in public sector financial management."¹⁶ Standards may be set at the national level. They can sometimes be geared towards the private sector and may need to be translated for the public service context.
- 4.26 **SC5 Auditing standards:** standards for auditors will generally cover the following issues:
- general issues: their competence and training, professionalism, including exercising due care, understanding the business of the entity that they audit, being objective and independent
 - field work: planning and managing audits, use of risk assessment techniques, evidence gathering, documentation and quality assurance
 - reporting: content required to report on, (e.g. external audit must report on financial statements and legal compliance); to whom they report, whether there are special circumstances, such as a report in the public interest.
- 4.27 **SC6 Budget classification and/or standard Chart of Accounts:** standardisation of the principal headings under which expenditure and income is grouped helps to aggregate, analyse and exchange financial information in a meaningful way. A chart of accounts will typically show allocations to spending unit, function, economic activity and programme and may also allow some locally defined detail. Classifying budgets and expenditure is a foundation for collecting and publishing information about the public sector and for enabling accountability and public discourse. Use of a uniform structure at sub national level will be necessary to produce consolidated Whole of Government Accounts.
- 4.28 **SC7 Role of the Chief Financial Officer (CFO):** the official charged with overall responsibility for financial affairs - should be set out through

¹⁶ International Public Sector Accounting Standards Board (IPSASB) operating under the auspices of the International Federation of Accountants – Overview of role <http://www.ipsasb.org>

'The [International Public Sector Accounting Standards Board](http://www.ipsasb.org) (IPSASB) focuses on the accounting and financial reporting needs of national, regional and local governments, related governmental agencies, and the constituencies they serve. It addresses these needs by issuing and promoting benchmark guidance and facilitating the exchange of information among accountants and those who work in the public sector or rely on its work.' (IPSASB website)

employment terms, and there are common insights into how that role can be made most effective. Codification can help to enable a shared understanding of the role and create the conditions for organisational effectiveness and accountability. The CFO should have a relevant qualification, exercise a professional duty of care and adhere to a code of ethics. The CFO's activities are likely to include participating in the development and leadership of the organisation's strategic purposes, as a member of its senior management, formulating a financial strategy that underpins the organisation's goals and enables its financial health in the short, medium and long term, acting as financial advisor and technical expert for the organisation and responsibility for financial administration. CIPFA has issued a standard, principles based Statement.

The CFO in a public service organisation:

1: is a key member of the Leadership Team, helping it to develop and implement strategy and to resource and deliver the organisation's strategic objectives sustainably and in the public interest;

2: must be actively involved in, and able to bring influence to bear on, all material business decisions, to ensure immediate and longer term implications, opportunities and risks are fully considered, and alignment with the organisation's overall financial strategy; and

3: must lead the promotion and delivery by the whole organisation of good financial management, so that public money is safeguarded at all times, and used appropriately, economically, efficiently and effectively.

To deliver these responsibilities the Chief Financial Officer:

4: must lead and direct a finance function that is resourced to be fit for purpose; and

5: must be professionally qualified and suitably experienced.

A key feature is leadership in financial management in addition to technical competencies.

Strategy and Planning

4.29 **SP1 Funding coherence:** both for countries receiving donor aid and for sub-national bodies, the credibility of the budget is underpinned by secure flows of funds from the organisation controlling the source of funds. Funding transfers need to be predictable as to amount and timing, and the calculation of allocations should be rational and explicable. Vertical allocation, e.g. to sub national agencies, is likely to be policy led, and horizontal allocation, for example, amongst local government bodies, should be principles based, following objective criteria or formulae. The amount that is ring fenced to specific purposes, or provided off- budget should be limited, in order not to distort the spending body's own priorities, although different tolerances may apply to major infrastructure projects. Where funding comes from a combination of sources there should be co-ordination between the different funders.

4.30 **SP2 Option appraisal and prioritisation:** the relative merits of spending on recurrent or investment options should be appraised in a structured way, comparing their benefits, costs and rates of return over the whole life of the project, using appropriate techniques.

- 4.31 **SP3 Funding sustainability strategy:** medium and long term resource planning should be informed by a forward projection of liabilities and the capacity to meet them from projected revenue sources. The aim should be to develop a sustainable funding strategy that supports future expenditure and liabilities, including those that may be outside the balance sheet, such as private finance initiative commitments or pensions liabilities. The strategy will need to consider issues such as solvency, variation in the tax base, inter-generational equity, and stability of taxation levels¹⁷. The projections should also take account of risk assessment and sensitivity testing, e.g. risks to future grant levels, or to taxation dependent on levels of economic activity.
- 4.32 **SP4 Integrating policy and financial strategy: medium term expenditure framework (MTEF):** the MTEF brings together fiscal targets and strategic policy priorities in a transparent and accountable planning process for three or more years ahead. It should be based on horizon scanning, so that it takes account of external forces that will shape future plans, such as new legislation, demographic change affecting service demand and social or technology change. It should integrate policy planning and performance with financial planning, and recurrent budgets with project budgets. Policy plans need to be reconciled with available resources and affordability. They should be grounded in a review of past and existing expenditure and income patterns, with projections of future spending and be supported by realistic funding forecasts and strategies. Where relevant, it should include external donor aid so that these objectives are integrated into budgets and are monitored consistently with other plans. Risk analysis and scenario testing can help to deal with the unavoidable uncertainty of forward projections, but the MTEF's value as a planning and accountability document is enhanced if future funding is predictable. At country level, the MTEF will gain in credibility if it is approved by the country's auditor general. The MTEF is a strategic tool for governments, but lower tier public service organisations should also develop a proportionate medium term financial strategy that integrates and trades off service priorities and affordability within a corporate planning process.¹⁸
- 4.33 **SP5 Integrating policy and shorter term financial planning:** the processes that apply to medium term strategy also apply to shorter term planning, resolving the allocation of resources in the light of competing policy priorities, spending pressures, savings opportunities, risk assessment and funding proposals. Medium term commitments implied by annual plans should form part of forward projections.
- 4.34 **SP6 Budget preparation (revenue and capital):** budget documents are the financial expression of service plans and they set the limits of expenditure authorisations for managers. Externally, annual plans should explain transparently the economic assumptions, e.g. inflation, and how the organisation is allocating resources between different services and programmes. Presentation should include summary budgets compared with the previous year's actual expenditure, current year and the next year's plans and explain major changes. Budgets should show functional expenditure gross with income detailed separately and should also identify the funding plan,

¹⁷ These categories are indebted to Schick, Sustainable Budget Policy – Concepts and Approaches, OECD Journal on Budgeting 2006

¹⁸ See also World Bank - What is MTEF?
<http://siteresources.worldbank.org/PSGLP/Resources/MTEFprocess.pdf>

detailing the source of funds. Budgets should be legal, realistic and based on robust assumptions and calculations, so that they are realistic targets for spending managers, and to minimise disruptive in-year adjustments. They should be comprehensive, with minimal off-budget expenditure, so that they form part of the overall fiscal policy framework and are subject to the same disciplines of monitoring and reporting. Funders are aware that budget predictability benefits service planning. Detailed service budgets should explain allocations to individual services and be the basis for managers to operate throughout the year. Individual spending units should have an opportunity to input to budget preparation, to strengthen credibility, and should be notified of their budget allocations before the year begins, so that they can plan their commitments and fulfil their policy goals.

- 4.35 **SP7 Finance for service decision makers:** financial information needs to support the needs of policy makers, planners and service managers, not just the financial experts. Managers need information based on calculating and interpreting cost drivers and trends, extrapolating forecasts, unit costs, variances and sensitivities, and the skills to understand their commitments so that they can manage risks, deliver value for money, make use of opportunities and take action to stay on budget.
- 4.36 **SP8 Costing and pricing/charging/subsidising:** understanding the unit costs of activities enables organisations to allocate resources more efficiently and to forecast the impact of demand variation. Organisations should also consider when services will be free or subsidised and when service costs will be recovered through charging or will even generate a profit that can cross subsidise other activities or client groups. The design of charges and income collection processes should be efficient, and arrears actively pursued.
- 4.37 **SP9 Balance sheet management:** this means a comprehensive approach to managing balance sheet asset and liabilities, in order to ensure that resources are being used effectively, both financially and operationally, and that appropriate governance arrangements are in place around the use of public sector assets and liabilities to demonstrate stewardship. It considers the future impact of changes in assets and liabilities, including contingent items, and shows the strength of financial standing and the capacity for investment. Information on debt, contingent liabilities and planned capital expenditure is necessary to ensure long term fiscal sustainability.
- 4.38 **SP10 Managing assets productively:** holding assets, whether property, IT or equipment, ties up cash and incurs running costs. So assets need to be managed, examining how they drive future costs, their importance for business continuity and maintenance and replacement planning, their utilisation and opportunities for greater productivity and rationalisation.

Operations

- 4.39 **O1 Budget execution:** delivering the budget as planned, against service analysis as well as aggregate totals, supports realisation of policy goals, while resource control underpins credibility. This relies on processes to track commitments and manage resources without overspending, which can destabilise other spending plans. The quality of expenditure is also important, and managers should try to achieve value for money, avoiding unnecessary spending, ensuring they buy at good prices, and manage staffing budgets carefully.

4.40 **O2 Procurement:** the process of acquiring goods, construction works and services. It is concerned with obtaining the best services, supplies and works to meet the needs of the purchasing organisation at a price it is prepared to pay. It therefore involves understanding service needs, understanding the market and applying sound procurement processes. Procurement spans the whole cycle from identification of needs, commissioning, specifying, tendering, letting and then managing a contract through to the end of a services contract or the end of an asset's useful life. Although it can be a full topic on its own, ensuring strong procurement arrangements is also integral to PFM:

- Appraising and selecting appropriate procurement strategies (e.g. Public Private Partnerships), considering their resource implications
- Ensuring probity and propriety in spending money on goods and services through establishing and monitoring transparent authorisation and contract procedures, and maintaining records, guarding against loss, fraud and corruption
- Ensuring value for money, for example, through competition and contestability, accessing wide markets, supply chain management, supplier relationships and market management/ development
- Ensuring value for money during the life of a contract through effective contract management and performance monitoring, and through opportunities for improved methods during long life contracts
- Ensuring efficiency through contracting arrangements, e.g. using framework and consortium contracts and exploiting economies of scale by aggregating purchasing power and market influence. Off contract purchasing should be minimised
- Ensuring efficient and low cost financial administration and transactions for example by automated purchase to pay processes, or electronic tendering, where feasible.

This is enabled by governance arrangements, such as a Procurement Board, that address procurement policy, coordinate a strategic approach to purchasing decisions, issue guidance to potential suppliers and to purchasers within the organisation, and address competencies, good practice and improvement plans.

4.41 **O3 Financial transactions – revenues, payments, payroll, pensions administration:** these are specialised key financial processes each requiring management through performance indicators that measure unit costs, trends, accuracy and timeliness. Because of the volumes of transactions and the sums involved internal controls should be tight and are likely to be audited annually

4.42 **O4 Revenue collection:** effective revenue collection is the foundation of robust spending plans. The assessment basis for taxation and other sources of revenue should be clear and not arbitrary, and the amount, time and manner of payments should be clearly set out. The registration, assessment, and payment processes should be efficient, so that high collection rates can be achieved and the cost of collection be proportionate to the yield. This will be backed by public information programmes, processes to pursue arrears promptly and controls that incentivise compliance, such as penalties and investigations.

4.43 **O5 Treasury management - debt and long term capital financing, investments, cash management:** the sums involved, and the long term

financial implications, mean that risk management, internal controls and regulatory arrangements need to be strong, and agreed at very senior executive level. Information on long term debt commitments (or their equivalent e.g. PPP liabilities) is necessary for prudential planning, to ensure that policies remain affordable. Complex or innovative funding arrangements will require specialist advice that may well not exist inside individual organisations. Specialist treasury management policies and practices must focus on securing a return compatible with the security of the capital sum. Reliable cash flow forecasts will help to plan debt and treasury activity and also to ensure that budgets are not unexpectedly adjusted during the year. Debt and investment activity will be supervised by national government bodies, and they will also play a part in the provision of capital and cash management facilities in the public sector.

- 4.44 **O6 Accounting:** records expenditure and income by type of expenditure and by activity, comparing actual records against budgeted allocations. It also includes measuring and recording the value of assets and liabilities. Accurate, timely and reliable financial information is required to understand and calculate costs, analyse trends and support decision making and financial control. Accounting information is also necessary to plan realistically how resources are allocated to policies, programmes and services, to assess relative value for money and to give an account of expenditure and income to stakeholders.
- 4.45 **O7 Financial management information systems (FMIS):** usually refers to computerized budgeting, accounting and payment operations, though the hallmarks of a good system apply equally to non IT applications. Systems output should be accurate, reliable and timely, and present information that is relevant and meets the straightforward needs of users, with little additional manipulation. IT systems need to be documented, well maintained, and users need to be trained.
- 4.46 **O8 Reporting:** reporting and publishing budget and accounts information clearly and objectively, in a variety of forms suitable for different audiences (whether citizens, government or donors) is a primary accountability function. Accountability generally should be a lever to make better use of resources. In relation to annual financial accounts it can be reinforced by public rights to inspect items of account, to lodge objections with auditors, and by publication of external audit reports. As well as reporting annual financial results in the statement of accounts and annual report, organisations will also compile in-year summary information as part of their accountability to government and other funders, enabling aggregate fiscal risks to be monitored. Informative reporting that can be used by citizen groups and the media as a lever to reform can be especially significant in the developing world where public information may be hard to access and interpret.

Monitoring and Control

- 4.47 **MC1 Financial performance management:** budget management is directed to financial flows but also to monitoring that the expected performance from using resources is being measured and achieved.
- 4.48 **MC2 Budget monitoring and management:** spending units should receive reliable in-year budget reports in a timely way. Monitoring should aim for 'no surprises'. It should be forward looking, focussed on large or important items and track lead operational indicators as well as time lagged financial records.

Budget reports should be timely and should explain clearly to decision makers the financial position and consequent options, so that corrective action can be taken in good time if necessary. Budget management during the year should enable outturn expenditure to match original budgets, in order to reflect original policy plans. Lessons learned from monitoring (as well as audit) should be absorbed and disseminated for future use in subsequent budget cycles.

- 4.49 **MC3 Financial risk management:** a logical and systematic method of establishing the context, identifying, analysing, evaluating, treating and monitoring the risks associated with any activity, function or process in a way that will enable an organisation to minimise losses and maximise opportunities. Where supported by analysis and an understanding of the likelihood of consequences, trading off impact and probability, it helps to determine the acceptable level of risk (risk appetite) and how it can be economically managed. Risk can be accepted or mitigated but is unlikely to be eliminated. In the aid context fiduciary risk assessment, trading off risk and reward, is an important discipline. For countries it is also necessary to monitor the fiscal risk that can result from the actions of sub national organisations.
- 4.50 **MC4 Internal financial control:** internal control refers to the systems established by management to help ensure that an organisation achieves its objectives in a manner that promotes economical, efficient and effective use of resources and safeguards its assets and interests. Controls should be risk proportionate. They should include ensuring legal compliance, physical security of assets and procedures such as accounting and bank reconciliations, clearance of suspense accounts, separation of duties and regular checks that help to prevent problems, identify if things go wrong and prompt early action. Sound internal control is a platform for delegation and management accountability.¹⁹
- 4.51 **MC5 Fraud and corruption prevention, detection and investigation:** prevention, investigation and detection are important aspects of the stewardship of public resources, whether fraud and/or corruption are suspected within an organisation or are being practised upon an organisation. Investigation requires somewhat different skills and techniques from an audit investigation, for example in understanding the legal and ethical framework, securing evidence, interviewing and preparing prosecution. National institutions can play a significant role in addressing money laundering, and in coordinating anti-fraud data matching, together with its legal frameworks and protocols.
- 4.52 **MC6 Financial regulations:** the framework, internal to an organisation, for managing its financial arrangements. Regulations set out the delegations, authorisations, responsibilities, freedoms and disciplines applicable to all those who take action on the organisation's behalf. That includes line managers who take decisions with financial implications, not just finance staff, so they should be well understood and promoted throughout the organisation. Breaches of regulations may result in disciplinary action. Regulations should cover principal financial activities, such as budgeting and committing expenditure, the duty to consider financial implications and take appropriate advice, year end carry forward and virement tolerances, accounting, treasury management, payroll, payments and income controls, bad debt and write off authorisations, treatment of grants and external funding, safeguarding of

¹⁹ World Bank Public Expenditure Management Handbook 1998, Getting the Basics Right

assets, work for outside bodies, authority to enter into financial partnerships and audit's access to records, information and staff.

- 4.53 **MC7 Operating manuals:** systems and processes should be documented to record and guide proper operations, as a reference for staff in their day to day work, and to auditors. Well documented procedures help to stop drifts that can jeopardise internal controls, and are an important part of business continuity when staff change.
- 4.54 **MC8 Procurement regulations:** in parallel with financial regulations these should set out the required processes for purchasing goods and services and letting contracts, including authorisations and financial limits, to ensure legal compliance, openness and competition, propriety and probity.
- 4.55 **MC9 Partnership frameworks:** organisations often need to establish formal relationships with others in order to achieve their goals. Partnership agreements will usefully cover the shared aims and objectives, powers, success criteria, strategic risks, decision making, performance management, review and accountability arrangements, funding arrangements and means of controlling finances, and arrangements in the event of dissolution.

Assurance

- 4.56 **A1 Internal audit:** is an assurance function that provides an independent and objective opinion to the organisation on risk management, control and governance, by evaluating their effectiveness in achieving the organisation's objectives. It objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources, focussing on areas of relatively greater risk²⁰. It provides assurance to management and other stakeholders, to prompt cost effective improvements that reduce risk. Auditors can advise management but, as an independent assurance function, internal audit should not be involved in developing or maintaining policies that it later reviews.
- 4.57 **A2 External audit:** a review carried out by an independent qualified person of the reliability and regularity of an organisation's financial arrangements, by analytical review, systems evaluation, compliance and substantive testing. In particular the external auditor gives an opinion on an organisation's financial statements. An unqualified opinion gives assurance that they are prepared in accordance with legal requirements and a recognised reporting framework and 'present fairly' the financial position. This is therefore an important buttress to accountability and can help to build confidence in the organisation's financial management, while recommendations should lead to improvements in how business is conducted and create pressure for stronger PFM. External auditors can also carry out thematic reviews, examining efficiency, economy and effectiveness or performance reviews, for example on major change or infrastructure programmes.
- 4.58 **A3 Audit Committee:** an audit committee is a key component of corporate governance. It is a source of assurance about the organisation's arrangements for managing risk, maintaining an effective control environment, and reporting on financial and non-financial performance. Its purpose, as defined by CIPFA²⁰, is: 'to provide independent assurance of the

²⁰ CIPFA - Audit Committee Principles
www.cipfa.org.uk/panels/audit/download/audit_committee_principles_in_local_government.doc

adequacy of the risk management framework and the associated control environment, independent scrutiny of the authority's financial and non-financial performance to the extent that it affects the authority's exposure to risk and weakens the control environment, and to oversee the financial reporting process.' Its core functions include oversight of internal audit's activity and effectiveness, of risk management arrangements and the control environment, review of the financial accounts and any external reporting on them. It should promote the significance of audit, seeking assurance that issues arising from internal or external audit reports are being addressed. It needs to be able to challenge the executive, with a membership that is balanced, objective, independent of mind, and knowledgeable.

- 4.59 **A4 Quality accreditation:** an independent assurance of the quality of processes or services which results in the award of a formal rating or accreditation. Such reviews may be carried out by service inspectorates, organisations awarding beacon status, or recognised quality assurance standards such as those of European Quality Foundation. Such assurance mechanisms require a formalised methodology for assessing and validating the activity under review, and an oversight body that underwrites the quality of accreditation.

Scrutiny

- 4.60 **S1 Scrutiny committees:** scrutiny committees can exist at parliamentary level, such as the legislative scrutiny of the budget law, or Public Accounts Committee scrutiny of external audit reports. Scrutiny Committees can also exist at local level. They are a formal way of overseeing budget execution, reviewing performance and pushing for both allocative and operational efficiency. They examine evidence, seek ideas and make recommendations to the Executive across financial or service activities. They are part of the wider checks and balances in the PFM system, and help to create a demand for accountability: "A decade of research has concluded that, unless there is strong demand for accountability, most PFM reforms are unlikely to be sustained in the long run".²¹
- 4.61 **S2 Citizen representation and influence:** civil society organisations can be influential in generating pressure for reform and in holding executive authority to account, as being a stimulus to improvements in financial management and decision making. Examples in relation to budgets include advocacy and influence on the allocation of resources, creating a demand for budget information and tracking the quality of implementation.²² In the developing world grass roots organisations can be of particular importance.
- 4.62 **S3 Media:** together with legislatures and citizens, the media help to create an environment of accountability and a demand for information that scrutinises

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²¹ Report on the Use of Country Systems in Public Financial Management July 2008 P26 Joint Venture of Public Financial Management Working Party on Aid Effectiveness.

²² International Budget Project, Linking budget analysis with aid advocacy: how civil society groups can monitor donor budget support, Lucy Hayes (EURODAD) and Albert Van Zyl (IBP)

February 2008 <http://www.internationalbudget.org/resources/briefs/eng1.pdf>

whether policies are being achieved, and can act as a stimulus to improvements. Their role, as well as that of civil society more generally, extends well beyond PFM.

- 4.63 **S4 Whistleblowing:** processes that enable individuals or groups to draw formal attention to unacceptable practices may be particularly significant where the executive performs poorly and other controls and balances in the system are weak
- 4.64 **S5 Ombudsman:** an official, usually appointed by the government or by parliament, who is charged with representing the interests of the public by investigating complaints reported by citizens and addressing them, usually through mediating a settlement. Making a complaint to an ombudsman is usually free of charge. The major advantage of an ombudsman is that he or she examines complaints from a position outside the institution, thus avoiding the conflicts of interest inherent in self-policing. However, to be successful, the ombudsman system relies heavily on the selection of an appropriate individual for the office, and on the cooperation of at least some effective officials from within the organisation being challenged. Perhaps for this reason, the introduction of ombudsmen has tended to yield mixed results.²³

Learning and Growing

- 4.65 **LG1 Competency needs analysis:** analysis of the skills and knowledge required to meet an organisation's needs lays the foundation for designing training programmes. The analysis should cover the finance skills of non-financial and devolved managers as well as finance staff, and the leadership, communication and influencing skills of finance experts as well as their technical competence.
- 4.66 **LG2 Developing financial literacy:** many spending decisions are taken by service based managers who do not have a financial qualification. They too need the capabilities to influence the realism of budgets, manage resources within organisational freedoms and disciplines, understand the financial consequences of policy decisions, and know when to seek advice.
- 4.67 **LG3 Professional development:**
- **Initial Professional Development and qualification:** the initial development of skills, knowledge and expertise that has been tested by examination and must be continuously developed in a structured and monitored context. Qualified individuals should adhere to professional values of accuracy, honesty, integrity, objectivity, transparency and reliability. They will be subject to oversight by a professional body that exercises disciplinary powers.²⁴ Professional staff can apply appropriate techniques across the public sector, but can also take local responsibility for strengthening PFM where they are based, enabling good practice to become embedded and self sustaining. Professional skills can be acquired at different levels, depending on the match to a competency needs analysis.
 - **Continuous Professional Development (CPD):** CPD refers to a structured process to broaden skills and keep up to date with professional

²³ Taken from Wikipedia

²⁴ From CIPFA's draft 'Role of the Finance Director' December 2008

developments and emerging themes, maintaining and enhancing competencies over time, and meeting the needs of a modern organisation in a changing world. CPD therefore benefits both the individual and their employer.²⁵ It embraces technical expertise, as well as the leadership, change management, communication and influencing skills that finance staff need to be effective.

4.68 **LG4 Peer improvement networks:**

- **Mutuality:** the principle of mutuality underlies networking where peers can share success stories, experience and learning, as an accelerated and self directed route to improvement. Peers understand the environment and challenges they each face and can bring a practical appreciation of issues that is directly relevant, recognising that 'a successful reform program must consider the country's current circumstances and capacities'.²⁶
- **Communities of practice:** allow practitioners to exchange information and experience, and contribute to a collective knowledge base in a loosely structured fashion, often through the internet.

4.69 **LG5 Self assessment (best practice models):** structured models are a tool for improvement, that use a recognised assessment process to enable the organisation to test itself against best practice, to identify areas of strength and opportunities for improvement, and, over time, to measure progress. By demonstrating a commitment to continuous improvement the adoption of such processes also hopes to gain a reputational advantage with stakeholders or funders. Models may address a particular area of business, such as the PEFA assessment, or CIPFA's Financial Management Model, or take a more holistic view, such as the European Quality Foundation.

4.70 **LG6 Efficiency and value for money (VFM) processes:**

- **Evaluation:** an objective evaluation process using planned criteria, or post implementation review, can support pilot initiatives, can test the effectiveness of implementation, and can provide a platform for dialogue about what works well and what doesn't, to guide future policy. Its lessons can be fed into future capacity building plans or can inform future activity.
- **Benchmarking:** comparison of costs and activities with other organisations, both the peer group and the best in field, help to identify scope for improvement. Learning from the practices used by sector leaders accelerates improvement and cost reduction. Organisations need to avoid being defensive about their performance: in the private sector watching the competition is seen as mission critical.

²⁵ For example, CIPFA's Statement of Expertise describes many of the professional skills required to operate effectively, including leadership and strategic management, strategic and operational financial management, financial and performance reporting, governance, ethics and values, audit and accountability, partnerships and stakeholder relations, change, risk and project management, and procurement and contract management. <http://www.cipfa.org.uk/members/expertise.cfm>

²⁶ Report on the Use of Country Systems in Public Financial Management July 2008 P24 Joint Venture of Public Financial Management Working Party on Aid Effectiveness. This chapter draws attention to PEMPAL –the Public Expenditure Management Peer Assisted Learning initiative in the Europe and Central Asia Region, and to the Collaborative African Budget Reform Initiative (CABRI).

- **Process review:** an approach that maps the stages in an activity from beginning to end, to analyse the value added by each stage in the process. The aim is to redesign the process to remove redundant or low value steps, focussing on meeting the needs of the customer, to improve user satisfaction and to look for opportunities to reduce transaction costs, for example, by reducing duplication, manual handling and automation.
- 4.71 **LG7 Research:** systematic investigation and evaluation of evidence in order to extend the intellectual capital available to the whole aid community and to enhance the effectiveness of practice, current and future.
- 4.72 **LG8 End user/taxpayer/citizen involvement:** the involvement of citizens and service users in public sector financial matters can take a variety of forms, from information (e.g. what services has the budget been spent on), to consultation (what are the citizen's preferences between services or on the trade-off between taxation and charging), to active engagement, for example, through participatory budgeting. Active involvement can improve the quality of decision making so that resources are targeted more effectively and with better chances of lasting support and impact. It also has wider relevance. A joint CIPFA/DFID technical briefing notes: "As well as giving disadvantaged populations a voice and promoting the interests of marginalised sections of society, participatory budgeting promotes a more democratic and transparent administration of resources and can assist in avoiding corruption and the mishandling of public funds. It encourages public investment towards society's most pressing needs for the benefit of the greatest number of people." A strong aim of the multi-country Civil Society Budget Initiative, that supports community based budget monitoring, is budgeting that is 'pro poor'.

Issues Arising

- 4.73 Evaluation of PFM reforms has been concerned that they do not seem reliably to produce the desired impact on service delivery. This paper considers this challenge through the lens of a proposed whole system approach to PFM. An emphasis on the whole system argues that the effectiveness and sustainability of aid intervention depends on a healthy balance across the full range of interlinked PFM components.

The role of PFM in strengthening service delivery

- 4.74 An important point to make is that finance staff do not have control of some of the most significant budgets and do not have responsibility for delivering services. Therefore reforms that focus principally on upskilling finance staff will be successful only if these skills are directed to supporting managers who do deliver services. Designing reform from this angle starts with the outcome – more effective services - and works backwards through the process chain, focussing on the processes that add most value to the outcome. Effective financial management helps service providers because it puts more money in their hands and helps them use it to best effect.
- 4.75 This approach highlights a set of PFM issues that exercise some leverage over service delivery, such as the following:
- the methodology for designing development initiatives, starting from the desired outcome and giving prominence to processes that make the most direct and important contribution to achieving the desired goal

- integrating financial and policy planning – so that resources are directed to priorities for services that benefit users and citizens. Bringing financial considerations together with strategic planning and operational design is fundamental to allocative efficiency, financial risk management and to resourcing priorities. In a way that is not sustainable in a commercial organisation, in the public sector financial input can often be seen as a drag on decision making rather than a stabilising force that enhances the probability of effective realisation. If financial management is seen as being about compliance and control, managers will not seek advice or support. They may even actively try to avoid finance staff involvement. But if financial management is part of policy design it can provide relevant information about accurate costing, financial implications, risk management and efficient implementation
- budget monitoring and financial performance management as a tool of budget management, enabling corrective action to be taken if programmes depart from the expected spending profile or do not deliver planned outcomes, so that available resources can be put where they will be used to maximum effect
- designing financial procedures that strike a balance between financial discipline and flexibility
- bidding for external resources to support priorities, but planning for exit strategies if resources are not to be sustained
- expertise for finance professionals in finance for decision making, such as scheme appraisal, assessing financial implications of policy, interpreting cost information and advising managers of options
- training and development that pays attention to the particular challenges of managing in the public sector, where resources are limited, but demand for services less so
- building capacity for finance professionals and service managers to work together on improving value for money and efficiency, so that money will stretch further
- training and development that increases the financial literacy of service managers
- professionalising finance staff so that they understand and can exercise leadership in financial management, will involve themselves actively and influentially in developing and implementing strategies to achieve the legitimate aims of their organisation, and will take responsibility for developing effective financial practices
- excellence in income collection because it increases the funds available for services and ensures fairness
- prevention and control of corruption, fraud and loss because they allow leakage of funds away from service provision and bar the public from basic services
- development of future funding strategies because it supports the sustainability of services at levels acceptable to the taxpayer and funders
- support for scrutiny processes because they create pressure for money to be demonstrably well spent
- focussing attention on the blockages that prevent financial management being effective. Improvement planning could
 - strengthen individual financial processes, for example by training in budget forecasting

- analyse the separate activities that contribute to the targeted outcome and focussing on the ones that will make most difference
 - look across all the processes that need to come together, and targeting improvement plans to attend to areas where change will have the biggest impact on overall effectiveness.
 - creating complementary programmes that are not directly to do with financial management but may be blocking reform, such as civil service pay and political legitimacy.
- 4.76 The PFM processes highlighted above are action oriented and future facing. This is not to say that other PFM activities, such as setting accounting standards for measuring, recording and reporting, are unimportant – just that they should not be expected to impact service outcomes in the most direct or speedy way. Similarly the benefits of audit are in the confidence they give to funders and the public to continue contributing their money, the pressure their independent reports create for improved practice, and in the lessons learned and acted upon. Essential as these factors are, they are also at best indirect approaches to improving the impact of financial management on service delivery.
- 4.77 In the PFM Process Architecture proposed in this paper, all elements need to be addressed. But from the point of view of service outcomes, Execution is at the heart of the picture, supported by Learning and Growing. Regulation, Standards and Assurance are a little further removed. These latter processes are particular concerns of accountancy and audit bodies. As we will see in later chapters, accountancy bodies (not primarily public sector) and audit bodies dominate the institutional PFM landscape.
- 4.78 **Hypothesis:** PFM reform has not been systematically directed at the elements of PFM that exercise greatest leverage on service outcomes and public benefit.
- 4.79 **Hypothesis:** CIPFA's whole system approach offers additional ways to choose priorities for improvement, for example:
- strengthening individual financial processes
 - analysing the separate activities that contribute to targeted outcomes and focussing on the ones that will make most difference
 - looking across all the processes that need to come together, and targeting improvement plans to attend to areas where change will have the biggest impact on overall effectiveness
 - creating complementary programmes that are not directly to do with financial management but may be blocking reform.
- 4.80 **Hypothesis:** Donors have not traditionally adopted this system based approach. It also lends itself well to coordinated donor intervention.
- 4.81 **Hypothesis:** Focussing directly on the contribution of PFM to service delivery highlights processes that have not always had a high profile in PFM improvement programmes, such as:
- integrated financial and policy/service planning
 - budget forecasting for budget managers
 - managing grant dependency

- financial literacy for service managers
- public service demand management.

Improving Decision Making

- 4.82 Shining the spotlight on the contribution of PFM to effective service delivery has a further implication. PFM has to get close to the decision points and management of services. This is quite likely to be in line ministries and sub-national organisations such as local authorities. It is hard for international agencies to access sub national organisations directly. Ministries of Finance must therefore be a conduit and champion for good financial management, because PFM processes and skills need to permeate all important levels of public service organisations.
- 4.83 The leaders and service managers who are responsible for decision making are very often not financial experts. Non-financial managers need to understand how to use financial information in their decision making, when to seek expert advice, how to manage financial risks and how to improve their use of resources.
- 4.84 **Hypothesis:** PFM processes and competencies should support service provision at sub national as well as at national level, and this has been relatively underdeveloped.
- 4.85 **Hypothesis:** PFM training and development programmes should include financial management training for those with service management responsibilities.

Sustainability

- 4.86 Aid interventions should address the ability of recipients to maintain the momentum of improvement. There is a risk that 'learning and growing' aspects of PFM will be underplayed if
- they are not explicitly addressed in development plans
 - donors' justifiable concerns with fiduciary risk lead them to stress compliance and control aspects of PFM at the expense of resource management and other aspects of the system that focus on its sustainability.
- 4.87 Without a whole system perspective reforms may also not be focused on the wider or longer term consequences of projects. For example, whole life cost assessment may not be selected as one of the techniques for first generation PFM reforms. But in fact its relevance appears early in many development programmes, such as the maintenance requirements of IT and physical investment, or the economic consequences of tax reform options.
- 4.88 **Hypothesis:** the control and compliance aspects of PFM that address donors' concerns for fiduciary risk should be balanced by attention to resource management and the sustainability of PFM improvements.

Using country systems

- 4.89 In the 2005 Paris Declaration countries committed to strengthen their PFM systems and donors committed to use these systems to the maximum. The 2008 Report on the Use of Country Systems in Public Financial Management

noted that the aggregate numbers on the latter front have changed little. Country led reform logically starts by addressing the country's need for PFM support. In turn this benefits from donor understanding of what PFM involves across its whole scope. Without that technical understanding, aid risks proceeding as isolated projects with limited impact, that do not raise up countries' longer term PFM capability.

- 4.90 **Hypothesis:** lack of technical understanding and practitioner experience in the donor community generally, of what PFM involves and how it connects to service delivery undermines donor strategies for improving aid effectiveness and its legacy impact. Reforms are at risk therefore of underperforming in terms of speed, effectiveness, quality and sustainability.

Training and development modalities

- 4.91 A list of usual solutions to capacity development would include short courses, one-off aid funded training programmes, academic training by universities, employing skilled staff from the private sector, long term programmes linked to international standards of the accountancy profession.²⁷ In order to maximise the impact of training it would include an assessment of need, based on the 'service quality supply chain', on relevance and on the probability of take-up in practice. This approach might result in an emphasis on modalities designed to accelerate learning and share experience, such as peer support, mentoring, improvement networks and communities of practice alongside course based learning.
- 4.92 **Hypothesis:** capacity development methods can be more systematically directed at sharing knowledge and experience with the aim of exercising greatest leverage on service outcomes and public benefit.
- 4.93 **Hypothesis:** regional practitioner learning (e.g. south-south exchange), drawing on the experience of implementation, should be supported, alongside learning aimed at technical information.

Issue 3: PFM Process Architecture

- 4.94 This paper proposes a description of the processes that make up a PFM system, with the checks and balances necessary for sustained success. This is organised by elements: legislation and regulation; standards and codes; execution – strategy and planning, operations, and monitoring and control; assurance; scrutiny and learning and growing. The model shows the component processes that relate to each of these elements, and describes their characteristics. Some preliminary findings are presented, derived by considering the current PFM position against the model.
- 4.95 Do you agree with the analysis of the PFM process elements?
- 4.96 Do you agree with the analysis of the PFM process components?
- 4.97 Do you have comments on the PFM process descriptors?
- 4.98 What changes, if any, would you propose?

²⁷ David Gray, DFID December 2008, Presentation Introduction to governance.

4.99 CIPFA proposes the following hypotheses for strengthening PFM reform and its impact, based on its analysis of the PFM process architecture. Do you agree with these hypotheses and what comments would you make?

The role of PFM in strengthening service delivery

4.100 PFM reform has not been systematically directed at the elements of PFM that exercise greatest leverage on service outcomes and public benefit.

4.101 A whole system approach offers additional ways to choose priorities for improvement, for example:

- strengthening individual financial processes
- analysing the separate activities that contribute to targeted outcomes and focussing on the ones that will make most difference
- looking across all the processes that need to come together, and targeting improvement plans to attend to areas where change will have the biggest impact on overall effectiveness
- creating complementary programmes that are not directly to do with financial management but may be blocking reform.

4.102 Donors have not traditionally adopted this system based approach. It also lends itself well to coordinated donor intervention.

4.103 Focussing directly on the contribution of PFM to service delivery highlights processes that have not always had a high profile in PFM improvement programmes, such as:

- integrated financial and policy/service planning
- budget forecasting for budget managers
- managing grant dependency
- financial literacy for service managers
- public service demand management.

Improving decision making

4.104 PFM processes and competencies must support service provision at sub national as well as at national level, and this has been relatively underdeveloped.

4.105 PFM training and development programmes must include financial management training for those with service management responsibilities.

Sustainability

4.106 The control and compliance aspects of PFM that address donors' concerns for fiduciary risk should be balanced by attention to resource management and the sustainability of PFM improvements.

Using country systems

4.107 Lack of technical understanding of what PFM involves and how it connects to service delivery undermines donor strategies for improving aid effectiveness and its legacy impact. Reforms are at risk therefore of underperforming in terms of speed, effectiveness, quality and sustainability.

Training and development modalities

4.108 Capacity development methods can be more systematically directed at sharing knowledge and experience with the aim of exercising greatest leverage on service outcomes and public benefit.

4.109 Regional practitioner learning (e.g. south-south exchange), drawing on the experience of implementation, should be supported, alongside learning aimed at technical information.

4.110 What additional issues would you propose?

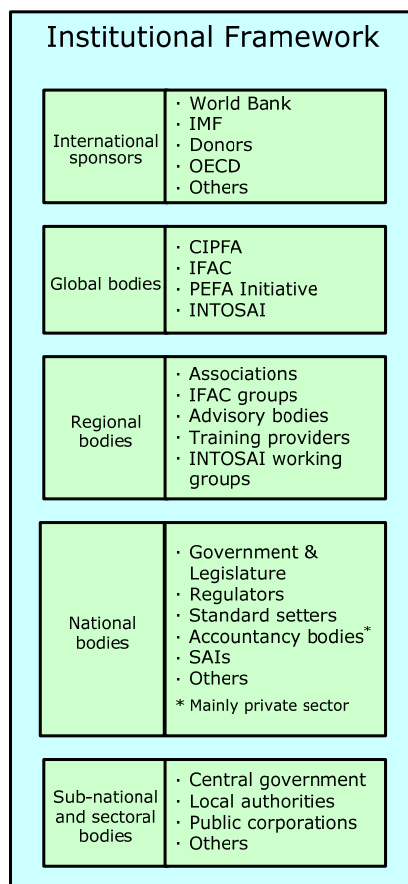
5 The PFM International Architecture: Institutional Framework

- 5.1 The institutional architecture depicts the structure of agencies and organisations that are directly involved in promulgating, operating, developing and overseeing PFM standards and practices.²⁸ In this chapter CIPFA proposes some organising principles for the collection of international institutions. The resultant taxonomy aims to facilitate analysis and debate about areas of strength and possible gaps in the existing PFM institutional framework and identify future requirements.
- 5.2 Within the PFM system, institutions operate at a number of different levels.
- 5.3 The whole system is described in progressive detail:
- Levels: that distinguish the reach of the institution - global, regional, national and sub-national
 - Types: distinguished by principal PFM function - for example, funding institution, bodies set up to promote the PFM profession, associations of peers, training providers.

Levels of institution

- 5.4 Four levels have been identified:
- International: institutions whose ambit and influence is intended to apply across the world. This includes world wide organisations, such as the World Bank, and other organisations whose ambit and influence extends across a number of countries, responding to the organisation's priorities and particular interests
 - Regional: institutions whose ambit and influence extend beyond a single country within a defined, usually geographical, region of the world. The key types are financial institutions funding development, associations of finance accountancy and audit professionals, the Supreme Audit Institutions' regional working groups, and several important topic based initiatives
 - National: institutions whose ambit and influence apply within the boundaries of a single country
 - Sub national: institutions whose ambit and influence apply within a country, limited to a particular geographic area or purpose. The types include deconcentrated national administration, provincial and local governments, and public corporations.

²⁸ The description of institutions is taken from CIPFA's International Glossary: <http://www.cipfa.org.uk/international/glossary.cfm>



Types of institution

- 5.5 PFM institutions also fall into different types. The taxonomy that follows is illustrated in relation to the international development community, rather than the developed world. There will be omissions: this is a complex and changing field.
- 5.6 A number of international organisations have a wide ranging role in the global economy, promoting economic development and poverty reduction and sponsoring high quality PFM.

International sponsors

World Bank

- 5.7 The Bank provides finance and advice to developing countries for the purposes of economic development and eliminating poverty, through a family of five international organisations: International Bank for Reconstruction and Development (IBRD); International Development Association (IDA); International Finance Corporation (IFC); Multilateral Investment Guarantee Agency (MIGA); International Centre for Settlement of Investment Disputes (ICSID). The World Bank Institute (WBI) is the capacity development arm of the World Bank, and helps countries share and apply global and local knowledge to meet development challenges. WBI builds capacity for development by providing learning programmes and policy advice on

economic management, financial and private sector development and governance.

International Monetary Fund (IMF)

- 5.8 The International Monetary Fund (IMF) was established to promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries to help ease balance of payments adjustment.

Donors

- 5.9 Individual countries may maintain programmes of assistance that express their own government's priorities. Within broad aims such as the Millennium Development Goals they may focus on defined regions or substantive priorities, for example, water and sanitation or supporting small businesses, and they may be involved in multilateral programmes. Regional emphases may reflect historical cultural ties. Countries may differ in the balance they strike between relief and tackling the causes of poverty and their commitment to building global partnerships for those working on development.
- 5.10 It follows that this is a mosaic of resources and interventions, that may require some orchestration to achieve synergy and avoid duplication, gaps and overload of differing requirements placed on developing countries with limited capability.

OECD-DAC (Development Assistance Committee)

- 5.11 The Paris Declaration (2005) asserted that a robust public financial management (PFM) system is vital to the effectiveness of aid funds. Since the Declaration, the OECD - DAC was working, through a Joint Venture on Public Financial Management, to help partners and donors alike fulfil their commitments and to share PFM knowledge among donors and partner countries. A new PFM Task Force has recently been established to support the Working Party on Aid Effectiveness.

Others

- 5.12 Other bodies with global reach may mobilise funds from sources different to those of the government subscribed institutions described above. They may also complement regionally based donor institutions, such as multilateral development banks (MDBs) or the European Commission (EC). The United Nations arms, and bodies such as international charities and emergency relief organisations have targeted or self selected objectives. These may be general, such as the relief of poverty; sectoral, for example focussing on children, health or refugees; or may relate to more specific activities such as providing medical assistance. These bodies form part of the institutional architecture because they inject very large amounts of funding, and in countries where governments are seen as having weak capacity to implement assistance effectively, they may be the chosen conduit for action. They are therefore part of the landscape in addressing donor coordination.

Global bodies

- 5.13 A number of umbrella organisations have been set up at global level by finance professionals to promote specific topics, to disseminate knowledge and to uphold the professional standards and status of their dispersed membership. The formulation of common standards and practices is the most notable function since this supports a baseline of understanding and accountability, of particular relevance to institutions, businesses and processes that operate across national boundaries. Much of this activity is driven by institutions rooted in the private sector.
- 5.14 By definition, the development community operates internationally. It has also come together to develop some public financial management tools in common to facilitate understanding, reduce duplication and ease the compliance burden for countries. Some major groupings are noted here, but there are also specific initiatives, that address individual PFM themes such as budgeting.

The Chartered Institute of Public Finance and Accountancy (CIPFA)

- 5.15 CIPFA is one of the leading professional accountancy bodies in the UK and the only major specialist in the world devoted to excellence in public sector governance and financial management. It is responsible for the education and training of professional accountants and for their regulation through setting and monitoring professional standards. Uniquely among the professional accountancy bodies in the UK, CIPFA has responsibility for setting accounting standards for local government, a significant part of the economy. CIPFA also undertakes training for public sector practitioners, supports improvement networks and continuous professional development through publications and events, and advises on public finance issues in the UK and internationally. CIPFA is a founding member of IFAC, has an increasing portfolio of advisory positions in international fora and works in partnership and collaboration on improving public financial management globally.

International Federation of Accountants (IFAC)

- 5.16 IFAC is the global organisation for the accountancy profession. IFAC develops international standards on ethics, auditing and assurance, education, and public sector accounting standards. It also issues guidance to support professional accountants in business, small and medium practices, and developing nations. A membership of 157 members and associates in 123 countries represents 2.5 million accountants employed in public practice, industry and commerce, government and academia.
- 5.17 There are four standards setting Boards of IFAC:
- The International Accounting Education Standards Board (IAESB)
 - The International Auditing and Assurance Standards Board (IAASB)
 - The International Ethics Standards Board for Accountants (IESBA)
 - The International Public Sector Accounting Standards Board (IPSASB), which focuses on issuing and promoting benchmark guidance and facilitating exchange of information for the public sector.
- 5.18 The Professional Accountants in Business (PAIB) Committee also provides resources and facilitates the exchange of knowledge and best practices. The

Developing Nations Committee (DNC) supports the development of the accountancy profession and capacity building worldwide, and ensures standard setters worldwide give attention to the interest of developing nations. IFAC recognises a number of Acknowledged Accountancy Bodies and Recognised Regional Organisations.

Public Expenditure and Financial Accountability Initiative (PEFA)

- 5.19 PEFA was developed to provide a shared pool of information on PFM that can facilitate dialogue on reform priorities among domestic and external stakeholders. It was established in 2001 as a multi-donor partnership committed to a set of core values linked to a Strengthened Approach to Supporting PFM Reform. Its objectives are formulated in a manner that: encourages country ownership; reduces the transaction costs to countries; enhances donor harmonisation; allows monitoring of progress of country PFM performance over time; addresses developmental and fiduciary concerns; facilitates improved impact of reforms.
- 5.20 PEFA supports the PEFA Framework, officially known as the PFM Performance Measurement Framework, which seeks to provide an integrated and harmonised approach for measuring and monitoring PFM performance progress, while also helping focus support on country-led PFM reform programmes. The Framework covers the full budget cycle. PEFA partners are: the World Bank, the European Commission, the UK's Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the International Monetary Fund and the Strategic Partnership with Africa.

International Organisation of Supreme Audit Institutions (INTOSAI)

- 5.21 INTOSAI operates as an umbrella organisation for the government external audit community. INTOSAI provides an institutionalised framework for supreme audit institutions (SAIs) to promote development and transfer of audit knowledge, improve government auditing worldwide and to enhance professional capacities, standing and influence of member SAIs in their respective countries. INTOSAI also issues the International Standards of SAIs (ISSAI). It sponsors the INTOSAI Development Initiative that aims to develop institutional capacity of SAIs. INTOSAI has 188 Full Members and 2 Associated Members.

Regional bodies

Multilateral Development Banks (MDBs)

- 5.22 In addition to the funding institutions established under the aegis of the World Bank, a number of multilateral Development Banks are regionally based, with shareholders drawn from the region and from partner countries. Their purpose is to promote economic and social development through loans, very long term loans (credits) at below market interest rates, equity investment and technical assistance, sometimes grant aided. The term Multilateral Development Bank typically refers to the four Regional Development Banks: the African Development Bank (AfDB), the Asian Development Bank (ADB), the European Bank of Reconstruction and Development (EBRD) and the Inter-American Development Bank Group (IDB). Other Multilateral Financial Institutions lend to developing countries, amongst them the European Investment Bank (EIB),

the Islamic Development Bank (ISDB), the OPEC Fund for International Development, the International Fund for Agricultural Development (IFAD), the Arab Fund for Economic and Social Development (AFESD) and the Nordic Development Fund. Other sub-regional development finance institutions include the East and West African Development Banks, the Caribbean Development Bank (Caribank) and the Central American Bank for Economic Integration (CABEI).

Regional Associations of finance professionals: Accounting

- 5.23 The accountancy profession has established a strong network at both regional and country level. Regional bodies include the umbrella organisations for recognised national associations of accounting professionals. Their purpose is to support professional advancement and continuous development, to exchange technical information and best practice and undertake research, and to establish a medium for closer relations, regional cooperation, and mutual assistance among members. These organisations do not have a distinctively public finance focus, and do not themselves confer accountancy qualifications.
- 5.24 The various organisations are charted in the following chapter on regional mapping, but they include a large number of bodies such as the Confederation of Asian and Pacific Accountants (CAPA), the South Asian Federation of Accountants (SAFA), the Fédération des Expert Comptables Européens (FEE), the Federation of Mediterranean Certified Accountants, the Fédération Internationale des Experts Comptables Francophones, the Arab Society of Certified Accountants, the Eastern Central and Southern African Federation of Accountants (ECSAFA), ABWA (The Association of Accountancy Bodies in West Africa), Gulf Cooperation Council Accounting and Auditing Organization (GCCAAO), Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI).
- 5.25 This is not an exhaustive list: it is given here in some detail to illustrate that there is a considerable thicket of institutions. But their place in the PFM system is dependent on the quality of their contribution to financial management specifically in the public service arena.
- 5.26 More particular to government practice are the associations of Accountants General and practice leaders, whose purpose is to develop professional practice through training, research, technical cooperation and the exchange of ideas, to develop and promote accounting standards in Government, adapted to the requirements of member countries, and to oversee the quality of implementation. Examples include the Association of Government Accounts Organisations of Asia (AGAOA), and the Federation of Accountants-General and Auditors-General of West Africa (FAAGWA). The Eastern and South African Association of Accountants General (ESAAG) is a cooperative effort between Accountants General, which seeks to strengthen and integrate the government accounting profession, support improvement of democratic processes through transparency and accountability, and assist each other in improving government accounting systems in order to produce financial statements to international standards.

Supreme Audit Institutions Regional Working Groups

- 5.27 Supreme Audit Institutions (SAIs) are also well represented in regional bodies.

- 5.28 There are seven Regional Working Groups gathered under INTOSAI, that provide training to improve the quality and performance of government auditors, promoting the exchange of information and cooperation among member institutions, and bringing together a membership from different countries. These are Asia (ASOSAI), which, for example, has 43 SAI members, EUROSAI, AFROSAI (with three language-based sub-groups), ARABOSAI, CAROSAI (Latin America and Caribbean), ECOSAI and ASOSAI (Middle East and North Africa). SAIs may also be buttressed by regional organisations aimed at strengthening the institutions such as the Conseil Régional de Formation des Institutions Supérieures de Contrôle des Finances Publiques de l'Afrique Francophone Subsaharienne (CREFIAP) and SAIGA, the Southern African Institute of Government Auditors.
- 5.29 Other groupings, such as the European Group of Auditors Oversight Bodies and the Association des Institutions Supérieures de Contrôle ayant en Commun l'Usage du Français oversee the quality of auditing bodies in the economy at large, through the approval and registration of statutory auditors and audit firms; adoption of standards on ethics, internal quality control of audit firms and auditing; and continuous education, quality assurance and investigative and disciplinary systems. These impact indirectly on public sector financial management through endorsement of international standards of auditing.
- 5.30 Regional assurance bodies may also be established for specific functions, such as the European Court of Auditors' assurance role in relation to the regularity and quality of the European Community's financial conduct, or the European Anti-Fraud Office (OLAF).

Internal audit

- 5.31 The Institute of Internal Auditors has members throughout the world who participate through their local chapters.
- 5.32 Four regional bodies at present have formal agreements of cooperation with the IIA:
- The Asian Confederation of Institutes of Internal Auditors (ACIIA)
 - The European Confederation of Institutes of Internal Auditing (ECIIA)
 - Federación Latinoamericana de Auditores Internos (FLAI)
 - Union Francophone de l'Audit Interne (UFAI)

Learning associations

- 5.33 OECD-DAC recognises initiatives to promote south-south learning as one of the tools to reflect on and spread good practice. Their significance to broader PFM success will be very much dependent on the quality and capacity of individual groups. Below are some of the better known examples.

Collaborative Africa Budget Reform Initiative (CABRI)

- 5.34 CABRI is a pan-African network of senior budget officials in ministries of finance and/or planning. Its aim is to contribute towards the efficacy of public finance management in Africa. CABRI was officially launched in collaboration with the AfDB in 2008.

Public Expenditure Management Peer Assisted Learning network (PEMPAL)

- 5.35 PEMPAL has created a network of public expenditure management professionals in various governments in the Europe and Central Asia (ECA) region. These professionals can benchmark their PEM systems against one another and pursue opportunities for 'peer' learning, as a means to enhance knowledge transfer.

Training providers

- 5.36 Most training providers in the field of PFM are thought to be single-country based. However, international firms offer consultancy and training at all levels. There are also some regional providers, for example, the Eastern and Southern African Management Institute (ESAMI), a pan-African Regional Management Development Centre; and the Institute of Development Management (IDM), a partnership of the public sector, private organisations and industry in Botswana, Lesotho and Swaziland.

National bodies

Ministry of Finance

- 5.37 The functions of the Ministry of Finance have been described as four business lines:
- macrofiscal coordination and policy
 - budget formulation
 - budget execution (including treasury, accounting policy, maintaining the public accounts, debt and cash management)
 - revenue policy and management²⁹
- 5.38 Accompanying responsibilities may include financial sector regulation, standard setting, aid management, government personnel management, procurement, oversight of state owned enterprises, government internal audit and regional economic cooperation. Because of their oversight role they may also be the champions of PFM in their countries across the whole public sector.

Accountancy bodies

- 5.39 Organisations equipped to support the professionalisation of finance specialists are those that perform the functions of awarding qualifications by examination, requiring continuous professional development and maintaining a code of ethics and discipline. Other functions include interpreting and maintaining uniform standards of accounting, enabling and supporting accountability. There is a very large number of country based accountancy bodies. The primary, if not sole, focus of most of these bodies is the private sector and in many there is little if any public sector expertise. The South African Institute for Public Finance and Auditing (IPFA) is the only public sector specialist 'professional' institute outside the UK, and is being assisted by CIPFA to progress towards IFAC membership.

²⁹ IMF Blog PFM Reform, Public Financial Management, World Bank November 2008.

- 5.40 It is sometimes argued that accounting is a universal discipline and that the distinction between public sector and commercial accountancy is immaterial. This misses a very important point. Financial accounting in both sectors does share many concepts and practices. But accounting and public financial management are not at all the same. As the PFM Process model described earlier in this paper shows, accounting, reporting and providing assurance on financial statements are only a small part of PFM. Other PFM functions like resource management, poverty sensitive charging mechanisms and anti fraud controls are distinctive contributions to good quality affordable public services.

Central bank

- 5.41 A central bank is the entity responsible for the monetary policy of a country or of a group of member states. It is a bank that can lend to other banks in times of need. Its primary responsibility is to maintain the stability of the national currency and money supply, but more active duties include controlling subsidized-loan interest rates, and acting as a lender of last resort to the banking sector during times of financial crisis. It may also have supervisory powers, to ensure that banks and other financial institutions do not behave recklessly or fraudulently.
- 5.42 Functions of a central bank (not all functions are carried out by all banks) may include:
- implementing monetary policy
 - controlling the nation's money supply
 - the Government's banker and the bankers' bank ("lender of last resort")
 - managing the country's foreign exchange and gold reserves and the Government's stock register
 - regulating and supervising the banking industry
 - setting the official interest rate – used to manage both inflation and the country's exchange rate – and ensuring that this rate takes effect via a variety of policy mechanisms
- 5.43 It is arguable that these functions are not directly related to financial management of public sector resources and that Central Banks should not form part of the Institutional PFM Architecture defined in this paper. They are included here because of their relevance to national budgeting and funding strategies. Their absence from the list would itself prompt question and their presence here allows room for that debate.

Internal audit: Institute of Internal Auditors (IIA)

- 5.44 The Institute of Internal Auditors is an IFAC Affiliate and has its headquarters in the USA. It issues International Standards for the Professional Practice of Internal Auditors, which are designed primarily for the private sector but are used in the public sector. It has 160,000 members in their country chapters.

Local training providers

- 5.45 There are a very large number of training providers, with some specialising in finance training although few have real centres of excellence or expertise in PFM. Included in this category are the universities and similar bodies, many of which offer training and related services including consultancy to the public sector.

Supreme Audit Institutions (SAIs)

- 5.46 SAIs carry out the external audit of public sector bodies and are one of the key links in the formal system of financial accountability in most countries. The strengthening of partner country SAIs is therefore often seen as a lever for improvements to the effectiveness of PFM systems as a whole.

Sub-National bodies

- 5.47 Further down the institutional hierarchy the complexity and variety of the landscape increases greatly and generalisation becomes more problematic. Institutions funded by the public purse in order to provide public services can take a number of shapes, including elected bodies with their own powers of autonomy within the national constitution and their own taxation and borrowing powers, such as states or provinces. They may have different ranges of responsibilities, for example, whether they cover secondary education or health facilities, whether they are multi purpose or single service providers, whether they have general powers of competence or are more narrowly governed. There may be a number of tiers of sub national authorities, such as the UK's regional, county, district and parish councils. These patterns may vary even within the same country, as they do in the UK. They may take different legal forms, such as public corporations or local governments. They may be deconcentrated arms of the national administration. As we are seeing in economic recession, new forms of publicly funded private sector businesses are being created.
- 5.48 The purpose of the PFM international architecture is to provide a framework of concepts in which differences can be positively highlighted and analysed. Despite the institutional variety, the elements of the PFM Process architecture – Legislation and Regulation, Standards and Codes, Execution, Assurance, Scrutiny, Learning and Growing - should be those that remain relevant across the scale, where public money brings the need for public accountability. Similar processes will need to be put in place, even though they will be proportionate to the financial commitment involved.

Issues arising

- 5.49 The existing architecture of institutions described in this chapter prompts a number of reflections on its potential effectiveness for delivering improved PFM and public services. These 'hypotheses' are put forward as a stimulus for further discussion and prioritisation for further analysis and action to strengthen the system.

Financial management distinguished from financial accounting

- 5.50 The sizeable international superstructure of accounting and audit bodies suggests a bias towards creating and assuring financial accounting standards. The practical demands of financial management, enabling services to understand cost drivers and behaviours, and to plan and deliver efficient operations on the ground in a public service context do not have such an obvious support. Nor are they the specialism of the bodies that donors often rely on to professionalise and improve PFM. Yet the pressures on financial management in the public services are different from those in the private sector. This observation reinforces a similar point in relation to the process architecture about the inadequate weight usually given to how money is deployed and managed in practice to deliver services.

- 5.51 **Hypothesis:** the prevalence in the institutional architecture of financial accounting and auditing interests, often with private sector backgrounds, should be balanced by institutional support for practical financial management in the context of the particular challenges for public services.
- 5.52 **Hypothesis:** there should be greater awareness and understanding in the development community of the implications of an over reliance on organisations that were set up to create and champion standards for a primarily private sector accountancy profession. This is especially the case when it is necessary to develop public financial management in countries, where it is weak and where the private sector itself still needs considerable attention.

The accountancy profession's role

- 5.53 The elements of the architecture associated with the international accountancy profession are accorded much weight in defining and ensuring high quality PFM. They are often expected to be the means for transmitting good practice towards the front line, where expenditure decisions are taken. The transmission works through:
- IFAC setting accounting and other standards such as educational standards, and that drive many of the lower level requirements e.g. the nature and extent of the training need in each country
 - countries expected to comply with external auditing standards defined by INTOSAI
 - internal auditing standards, many set de facto by IIA, assumed to be relevant to the needs of public sector bodies although in many cases these have been developed in a private sector environment
 - increasing global convergence of accounting standards, that reduces discretion available to professional bodies in an individual country
- 5.54 However in reality, there is a gulf between the technical expertise of IFAC members who define standards and that existing in country and regional bodies. International standards may not be sensitive to the needs of the public sector, may be disproportionate to the level of capacity and development in countries, may disregard sequencing needs (e.g. 'Account for cash before accounting for accruals'³⁰) and may not be helpful in terms of defining a transitional path, such as that required to move from cash to accruals accounting. Furthermore local capabilities may be too weak to apply centrally prescribed standards.
- 5.55 **Hypothesis:** the drive to global convergence of accounting standards should recognise the gap between the technical sophistication of those engaged in setting international accounting and auditing standards and the fragile capacity of some countries expected to implement them, together with the proportion of capacity that may be devoted to convergence compared with other PFM reforms. These relative imbalances need to be taken into account in donors' expectations. The path to compliance should take into account relevance, proportionality and meaningfulness in the public sector context, supporting where necessary the work of national government Accountants General, and ensuring that the path to full adoption of international standards is well charted and supported.

³⁰ Shick Getting the Basics Right, World Bank Public Expenditure Management Handbook 1998

The sub national PFM infrastructure

- 5.56 The number of sub national delivery bodies and the differences between them in scope, resources, functions and autonomy means that bilateral engagement between donors and these institutions becomes a practical impossibility for most donors. Donors often relate principally to Ministries of Finance and organisations such as Supreme Audit Institutions, on whom they rely to manage a structure of delivery bodies.
- 5.57 However, the Ministry of Finance is not where money gets spent. In practical terms effective delivery is too diverse and complicated to be driven through a primarily top down approach. Aid modalities that favour a devolved approach are not adequately served by fostering capacity predominantly at national level. Building a capability ground up is also necessary, both to deliver aid programmes and to create a sustainable legacy.
- 5.58 **Hypothesis:** a sub national PFM capability, close to service delivery points, needs to complement country level PFM reform in order to create a sustainable legacy.
- 5.59 **Hypothesis:** creating a ground up infrastructure calls for a programme of professionalisation that encourages its members to pursue excellence in public financial management and equips them with the skills and tools to do so. This goes beyond reliable financial accounting even though this is an important element.
- 5.60 **Hypothesis:** professionalisation has a key role to play in overcoming the complexity of engaging with multifarious sub regional types of organisations and in embedding a legacy of effective PFM. It should aim to support finance staff in moving to financial leadership not just in technical expertise, and in taking responsibility for future development of themselves and others. However for this to happen, professional qualification needs to take place in a supportive environment that recognises, rewards and uses personal development.

Issue 4: The International Architecture: Institutional Framework

- 5.61 The Institutional Architecture depicts the structure of agencies and organisations that are directly involved in formulating PFM standards and practices. CIPFA believes that understanding and applying the whole system perspective should improve the effectiveness of donor strategies and PFM intervention, and gives examples.
- 5.62 Do you agree with the general taxonomy of the Institutional Architecture?
- 5.63 What changes, if any, would you propose?
- 5.64 CIPFA proposes some initial hypotheses for strengthening PFM reform and its impact, based on its analysis of the PFM institutional architecture. Do you agree with these hypotheses and what comments would you make?

Financial management distinguished from financial accounting

- 5.65 The prevalence in the institutional architecture of financial accounting and auditing interests, often with private sector backgrounds, should be balanced by institutional support for practical financial management in the context of the particular challenges for public services.

5.66 There should be greater awareness and understanding in the development community of the implications of an over reliance on organisations that were set up to create and champion standards for a primarily private sector accountancy profession, to develop public financial management in countries, especially where it is weak and where the private sector itself still needs considerable attention.

The accountancy profession's role

5.67 The drive to global convergence of accounting standards must recognise the gap between the technical sophistication of those engaged in setting international accounting and auditing standards and the fragile capacity of some countries expected to implement them. Another development concern is the proportion of capacity that may be devoted to convergence compared with other PFM reforms. These relative imbalances need to be taken into account in donors' expectations. The path to compliance should take into account relevance, proportionality and meaningfulness in the public sector context, supporting where necessary the work of national government accountants general, and ensuring that the path to full adoption of international standards is well charted and supported.

The sub national PFM infrastructure

5.68 A sub national PFM infrastructure, close to service delivery points, needs to complement country level PFM reform, in order to create a sustainable legacy.

5.69 Creating a ground up infrastructure calls for a programme of professionalisation that encourages its members to pursue excellence in public financial management and equips them with the skills and tools to do so. This goes beyond reliable financial accounting even though this is an important element.

5.70 Professionalisation has a key role to play in overcoming the complexity of engaging with multifarious sub regional types of organisations and in embedding a legacy of effective PFM. It should aim to support finance staff in moving to financial leadership not just technical expertise, and to take responsibility for future development of themselves and others. However, for this to happen, professional qualification needs to take place in a supportive environment that recognises, rewards and uses personal development.

5.71 What additional findings would you propose?

5.72 What further issues would you like to see raised?

6 The Regional Mapping

6.1 In the pages that follow, the principal institutions have been mapped to the main regions of the world. (Acronyms used in the mapping refer to institutions described in the previous chapter.) Regions are not always consistently defined by the various stakeholders across the world, so some judgement has been applied to classification. This is made clear in the countries listed for each. The maps show institutions at the different geopolitical levels of Global, Regional, and National. Description has not been extended to sub national level, because of the complexity involved, although this is something that could be pursued on a case by case basis.

6.2 The maps prompt some immediate and significant observations:

- this is not an architecture that has developed by design. It grows out of a long history but not out of system logic
- the proliferation of bodies says nothing about quality, and institutions with similar titles may have very different PFM capacity
- institutional specialisation tends more to fragment PFM topics, e.g. audit, budgeting, rather than to pull them together
- for countries with underdeveloped professionalisation and weak capacity, servicing the requirements of the large institutional superstructure and participating in regional initiatives may absorb an unsustainable share of resources more importantly needed for national service priorities
- a striking feature is the general paucity of institutions dedicated to PFM as opposed to accountancy with a private sector focus.

6.3 CIPFA believes that mapping of the regional architecture can play a significant role in its analysis and strengthening. It can assist donors' decisions and hence the effectiveness of development funding and programmes:

- it can give a speedy overview of the institutions in each region
- it can help donors decide whether institutions are the right partners for the intended purpose by focussing on the type and function of each institution. They also need to look at the capacity of organisations, some of which may be quite fragile
- it assists technical understanding of the structure, purpose and role of the PFM architecture
- it counters the risk that donors may bypass existing organisations because they are unaware of their existence or function
- it helps to surface issues about the completeness of the arrangements in each region to support PFM and suggests where gaps may need to be addressed
- it opens up discussion about what functions are best performed at regional level and what at country or sub national level. For example, setting up regional communities of practice or common PFM qualifications frameworks such as the Africa Capacity Development Initiative (SCDI) may avoid duplicating cost or time and create benefits for knowledge exchange. Some PFM initiatives may work well with a common regional spine and local tailoring, for example, an audit manual. Other PFM aspects may be better tailored for country conditions. For example, professional qualifications could be awarded at country level, with a regional system for continuous professional development

- it highlights the importance of confidence about transmission or trickle down efficiency where regional bodies are selected to create country PFM improvements.
- 6.4 The charts produced in this paper are high level, and the development community will also want to examine more detailed aspects of institutions they might support, such as their capacity and track record.

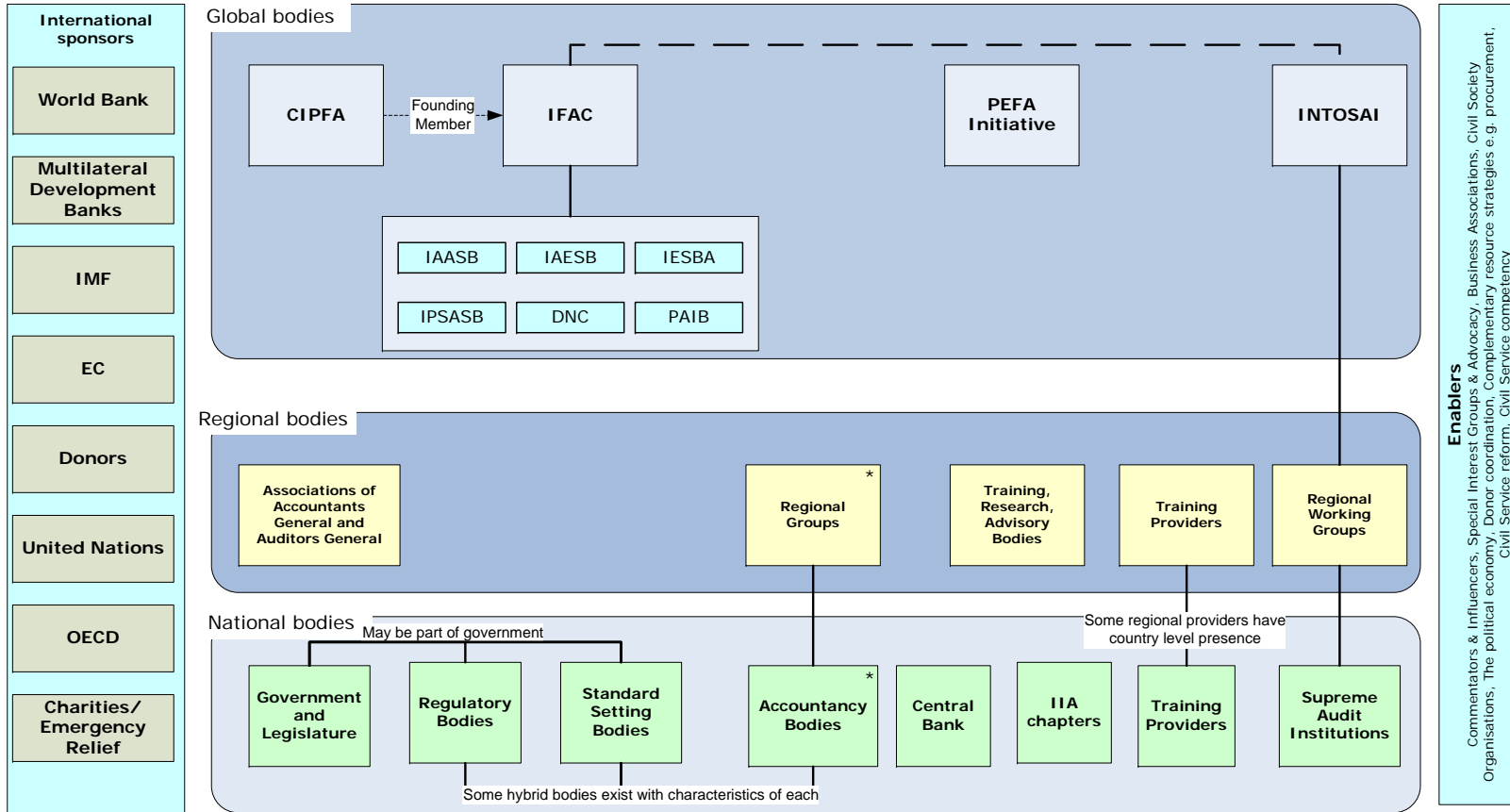
Issues arising

- 6.5 The purpose of this paper is to offer a framework and initial analysis to stimulate discussion that helps to create a more efficient outcome for development partners and partner countries. In that spirit, the following hypotheses are put forward. Readers are invited to identify other gaps or issues in the regional framework that can be the subject of future analysis.
- 6.6 **Hypothesis:** Institutional mapping can play a significant role in the selection and design of donor interventions.
- 6.7 **Hypothesis:** An understanding of the functions and purposes of regional and national bodies is important when donors are selecting institutions to support country reform initiatives.

Issue 5: Regional Mapping

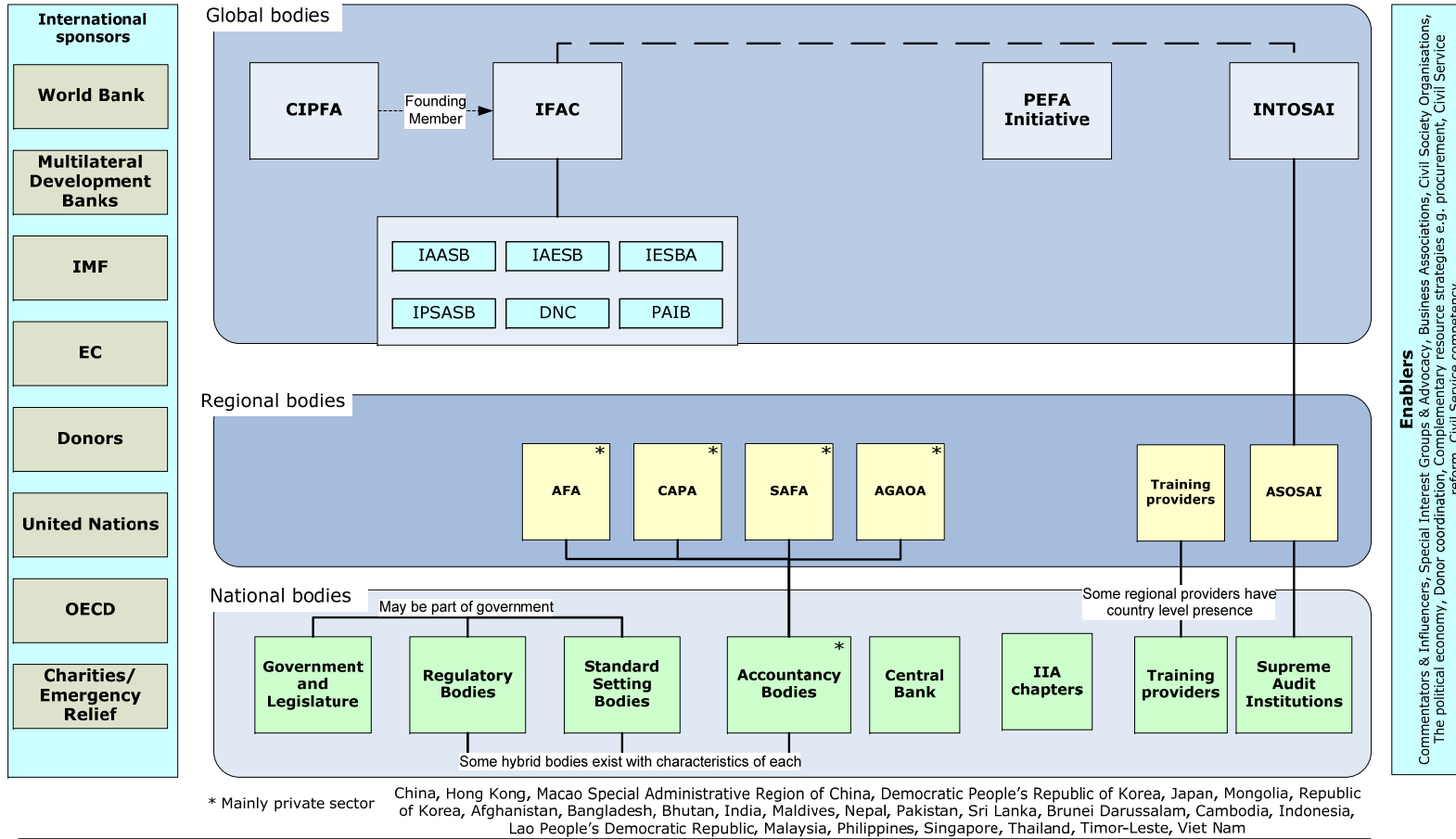
- 6.8 Charting the institutions present in each of the major geographical regions is a basis for development partners to consider how best to route PFM reform projects, and prompts some general reflections on the distribution of institutions across the levels, global, regional and national.
- 6.9 Do you agree with the generic framework for the regional maps?
- 6.10 Is the map proposed for each region accurate?
- 6.11 What changes, if any, would you propose?
- 6.12 What benefits, if any, do you see from mapping the relevant institutional and functional architecture?
- 6.13 CIPFA proposes the following hypotheses for strengthening PFM reform and its impact, based on its analysis of the PFM regional architecture. Do you agree with these hypotheses and what comments would you make?
- 6.14 Institutional mapping can play a significant role in the selection and design of donor interventions.
- 6.15 An understanding of the functions and purposes of regional and national bodies is important when donors are selecting institutions to carry forward their reform initiatives.
- 6.16 What additional findings would you propose?
- 6.17 What further issues would you like to see raised?

PFM International Architecture: Institutional Framework

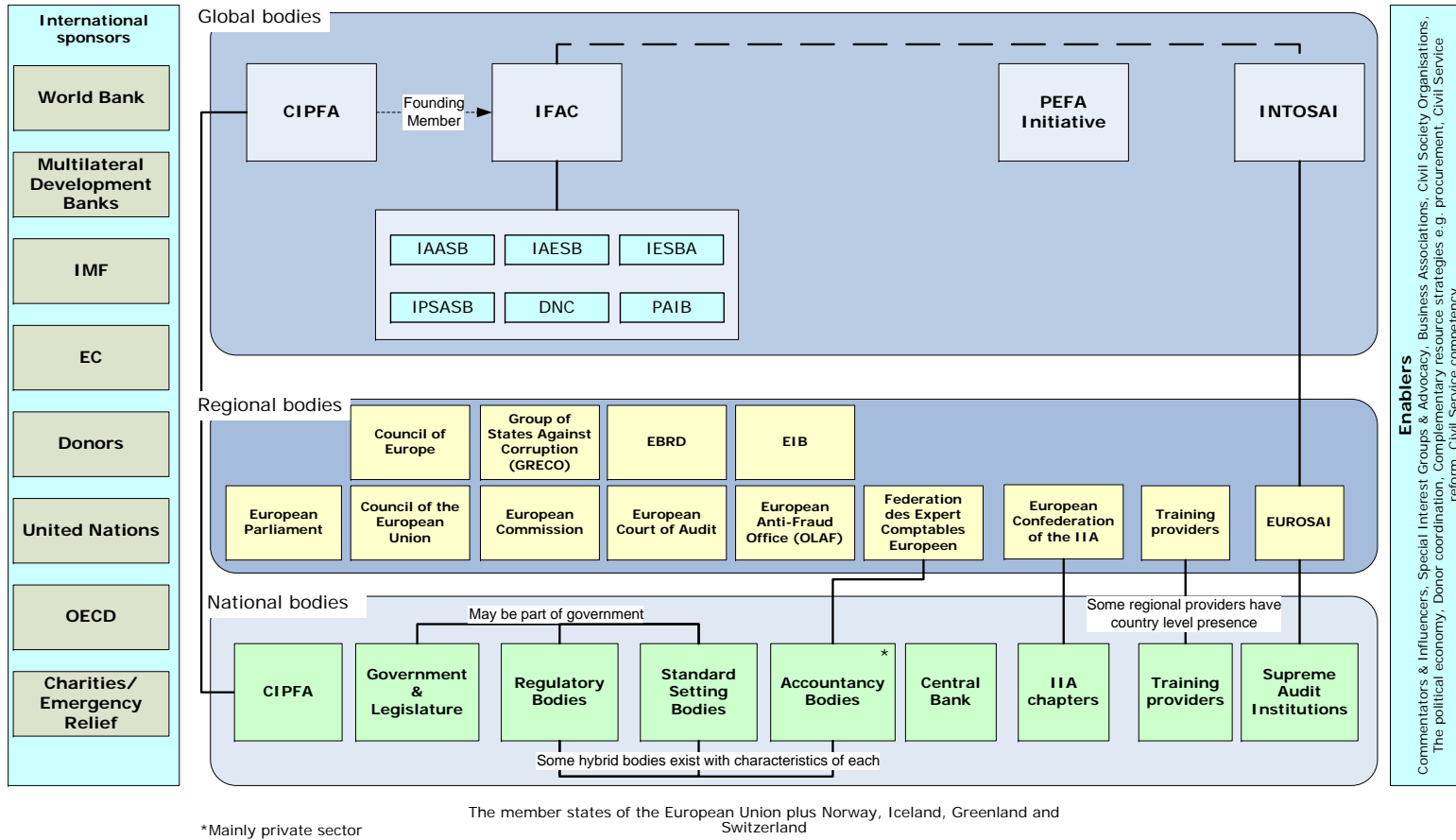


*Mainly private sector

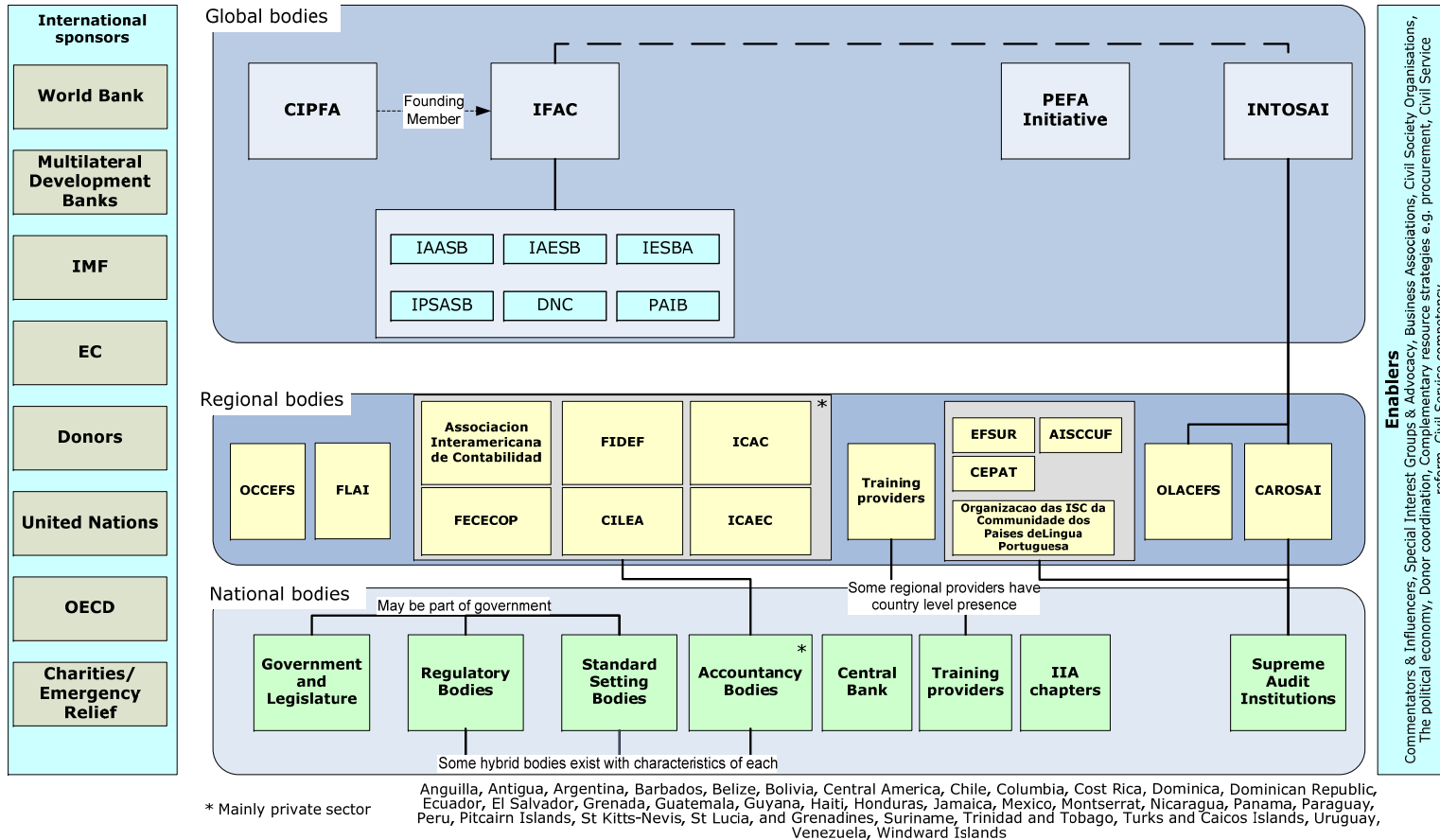
PFM International Architecture: Institutional Framework: Asia



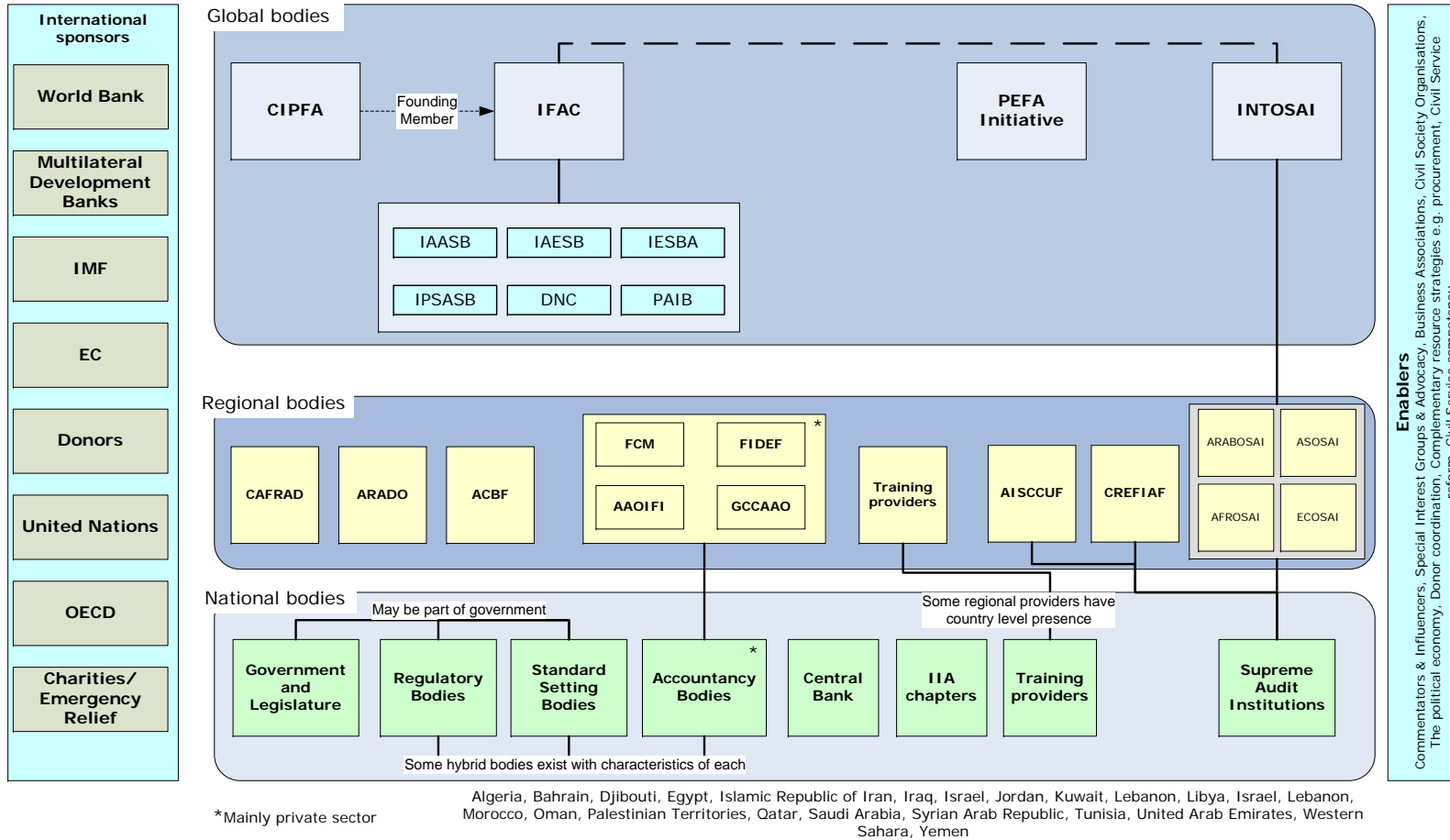
PFM International Architecture: Institutional Framework: Europe



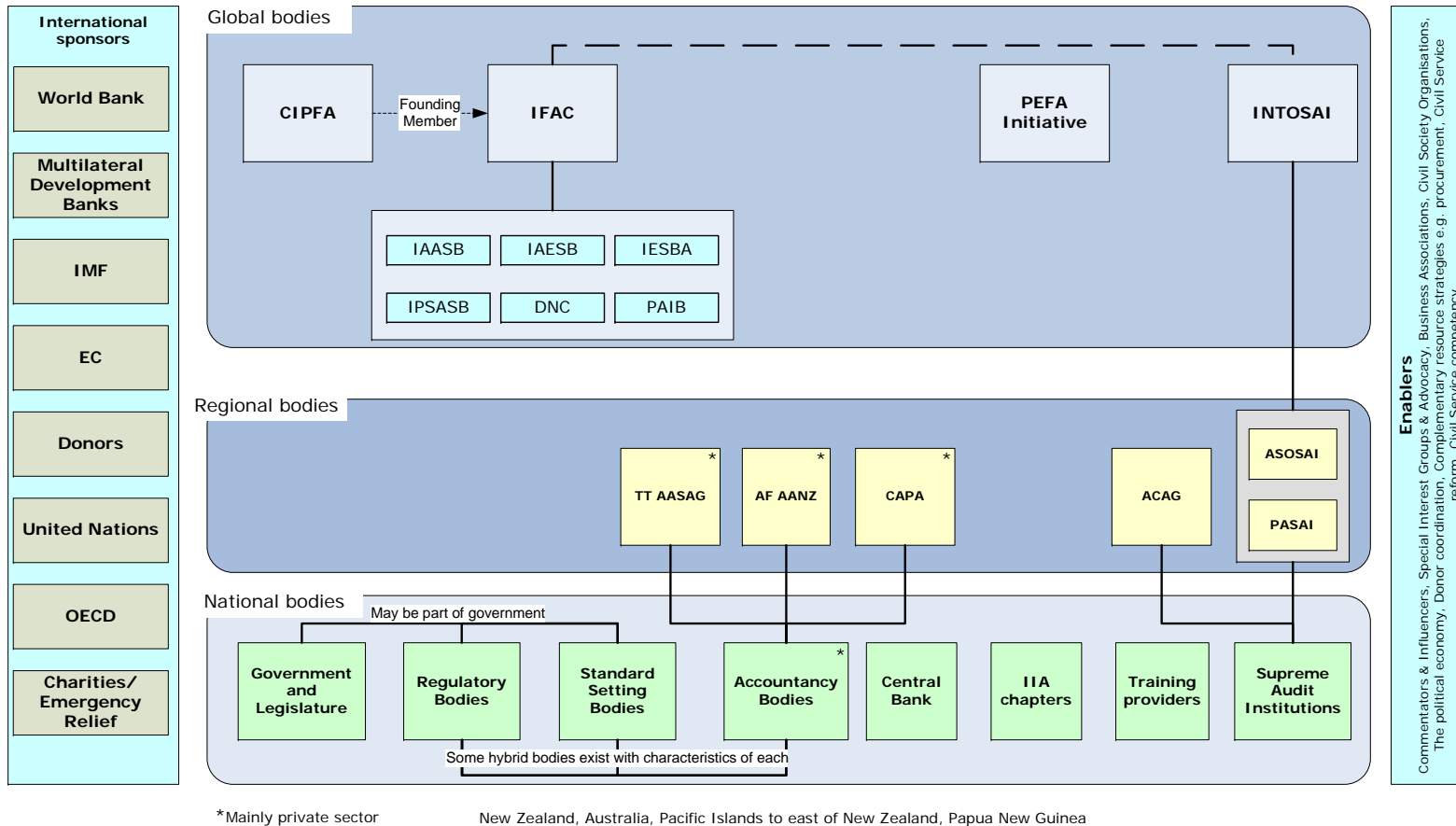
PFM International Architecture: Institutional Framework: Latin America & The Caribbean



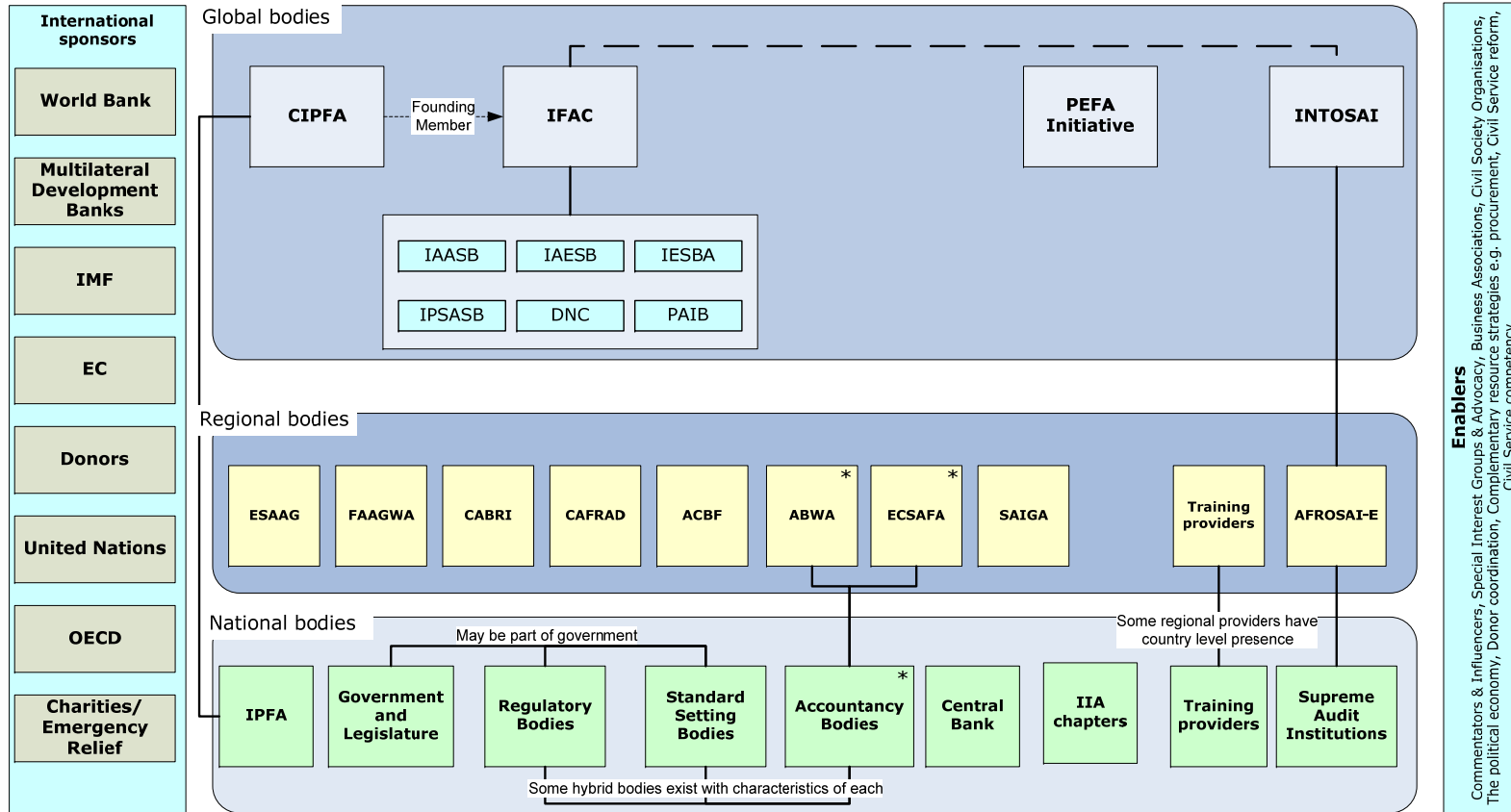
PFM International Architecture: Institutional Framework: Middle East and North Africa



PFM International Architecture: Institutional Framework: Pacific



PFM International Architecture: Institutional Framework: Sub-Saharan Africa



Enablers
 Commentators & Influencers, Special Interest Groups & Advocacy, Business Associations, Civil Society Organisations, The political economy, Donor coordination, Complementary resource strategies e.g. procurement, Civil Service reform, Civil Service competency

*Mainly private sector

Angola, Benin, Botswana, Burundi, Cameroon, Congo (Democratic Republic of), Cote d'Ivoire, Eritrea, Ethiopia, Gambia, Ghana, Guinea, Kenya, Lesotho, Liberia, Madagascar, Malawi, Mozambique, Namibia, Niger, Nigeria, Rwanda, Sierra Leone, South Africa, Sudan, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe

7 Request for Comments

- 7.1 CIPFA wishes to test the concepts it has developed in this paper and to seek views about the hypotheses it has drawn from examining the whole system of PFM. It also seeks views from others working in the financial management and international field about the issues that they see, using the whole system perspective.
- 7.2 CIPFA welcomes comments on all of the matters and issues addressed in this Consultation Paper. Notwithstanding that, CIPFA has identified a number of key issues, and would particularly welcome views on each of these. Comments will be most useful when they give reasons for the views expressed.

Issue 1: PFM Definition

- 2.15 There is currently no single accepted definition of PFM, but it is often narrowly expressed in terms of the stages of the budget cycle. This paper defines PFM as a system of financial management directed towards realising the goals of the public services.
- 2.16 "Public financial management is the system by which the financial aspects of the public services' business are directed, controlled and influenced, to support the delivery of the sector's goals."
- 2.17 Do you agree with CIPFA's proposed definition of PFM?
- 2.18 The definition, like the traditional focus on budgetary processes, is concerned with managing finances in the public services. It is a broader definition than that generally adopted. However, it does not include broader management of the economy or fiscal policy. It recognises relationships with other management processes, and with other resource management strategies - such as procurement and risk - and with forces like the influence of the media, but they are included as part of PFM only if they are directly related to financial management.
- 2.19 Do you agree with the approach to the boundaries of the definition?

Issue 2: Relationship between PFM and contextual factors

- 3.7 The PFM system is powered by contextual factors, such as the political economy and the influence of civil society. In the whole system approach proposed here these are treated as framing elements that influence the effectiveness of PFM, but are not an intrinsic part of PFM processes. The chart on page 22 locates PFM in its overall context.
- 3.8 Do you agree with the approach to the contextual factors of PFM?
- 3.9 Do you agree with the categorisation of the institutional framework?
- 3.10 Do you agree with the categorisation of enablers in the framework?

Issue 3: PFM Process Architecture

- 4.94 This paper proposes a description of the processes that make up a PFM system, with the checks and balances necessary for sustained success. This is

organised by elements: legislation and regulation; standards and codes; execution – strategy and planning, operations, and monitoring and control; assurance; scrutiny and learning and growing. The model shows the component processes that relate to each of these elements, and describes their characteristics. Some preliminary findings are presented, derived by considering the current PFM position against the model.

- 4.95 Do you agree with the analysis of the PFM process elements?
- 4.96 Do you agree with the analysis of the PFM process components?
- 4.97 Do you have comments on the PFM process descriptors?
- 4.98 What changes, if any, would you propose?
- 4.99 CIPFA proposes the following hypotheses for strengthening PFM reform and its impact, based on its analysis of the PFM process architecture. Do you agree with these hypotheses and what comments would you make?

The role of PFM in strengthening service delivery

4.100 PFM reform has not been systematically directed at the elements of PFM that exercise greatest leverage on service outcomes and public benefit.

4.101 A whole system approach offers additional ways to choose priorities for improvement, for example:

- strengthening individual financial processes
- analysing the separate activities that contribute to targeted outcomes and focussing on the ones that will make most difference
- looking across all the processes that need to come together, and targeting improvement plans to attend to areas where change will have the biggest impact on overall effectiveness
- creating complementary programmes that are not directly to do with financial management but may be blocking reform.

4.102 Donors have not traditionally adopted this system based approach. It also lends itself well to coordinated donor intervention.

4.103 Focussing directly on the contribution of PFM to service delivery highlights processes that have not always had a high profile in PFM improvement programmes, such as:

- integrated financial and policy/service planning
- budget forecasting for budget managers
- managing grant dependency
- financial literacy for service managers
- public service demand management.

Improving decision making

4.104 PFM processes and competencies must support service provision at sub national as well as at national level, and this has been relatively underdeveloped.

4.105 PFM training and development programmes must include financial management training for those with service management responsibilities.

Sustainability

4.106 The control and compliance aspects of PFM that address donors' concerns for fiduciary risk should be balanced by attention to resource management and the sustainability of PFM improvements.

Using country systems

- 4.107 Lack of technical understanding of what PFM involves and how it connects to service delivery undermines donor strategies for improving aid effectiveness and its legacy impact. Reforms are at risk therefore of underperforming in terms of speed, effectiveness, quality and sustainability.

Training and development modalities

- 4.108 Capacity development methods can be more systematically directed at sharing knowledge and experience with the aim of exercising greatest leverage on service outcomes and public benefit.

- 4.109 Regional practitioner learning (e.g. south-south exchange), drawing on the experience of implementation, should be supported, alongside learning aimed at technical information.

- 4.110 What additional issues would you propose?

Issue 4: The International Architecture: Institutional Framework

- 5.61 The Institutional Architecture depicts the structure of agencies and organisations that are directly involved in formulating PFM standards and practices. CIPFA believes that understanding and applying the whole system perspective should improve the effectiveness of donor strategies and PFM intervention, and gives examples.

- 5.62 Do you agree with the general taxonomy of the Institutional Architecture?

- 5.63 What changes, if any, would you propose?

- 5.64 CIPFA proposes some initial hypotheses for strengthening PFM reform and its impact, based on its analysis of the PFM institutional architecture. Do you agree with these hypotheses and what comments would you make?

Financial management distinguished from financial accounting

- 5.65 The prevalence in the institutional architecture of financial accounting and auditing interests, often with private sector backgrounds, should be balanced by institutional support for practical financial management in the context of the particular challenges for public services.

- 5.66 There should be greater awareness and understanding in the development community of the implications of an over reliance on organisations that were set up to create and champion standards for a primarily private sector accountancy profession, to develop public financial management in countries, especially where it is weak and where the private sector itself still needs considerable attention.

The accountancy profession's role

- 5.67 The drive to global convergence of accounting standards must recognise the gap between the technical sophistication of those engaged in setting international accounting and auditing standards and the fragile capacity of some countries expected to implement them. Another development concern is the proportion of capacity that may be devoted to convergence compared with other PFM reforms. The path to compliance should take into account relevance, proportionality and meaningfulness in the public sector context, supporting where necessary the work of national government accountants general, and ensuring that the path to full adoption of international standards is well charted and supported

The sub national PFM infrastructure

- 5.68 A sub national PFM infrastructure, close to service delivery points, needs to complement country level PFM reform, in order to create a sustainable legacy.
- 5.69 Creating a ground up infrastructure calls for a programme of professionalisation that encourages its members to pursue excellence in public financial management and equips them with the skills and tools to do so. This goes beyond reliable financial accounting even though this is an important element.
- 5.70 Professionalisation has a key role to play in overcoming the complexity of engaging with multifarious sub regional types of organisations and in embedding a legacy of effective PFM. It should aim to support finance staff in moving to financial leadership not just technical expertise, and to take responsibility for future development of themselves and others. However, for this to happen, professional qualification needs to take place in a supportive environment that recognises, rewards and uses personal development.
- 5.71 What additional findings would you propose?
- 5.72 What further issues would you like to see raised?

Issue 5: Regional Mapping

- 6.8 Charting the institutions present in each of the major geographical regions is a basis for development partners to consider how best to route PFM reform projects, and prompts some general reflections on the distribution of institutions across the levels, global, regional and national.
- 6.9 Do you agree with the generic framework for the regional maps?
- 6.10 Is the map proposed for each region accurate?
- 6.11 What changes, if any, would you propose?
- 6.12 What benefits, if any, do you see from mapping the relevant institutional and functional architecture?
- 6.13 CIPFA proposes the following hypotheses for strengthening PFM reform and its impact, based on its analysis of the PFM regional architecture. Do you agree with these hypotheses and what comments would you make?
- 6.14 Institutional mapping can play a significant role in the selection and design of donor interventions.
- 6.15 An understanding of the functions and purposes of regional and national bodies is important when donors are selecting institutions to carry forward their reform initiatives.
- 6.16 What additional findings would you propose?
- 6.17 What further issues would you like to see raised?