

# Assessing and Reforming Public Financial Management

*A New Approach*

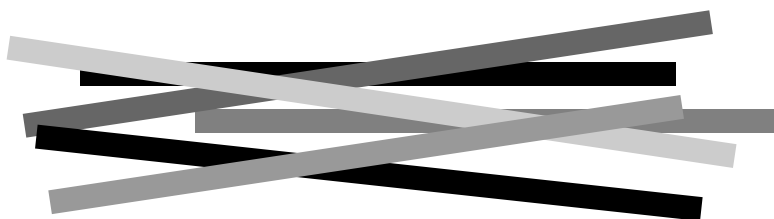
Richard Allen  
Salvatore Schiavo-Campo  
Thomas Columkill Garrity



THE WORLD BANK

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The World Bank  
1818 H Street, N.W.  
Washington, D.C. 20433  
Telephone 202-473-1000  
Internet [www.worldbank.org](http://www.worldbank.org)  
E-mail [feedback@worldbank.org](mailto:feedback@worldbank.org)

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## Preface

Over the past 15 years donors seeking to advance development and abate poverty have placed growing emphasis on the need for effective public expenditure management and financial accountability systems. Numerous trends explain this evolution, including the realization that aid resources are fungible, the shift toward policy-based adjustment lending, the need to strengthen the links between policymaking and budget preparation, and the recognition of corruption's destructive effects. As a result many donors have introduced new diagnostic instruments and reports that describe and assess public expenditure and financial accountability laws, systems, and procedures in countries that receive international aid and technical assistance. These diagnostic instruments contain information on the fiduciary risks facing aid donors and recipients, and are often required by donors before aid is provided. Such information is also valuable to a recipient country as a foundation on which it can craft sustainable reforms in public expenditure and budgeting, and build institutional capacity.

Drawing on a technical mapping of current assessment instruments' coverage, a review of staff guidelines and sample assessment reports, and interviews with experts from donor agencies and recipient governments, this study recommends a new approach to assessing and reforming public expenditure management. This approach has several goals:

- Streamlining instruments to avoid unnecessary duplication and fill gaps in coverage.



- Enhancing collaboration and promoting information-sharing between donors, recipient governments, and other stakeholders.
- Providing more complete, accurate, and timely assessments of fiduciary risk.
- Monitoring improvements in public expenditure management using appropriate indicators and benchmarks.
- Increasing the development impact of public expenditure assessments and reforms.
- Developing a standardized assessment—one that synthesizes information using a common format, including key performance indicators—that is accepted by all donors as a basis for measuring and monitoring fiduciary risk when providing budget support.

Some efforts are already under way to strengthen collaboration on public expenditure work between the World Bank and the International Monetary Fund (IMF), among multilateral development banks, between the Bank and IMF and the European Commission, and between multilateral and bilateral donors. These harmonization efforts—recognized in the February 2003 Rome Declaration on Harmonization—are being supported by organizations such as the OECD's Development Assistance Committee and the Public Expenditure and Financial Accountability (PEFA) program. Boards of directors of donor organizations, the European Parliament, and the European Court of Audit are also exerting considerable influence.

But such initiatives are only just beginning. Considerable effort will be required to sustain and advance them, supported by changes in operational procedures and incentives in the agencies concerned. In addition, recipient governments must take a stronger leadership role in this work—particularly in developing and implementing strategic action plans to build capacity and manage reform. This report is designed to foster and further such developments, drawing on global experiences to strengthen assessment instruments and improve public expenditure management around the world.



## Acknowledgments

The analysis in this study was carried out under the Public Expenditure and Financial Accountability (PEFA) program, a partnership established in December 2001 involving the World Bank, IMF, European Commission, Strategic Partnership with Africa, and several bilateral donors (France, Norway, Switzerland, and the United Kingdom).

PEFA's mandate is to support integrated, harmonized approaches to the assessment and reform of public expenditure, procurement, and financial accountability, focusing on the use of diagnostic instruments. Many such instruments have been developed in recent years. In 2002 PEFA conducted a research project that mapped the technical scope and coverage of the instruments and identified areas of overlap as well as areas inadequately covered. The project also investigated the methods and procedures used by donor agencies in undertaking these diagnostic reviews, the extent to which the work was done in collaboration with other donors and recipient governments, and its likely impact on development. This work resulted in a PEFA report issued in the spring of 2003 that has been adapted into this book.

The authors are grateful to Serif Sayin and David Steedman for valuable contributions to initial work on the PEFA research project; to the PEFA Secretariat—particularly Mike Boniakowski, Odile Keller, and Nicola Smithers—for advice and technical input; to members of the PEFA Steering Committee—Armando Araujo, Ivor Beazley, Paul Bermingham, Pamela Bigart, Jim Brumby, Jack Diamond, Simon Gill, Cheryl Gray, Hen-

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## Executive Summary

This study is intended to help underpin a more coordinated, effective approach to assessing and reforming systems for public expenditure, procurement, and financial accountability in developing countries—especially countries that receive international aid for budget support. Such support, also known as adjustment lending, has become far more important in recent years. At the World Bank, for example, it increased from less than 10 percent of total assistance in the 1980s to about 50 percent in fiscal 2002. Many other development agencies are also increasing aid for budget support.

This support has been accompanied by—and reflects—widespread recognition that aid is fungible and that resources can be transferred, so that aid intended for one project can effectively be used to finance another. Thus, efforts to safeguard the integrity of donor resources mean little without safeguards on the use of government resources. Moreover, growing awareness of the destructive effects of corruption—emphatically underscored by the East Asian financial crisis of 1997–99—has given new urgency to donors’ need to ensure that aid is not diverted to private ends or misallocated to activities not conducive to fostering growth and reducing poverty. For all these reasons it is important, for donors and recipient governments alike, that the strengths and weaknesses of national budget systems be well understood and that governments implement reforms where needed, especially in high-risk areas.

Development agencies use a variety of instruments to assess these systems; this study focuses on World Bank Public Expenditure Reviews (PERs), Country Financial Accountability Assessments (CFAAs) and Country Procurement Assessment Reports (CPARs), International Monetary Fund (IMF) Reports on the Observance of Standards and Codes of Fiscal Transparency (Fiscal ROSCs), IMF–World Bank Public Expenditure Tracking Assessments and Action Plans for Heavily Indebted Poor Countries (HIPC AAPs), EC audits of public expenditure management systems, and U.K. Department for International Development (DFID) assessments of fiduciary risk.

The study's review of these assessment instruments raises many important issues. Accordingly, its findings and recommendations are intended to generate discussion and debate between development agencies, recipient governments that are (or may become) the subject of such assessments, and other stakeholders.

If the findings and recommendations are accepted, they will need to be translated into changes in the operational rules and practices of the agencies concerned. Organizational structures, management processes, staffing requirements, training programs, and internal incentives will need to be reviewed, as will arrangements for improving cooperation and coordination between development agencies, recipient governments, and other stakeholders.

The World Bank, IMF, European Commission, and other development agencies are already considering important reforms to their approaches to public expenditure work, including ways of increasing their collaboration. But increased efforts are needed—and it is hoped that this study will contribute to these and other emerging reforms.

## MAIN FINDINGS

At the core of this study is a mapping exercise that compares the main features and focuses of donor instruments for assessing public expenditure management. This comparison, complemented by interviews with government and donor officials and by reviews of assessment guidelines and sample reports, shows that the wide variety of assessment instruments has evolved in an uncoordinated way. As a result these instruments often impose high transaction costs on recipient governments and development agencies.

The instruments have a range of objectives, including gauging fiduciary risk, supporting development goals, defining action plans, and monitoring progress on implementing those plans. Sometimes these objectives are combined in a single instrument, as with CFAAs, CPARs, and EC audits. This mix of objectives—both within and across instruments—often inhibits clear, coherent assessment work. Moreover, though the instruments reviewed in this study are often referred to as assessments of public expenditure management, some provide limited coverage of a broader set of issues—including the forecasting of government revenue, and the management of public debt, of the government’s assets (physical and financial), and of the procedures for maintaining records of its financial business and transactions. This broader concept should be used in rationalizing the use of these instruments.

Though efforts are being made to strengthen it, collaboration on assessments between the World Bank, IMF, European Commission, and other donors remains relatively weak. As a result there is substantial overlap between some of the instruments’ coverage of public expenditure management—especially between CFAAs and Fiscal ROSCs. In addition, there is overlap between CFAAs and PERs on “upstream” (preparation and programming) and especially “downstream” (execution, accounting, control, reporting, monitoring and evaluation) issues. But in most cases this overlap is manageable because CFAAs focus on budget comprehensiveness, realism, and classification, and draw on analysis from PERs whenever possible.

Guidelines for EC audits were recently revised, while those for HIPC AAPs were only recently developed. Both instruments have different approaches and objectives from the others, and as such add value to assessment efforts. EC audits include “compliance tests,” which use audit techniques to provide reasonable assurance that public expenditure management systems and procedures are implemented consistently, in line with relevant rules and regulations. HIPC AAPs provide comprehensive summaries of public expenditure management systems and performance—including benchmarks and indicators that allow for monitoring over time. Although efforts are needed to integrate HIPC AAPs with other diagnostic work, work on HIPC AAPs is genuinely collaborative, relying on joint teams of Bank and IMF staff.

None of the instruments provides a comprehensive analysis of government management of taxes and revenues—though revenue issues are partly covered in PERs, and recently updated CFAA guidelines recommend

addressing accounting and control issues. There are also gaps in coverage of asset management, aid and debt management, management of government financial records, and public finance issues related to subnational governments, public enterprises, and off-budget public agencies.

Analysis of institutional and governance issues—including corruption—is also insufficient. Better understanding of the political, cultural, and institutional underpinnings of the budget process would enhance dialogue with recipient governments, strengthen risk assessments, and improve the development and implementation of action plans.

Finally, the extent and speed of reform for assessment instruments may be subject to donor-driven constraints, including statutory obligations, operational and scheduling issues, requirements of management boards and oversight bodies, and institutional turf, cultures, and incentives.

## MAIN RECOMMENDATIONS

Assessments and reforms of public expenditure management should be country-led but supported by donors and based on a coherent, integrated medium-term strategy. To that end, efforts are needed to streamline the coverage of assessment instruments (to avoid unnecessary duplication), enhance collaboration between donors, governments, and other stakeholders, provide more complete, accurate, timely assessments of fiduciary risk, and increase the development impact of assessment work. But reforms could go further—which is why this study also recommends developing a programmatic, modular framework for assessments.

### Streamlining coverage

- The Bank, IMF, European Commission, and other development agencies should adjust their instruments to reduce unnecessary overlap.
- Though the measures being considered to strengthen collaboration between CFAAs and Fiscal ROSCs should address the overlap between the two, it would be desirable for the Bank to first provide an authoritative clarification of the boundaries between CFAAs and PERs.
- The Bank, IMF, European Commission, and other agencies should consider how to fill the gaps in coverage, whether by supplementing current

instruments or developing new questionnaires and toolkits containing specific information.

- The Bank should streamline its internal arrangements and operational practices for planning and conducting assessments, drawing on PEFA's 2002 report on integrating PERs, CFAAs, and CPARs.
- The European Commission should develop its policy and methodology for carrying out compliance tests and annual audits to facilitate the integration of such work with CFAAs, Fiscal ROSCs, HIPC AAPs, and other instruments.
- Staff guidelines for assessments should be harmonized to facilitate integrated efforts and encourage collaboration.
- Steps should be taken to make assessment reports more consistent and readable. For example, templates should be developed for PERs and CFAAs.

### **Enhancing collaboration**

To increase their collaboration with donors, governments should be given complete access to staff guidelines, assessment work plans, schedules, and reports, and other information—for example, through the Country Analytic Work Website being developed by the Bank and other development agencies. The Bank and IMF would continue to take the lead in conducting most assessments of public expenditure management and would make them available as primary sources of information. Though governments and other donors would use these assessments, they would still be fully responsible for making their own judgments of fiduciary risks and development needs.

- Cooperation, coordination, and collaboration between agencies should be enhanced—especially between the Bank and IMF, drawing on their recent joint paper on strengthening collaboration on public expenditure work (World Bank and IMF 2003).
- Steps should be taken to increase the participation of bilateral donor agencies in discussions with governments on public expenditure management and in follow-up efforts to implement recommendations. Coordination with regional institutions and initiatives—such as regional multilateral development banks, the Strategic Partnership with Africa, and the New Partnership for Africa's Development—should also be strengthened.



- All assessment reports should include standardized executive summaries, providing core information to facilitate analysis, dissemination, and sharing of information between agencies, governments, and other stakeholders.
- Agencies should consider establishing quality assurance procedures for donors participating in multidonor assessments, perhaps building on the internal procedures used by the World Bank's Quality Assurance Group.
- Common definitions and terminology should be used in assessment work.

### **Evaluating fiduciary risk and contributing to development goals**

- Governments and donors should agree on how to define fiduciary risk.
- The role of assessments in evaluating fiduciary risk and contributing to long-term development goals should be clarified.
- Consideration could be given to splitting the fiduciary and development aspects of assessments into separate processes and reports—and to creating a more independent process for assessing risk, with some element of joint ownership by donors and external quality control and validation. This approach would allow donors to develop stronger partnerships with countries, reduce possible conflicts of interest, and make assessments more focused on development and capacity building.

### **Increasing the development impact of assessments and reforms**

- New approaches to assessing and reforming public expenditure management should take full account of the views of governments (and other local stakeholders), because governments play the main role in designing and implementing reform strategies.
- High-quality analysis and advice on public expenditure, procurement, and financial accountability requires seeing all aspects of public expenditure management as parts of an interrelated whole—not separating such efforts based on the most efficient “division of labor.” Thus, strengthening the substance and quality of analysis requires increasing collaboration within and between agencies.
- Because governance, corruption, and cultural and institutional factors are often crucial to reforms of public expenditure management, better guidelines are needed on their definition, scope, and importance and on how to integrate them with assessments.

- More attention should be paid to how recommendations and action plans are followed up and how changes in public expenditure management can be monitored and evaluated.
- Priority should be given to developing a robust, internationally accepted framework for benchmarking and measuring the performance of public expenditure management, building on the HIPC AAP approach. EC compliance tests might also provide useful data. Such work should be linked to the streamlining of assessment instruments.

### **Developing a “programmatic,” “modular” approach**

The recommendations above focus on improvements in the scope and application of current assessment instruments. Though those changes would be welcome, this study's ultimate aim is to foster more far-reaching reform of work on public expenditure management—developing an approach that is both “programmatic” and “modular.” In this context it is encouraging that a working group, led by the World Bank and IMF and supported by the PEFA program, was established in summer 2003 to examine ways of making such work more robust, relevant, and cost-effective.

The new approach to public expenditure work proposed in this study has several key features, some of which are new. First, it would emphasize the importance of recipient governments participating in—and ideally, leading—the design and implementation of public expenditure reforms. Second, it is a strategic approach, taking a medium- or long-term perspective that focuses on the steps that should be taken to move from a diagnostic assessment to the design and implementation of a sustainable program of reform and capacity building. Third, the approach would be “programmatic” in that it would be based not on the delivery of standardized products—such as PER, CFAA, or CPAR reports—but on a coordinated, sequenced program of diagnostic and capacity building work agreed between recipient governments and development agencies based on extensive dialogue. Such a work program would comprise a series of “modules,” each dealing with a different aspect of the budget process. Fourth, the work program would be designed to fit with a country's Poverty Reduction Strategy Paper and the associated financial and technical support provided by donors. Finally, progress in improving public expenditure management would be measured by donors and recipient governments, using an agreed set of performance indicators.

An important component of the programmatic approach could be a standardized overview of information obtained through assessments,

including performance indicators, similar to those used in HIPC AAPs, that could be updated periodically. Standardized assessment overviews would be useful to both donors and recipient governments, providing a concise analysis of public expenditure issues and assessments of fiduciary risk, highlighting areas requiring reform, and providing a tool for monitoring progress. Each overview could be subject to a joint quality review involving donors and the recipient government.

## **STRUCTURE OF THE STUDY**

Following an introductory section and a discussion of fiduciary risk and accountability in public expenditure management, the study summarizes the scope and content of the main assessment instruments. It then describes the methodology and sources and presents the findings from the mapping of the instruments' coverage. The last section offers recommendations and identifies issues meriting further consideration. In addition, there are annexes describing the main assessment instruments in greater detail, discussing good practices for measuring performance in public expenditure management (an OECD-DAC study), and presenting detailed results of the mapping exercise.



## Abbreviations and Acronyms

CAS	Country Assistance Strategy (World Bank)
CFAA	Country Financial Accountability Assessment (World Bank)
CONTACT	Country Assessment in Accountability and Transparency (UNDP)
CPAR	Country Procurement Assessment Report (World Bank)
DFID	Department for International Development (U.K.)
EC	European Commission
EDF	European Development Fund
EU	European Union
Fiscal ROSC	Report on the Observance of Standards and Codes of Fiscal Transparency (IMF)
HIPC AAP	Assessment and Action Plan for a Heavily Indebted Poor Country (World Bank–IMF)
IFAC	International Federation of Accountants
IGR	Institutional and Governance Review (World Bank)
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
OECD	Organisation for Economic Co-operation and Development
PEFA	Public Expenditure and Financial Accountability Program

PER	Public Expenditure Review (World Bank)
PREM	Poverty Reduction and Economic Management Network (World Bank)
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
QAG	Quality Assurance Group (World Bank)
SIDA	Swedish International Development Authority
SIGMA	Support for Improvement in Governance and Management in Central and Eastern European Countries (EC and OECD)
SPA	Strategic Partnership with Africa
UNDP	United Nations Development Programme



# Assessments of Public Expenditure Management: Rationale and Context

This study—carried out under the auspices of the Public Expenditure and Financial Accountability (PEFA) Program, a multi-donor partnership—is intended to help international development agencies generate more coordinated, effective instruments and procedures for assessing and strengthening public expenditure, procurement, and financial accountability systems in developing countries—especially countries that receive international aid for budget support.<sup>1</sup> It analyzes instruments and approaches used by the World Bank, International Monetary Fund (IMF), European Commission (EC), U.K. Department for International Development (DFID), and other agencies, identifies gaps and overlaps by mapping each instrument’s coverage of the various elements of expenditure management, and provides recommendations for strengthening and integrating the instruments.

The main assessment instruments reviewed are World Bank Public Expenditure Reviews (PERs), Country Financial Accountability Assessments (CFAAs), and Country Procurement Assessment Reports (CPARs), IMF Reports on the Observance of Standards and Codes of Fiscal Transparency (Fiscal ROSCs), IMF–World Bank Public Expenditure Tracking Assessments and Action Plans (AAPs) for Heavily Indebted Poor Countries (HIPC), EC audits of public financial management systems, and DFID assessments of fiduciary risk.

## WHAT IS PUBLIC EXPENDITURE MANAGEMENT?

Public expenditure management includes all the components of a country's budget process—both “upstream” (preparation and programming) and “downstream” (execution, accounting, control, reporting, monitoring and evaluation)—including the legal and organizational framework and arrangements for:

- Forecasting revenues and expenditures.
- Formulating medium-term expenditure frameworks.
- Linking the budget to policymaking.
- Preparing the budget.
- Managing cash and monitoring expenditures.
- Performing internal control and audits.
- Accounting and reporting.
- Procuring public goods and services and managing assets.
- Assessing performance.
- Conducting external audits.
- Ensuring oversight by the legislature and other bodies.

The broad objectives of public expenditure management are to achieve fiscal discipline, allocate resources to uses that reflect government policy priorities, and deliver public services efficiently and effectively.

The terms *public financial management* and *public expenditure management* are often used interchangeably. But for the purposes of this study, public financial management has a narrower definition, involving issues related mainly to the downstream phase of the budget cycle, and the term public expenditure management is used more often.

## THIS STUDY'S PURPOSE AND OBJECTIVES

The main concerns driving this study include the scope and coverage of the assessment instruments, adequacy of the institutional and governance analysis in the assessments, attention paid to fiduciary risk and its relationship

with development objectives, availability of questionnaires, checklists, and other tools to support assessment work, adequacy of review and quality control procedures, and fit between the experience and skills of teams that conduct assessments and the technical and institutional issues being assessed.

A consultative approach was used to prepare the study, including with staff of the development agencies concerned—especially task leaders—and with government officials in some recipient countries. This approach was vital because balanced conclusions in this complex area require the informed judgments of those involved in actual assessments.

To understand the context for both the PEFA program and this study, the next section reviews the evolution in approaches to assessing public expenditure, procurement, and financial accountability, protecting the integrity of financial resources (by containing fiduciary risk), and achieving development objectives. The study then provides a conceptual framework for assessing fiduciary risk, financial accountability, and public expenditure management, summarizes the coverage and content of various instruments that do so, describes available questionnaires and other tools, explains the study's methodology and information sources, presents findings from the technical mapping of the instruments' coverage, the review of staff guidelines and sample reports, and interviews with experts from donor agencies and government officials, and offers recommendations and identifies issues meriting future attention.

## **GENESIS OF ASSESSMENTS OF PUBLIC EXPENDITURE MANAGEMENT AND FINANCIAL ACCOUNTABILITY**

Until the late 1970s most external assistance to developing countries focused on individual projects, including efforts to increase financial integrity and aid effectiveness. Moreover, the literature on development made a clear distinction between development and nondevelopment spending, with development spending usually identified as investment and nondevelopment as current spending. This approach to aid corresponded to the “golden rule” of budgeting, which calls for all government borrowing to be used for investment and for current spending to be fully financed by domestic receipts. This approach was considered essential to assessing whether the debt service incurred by new investment would be more than offset by the increase in debt servicing capacity it made possible—both measured in foreign currency terms.



But over the past 25 years four developments have produced far-reaching changes in approaches to and perspectives on external assistance. First, it was recognized that all resources are fungible—especially convertible resources. Thus aid ostensibly earmarked for a well-prepared, well-supervised donor project could result in government resources being used to finance another project about which the donor knew nothing. (The notion of resource fungibility was first formulated by de Vries 1967 and subsequently elaborated by Schiavo-Campo and Singer 1970; Devarajan and Swaroop 2000 recently reviewed these arguments.)

Moreover, safeguards to ensure the integrity of donor resources provided to a project meant little in the absence of safeguards on the use of government resources effectively released by the aid. Thus the World Bank and other donors began to consider it necessary, when financing a large share of a country's public investment, to appraise the entire investment portfolio rather than just aid-financed projects. The Bank's resulting Public Investment Reviews were also useful to other development agencies in the context of their project-centered assistance. In addition, because Public Investment Reviews required identifiable public investment portfolios, they led to the provision of technical assistance in formulating public investment programs—which quickly became standard in most developing countries.<sup>2</sup>

Second, in line with the global shift away from central planning and mounting evidence of the importance of social factors for development, the distinction between development and nondevelopment spending lost meaning. It became accepted that new teachers and new textbooks are just as crucial for development as new schools, and thus that current spending and investment form (or should form) an integrated whole. Hence, the World Bank's Public Investment Reviews expanded into Public Expenditure Reviews (PERs)—though this is often a misnomer because most such reviews cover only government spending, and usually only central government spending. (PERs are discussed later in this study along with other donor instruments used to assess public expenditure and financial accountability.)

Third, the dominant influence of economic and social policies on project effectiveness came to be more widely understood. After the early 1980s it was no longer possible to believe that project-centered aid could be effective for development if macroeconomic policies were badly flawed. Accordingly, untied lending conditional on policy reforms began to complement project assistance. This gradual shift to policy-based adjustment lending—originally permissible only to finance foreign exchange gaps, then from the

mid-1990s justifiable as pure budget support—made increasingly clear the need to periodically assess the recipient government's budget policies and budget management.

Yet for much of the 1980s most donors, still in the grip of Harrod-Domar thinking (which argues that growth is a function only of the amount of physical investment and has no relation to the quality of governance or public sector management), remained focused on aggregate spending, its compatibility with the macroeconomic framework, and its sectoral and economic allocations. Not until the early 1990s were the links between good public sector management and development sufficiently understood.<sup>3</sup> It became increasingly accepted that effective development outcomes require not only sufficient resource transfers and sound macroeconomic and social policies, but also efficient spending. Efficient spending, in turn, depends on strong systems for budgeting, financial management, and accountability. The need for donors to get involved in budgeting, accounting, auditing, and control could no longer be ignored.<sup>4</sup>

Finally, the recognition from late 1996 of the destructive effects of corruption—official and private, and highlighted emphatically by the East Asian crisis of 1997–99—gave new urgency to donor agencies' need to assure their constituencies that aid resources were not being diverted for private ends or misallocated to activities not conducive to promoting growth and reducing poverty. To that end the World Bank adopted an anti-corruption policy in 1997, the Asian Development Bank followed suit in 1998 (see <http://www.adb.org>), OECD countries negotiated an Anti-Bribery Convention in 1999, and other agencies placed corruption at the fore of their concerns. In addition, because lack of transparency had permitted deep-seated financial and governance problems to fester until they erupted in the 1997 East Asian crisis, the IMF developed Standards and Codes of Fiscal Transparency addressing similar issues (see IMF 2001). (IMF Fiscal ROSCs are examined in greater detail later in the study.)

This evolution in development policies and practices has raised the pressure on governments and donors to understand the public expenditure management and financial accountability environment in which all budget funds are used. Thus, donors have created instruments that share many objectives, processes, analytical methods, and development goals, but that are grounded in each agency's specific concerns. As noted, later sections of this study examine these instruments and assess their coverage in detail. But underlying all these instruments are basic notions of fiduciary risk and accountability and concepts of public expenditure management—the subject of the next section.

## NOTES

1. Strengthening such instruments is one of the two main activities of the Public Expenditure and Financial Accountability (PEFA) program; the other is supporting country assessments and reforms. PEFA is a joint program of the World Bank, European Commission, International Monetary Fund (IMF), development agencies from France, Norway, Switzerland, and the United Kingdom, and the Strategic Partnership with Africa (SPA). The program was established in December 2001 and functions through a secretariat based in World Bank headquarters under the guidance of a steering committee representing all the partner institutions. PEFA was established out of concern that the instruments used by different development agencies to assess public expenditure, procurement, and financial accountability are insufficiently integrated, impose unnecessarily high transaction and compliance costs on recipient governments, and may be on a divergent course. Moreover, with increasing aid for budget support—where the fungibility of the assistance precludes a direct link between the aid and desired outcomes—these instruments have become more important, especially in terms of strengthening financial accountability.

2. First-generation public investment programs suffered from a number of weaknesses, were often formalistic documents produced as wish lists for consultative groups or other donor meetings, and sometimes even produced adverse budget outcomes over the long term. More recent second-generation public investment programs preserve the advantages of sound medium-term investment programming while avoiding the mistakes of earlier years (Schiavo-Campo and Tommasi 1999).

3. These links were first emphasized in World Bank (1989a) and subsequently formalized in a policy paper (World Bank 1992) and progress report (World Bank 1994). Other international organizations issued similar policy statements (such as Asian Development Bank 1995), as did bilateral donor agencies. The general consensus is that good governance revolves around four pillars: accountability, transparency, rule of law, and popular participation. The World Bank's public sector and governance strategy was first discussed by its Board in 1991; a progress report was issued in 1994, and a revised strategy was issued in October 2000.

4. Budget support also avoids the suggestion of donor interference and micromanagement inherent in some forms of earmarked assistance. For example, the World Bank's first loan, in May 1947, was for \$250 million and

went to France. France had difficulty accepting the Bank's unprecedented policy of specific certification for the use of every dollar of the loan and the negative pledge clause in the Bank's Articles of Agreement. French authorities considered the requirements "a derogation of the dignity of [their] country." During the loan negotiations a Bank staff member noted that "the requirement for specific designation of the use of all the proceeds meant that every contract for purchase of equipment and materials must be submitted and approved by the staff of the Bank against certified bills of the suppliers. We agree to station a staff member in Paris to facilitate the necessary approvals and the system which we set up has been followed by the Bank." See World Bank (1987) and the Bank's online archives at [www.worldbank.org](http://www.worldbank.org).





# Fiduciary Risk and Financial Accountability

Efforts to increase accountability in the context of untied budget support call for appropriate definitions of the interrelated notions of risk and accountability—both to interpret the technical mapping of the instruments reviewed in this study and to underpin its eventual recommendations. Although these terms are widely used, their meaning is not always clearly defined or understood.

The discussion in this section is not meant to suggest that the diagnostic instruments under review are intended only to assess public expenditure and financial accountability systems from the viewpoint of risk and accountability. Indeed, the instruments have much broader objectives, including:

- Describing the rules (formal and informal) and operational procedures underpinning public expenditure management systems.
- Assessing the strengths and weaknesses of these systems.
- Offering recommendations for improving the systems' rules and procedures, taking into account a country's political, legal, and cultural traditions and its capacity—and political willingness—to reform.
- Supporting the development and implementation of country assistance and poverty reduction programs.

- Informing the sponsoring agencies and their development partners about fiduciary risk.

## RISK

The notion of risk is inherently different and more ambiguous in public sector activity, including development aid, than in private enterprise. In commercial lending the biggest risk is that loans will not be repaid. But the risk of nonpayment is inapplicable to development grants and very remote for soft loans—especially for international financial institutions that do not allow loan rescheduling. Risk is generally defined as “exposure to the chance of injury or loss” (Merriam-Webster 1997), and fiduciary as a “person or entity in a position of trust, obliged to act in the interest of another” (Walker 1980). How such “interest” is defined thus becomes the central question.

A distinction is often made between fiduciary risk and development risk. Fiduciary risk refers to the possibility that funds provided will be misused or stolen. But in the context of development aid even a narrow conception of fiduciary risk must also include the possibility that actual expenditures will diverge from authorized expenditures (as reflected in the borrowing country’s budget), whether because of misappropriation or misallocation. This is the definition of risk used in the World Bank’s Country Financial Accountability Assessments (World Bank 2002b). To avoid fiduciary risk, the borrowing country’s budget must be reasonably comprehensive, its fiscal situation should be on a path to sustainability, and the borrower and the provider of funds must agree on how expenditures should be allocated. (All three conditions are also standard requirements of adjustment lending.)

This definition of risk also has a strong governance underpinning. In representative governments no funds can be mobilized from citizens or spent except through official and public sanction by their elected representatives. Thus unauthorized discrepancies between budgeted and actual spending place a cloud over the legitimacy of the entire public expenditure apparatus.

The above construction of fiduciary risk does not include an obligation to ensure “value for money” or any other efficiency objective. But notions of efficiency and effectiveness are integral to development assistance. Hence development risk adds to the risk of misappropriation and misallocation the risk that resources will be wasted as a result of inefficient institutions and organizational practices. This broader definition of risk is used, for example, by the U.K. DFID (though the agency still refers to it as fiduciary risk).

Assessing performance—let alone quantifying it—is exceedingly complex and fraught with potential misinterpretations and misapplications. But DFID’s implementation criteria for its “value for money” requirement are generic enough not to raise the risk of micromanagement or misplaced concreteness. (For more details on the DFID approach, see annex 1.)

Thus the fiduciary objective is met by reasonable assurance that aid money will not be stolen or used for guns instead of butter. The development objective requires, in addition, some indication that money will be spent efficiently and effectively. These objectives share a kinship with the three classic levels of public expenditure management: overall expenditure control, strategic allocation, and operational management (Campos and Pradhan 1996).

Except in severely dysfunctional systems—where expenditure control is paramount—these three levels are interrelated. Improvements at one level facilitate, and are not sustainable without, improvements at the other two. For example, imposing a hard ceiling on sector spending during budget preparation without linking that ceiling to sector policies and programs will likely result in underfunding of economically valuable activities, because such activities tend to offer less potential for rent seeking. Conversely, efforts to strengthen the links between policies and budgets will fail if fiscal discipline is weak. Similarly, operational management cannot be improved without fiscal discipline and sound resource allocation—for which good management is crucial.

Over time, fiduciary and development risks tend to merge, and lasting improvements in expenditure management and accountability also should increase operational effectiveness because they reinforce the links between policies and budgets and strengthen fiscal discipline. Moreover, if reducing poverty through faster growth and pro-poor measures is assumed to be the main objective of recipient governments (which requires some judgment about the quality of governance), the fiduciary and development obligations of development agencies are to both the providers and recipients of aid funds. Correspondingly, ownership becomes a two-sided concept, and partnership becomes the hallmark of effective financial accountability assessments.

Still, a tension often exists between assessments of fiduciary risk and long-term development objectives and requirements. In principle, these are two sides of the same coin. Recipient governments should have a strong interest in precise assessments of the risks associated with their public expenditure management systems, as measured in terms of achieving aggregate fiscal discipline, efficient resource allocation, and efficient and effec-



tive service delivery. Indeed, such assessments can guide the design and implementation of public expenditure management reforms.

But in practice the *process* through which such information is collected and analyzed is extremely important and can influence government perceptions and incentives. If a development agency appears to be setting the agenda and collecting and using information that a country perceives could be used against its interests—for example, in setting difficult conditions for a structural adjustment loan or technical assistance operation—it is much harder to internalize the diagnostic process in a country, ensure its ownership by the government, and promote transparent provision and exchange of information. This point has important implications for the structure and management of assessment tools, and these issues are discussed later in this study.

## ACCOUNTABILITY

Though accountability is at the core of good governance, the concept is inherently relative, requiring a specification of accountability to whom and for what. As noted, development agencies must be accountable to aid providers and share with aid recipients responsibility for achieving common objectives. Thus, there must be a way to systematically assess such achievements.

There is a panoply of possible results, from the immediate output of a specific activity to the broader outcomes of an overall program. In well-defined projects close to their final users (such as urban transport projects) the link between outputs and outcomes is clear and immediate enough to permit the use of output indicators as a proxy for outcomes. In adjustment lending and budget support this is not the case: to be defined meaningfully the results must be defined broadly, and should include both outcomes and process indicators. There is an “accountability tradeoff”: accountability can be tight or broad, but not both (Schiavo-Campo 1999). Individuals can be held strictly accountable for narrow and specific results, but only loosely for broad results—achievement of which partly depends on factors beyond their control.

Moreover, accountability has two elements: answerability and consequences. A systematic dialogue on the uses and results of expenditure can be valuable even in the absence of direct implications (provided the results are defined appropriately). As a rule, however, such a dialogue should be

accompanied by the specification of relevant targets or benchmarks, with program managers facing consequences for their success or failure in achieving these targets.

Because effective accountability usually requires appropriate benchmarks, it raises (directly or indirectly) the often misunderstood concept of conditionality. In Joseph Gold's (1981) classic definition, conditionality is nothing more than "a means for the appropriate use of resources." Because resources are never provided without reason or purpose, the relevant question is not whether conditions should exist. Rather, it is whether the conditions specified are relevant and sufficient—or unnecessarily burdensome, intrusive, or even counterproductive—and whether they are derived through genuine dialogue (essential for effective implementation of reforms with a significant institutional content)—or imposed from the outside. Even when an external accountability assessment is intended to be purely advisory, it is generally understood by the aid agency and the recipient government that the assessment's conclusions will be taken into account in the future provision of assistance.

So, in developing countries the operational issue is not whether public financial accountability is fully adequate. In most cases it is not. The operational issue is whether accountability is being strengthened at a sufficient pace to warrant representing to aid providers and recipients that fiduciary and development objectives are more likely to be achieved, partly through the use of the aid. This in turn calls for measures to improve the legal and organizational framework for public expenditure management, systems and processes for expenditure programming and budget preparation and execution, accounting, reporting, and audit, and administrative and financial management capacity. (As discussed below, these are the five broad headings under which components of public expenditure management are grouped in this study for the technical mapping of the various assessment instruments.)

## **OPERATIONAL IMPLICATIONS**

The preceding discussion has four main practical implications. First, it can be misleading to assess overall risk by adding up the individual weaknesses in a public expenditure management system. The three levels of public expenditure management are interrelated, as are the various parts of the administrative apparatus. Just as the balance of payments or fiscal accounts must be analyzed as an interrelated whole, the assessment of the risks asso-

ciated with untied budget support should be based on the entire system for public expenditure management. In some cases the overall risk may be smaller than the sum of individual risks; in other cases it may be larger. What is needed is judgment, not a mechanical exercise.

Second, because development agencies have differing goals and objectives as regards their aid programs and development assistance, their views of risk differ as well—as do the objectives, coverage, and methodologies of their financial accountability instruments. This is a major reason for the duplication between the instruments used by different agencies.

Third, if an instrument covers a broad range of issues, it is bound to be more diffuse than an instrument focused on a specific component. It is tautological to say, for example, that a procurement review is more narrowly targeted than a public expenditure review.

Finally, a given instrument may cover many components of public expenditure management but some only superficially, while another instrument may have narrower coverage but greater depth. With these considerations in mind, the next section describes the key features of the main assessment instruments.



## The Main Instruments for Assessments

Donors use six main instruments to assess public expenditure, procurement, and financial accountability: World Bank Public Expenditure Review (PERs), Country Financial Accountability Assessments (CFAAs), and Country Procurement Assessment Reports (CPARs),<sup>1</sup> IMF Reports on the Observance of Standards and Codes of Fiscal Transparency (Fiscal ROSCs), World Bank–IMF Public Expenditure Tracking Assessments and Action Plans for Heavily Indebted Poor Countries (HIPC AAPs), and EC audits. In addition, the U.K. Department for International Development (DFID) is developing a new approach to assessing fiduciary risk based on a methodology similar to that of the HIPC AAPs.<sup>2</sup>

All these assessment instruments share common approaches and objectives, including describing and analyzing systems for public expenditure, procurement, and financial accountability, recommending improvements, increasing financial integrity, and improving budget outcomes. Assessments also foster another crucial outcome: increased interaction between development agencies and recipient governments (see box 1). Yet the instruments' emphasis, coverage, and approach vary considerably, reflecting the fact that they were developed by different agencies or different parts of the same agency. The instruments are summarized below and described in more detail in annex 1. (Because the DFID approach to assessing fiduciary risk is still being developed, it is not part of the mapping exercise—though it is discussed below and in annex 1.)

**Box 1****The role of assessments in promoting dialogue between donors and recipient governments, and reform**

For development agencies, recipient governments, and other stakeholders, the process of interaction—the dialogue set in motion by assessments—is just as important as the specific report itself, whether a PER, CFAA, or Fiscal ROSC. The reason is simple: the goal of any assessment is to facilitate the development of sustainable reforms that will both strengthen a country's public expenditure system and achieve key policy objectives such as poverty reduction.

Diagnostic reports provide valuable data, analyses, and recommendations, and form the basis for formal discussions with recipient governments. But if an assessment is conducted well, most such discussions will already have occurred, and change will have been initiated through the assessment process. Moreover, dialogue between an assessment team and a recipient government provides an opportunity for ministries and agencies to communicate with each other, uncover sources of common difficulties, and begin working together toward solutions that take account of the institutional and governance reasons for weak public expenditure management. Indeed, some analysts argue that triggering this internal dialogue is the most important output of an external assessment. Integration, then, should be understood more as integrating assessment processes than as delivering standardized reports on different aspects of public expenditure management or merely eliminating ex post inconsistencies between these reports.

Interestingly, all the instruments reviewed in this study focus on the legal frameworks and organizational structures and processes for public expenditure management—describing the laws, regulations, and operational procedures for budget formulation and budget execution. Though such information is useful and relevant, it is not clearly linked to aggregate fiscal discipline, efficient resource allocation, and efficient and effective delivery of public services—the three basic public expenditure policy objectives defined by Campos and Pradhan (1996) that have become widely accepted in the international development community. Some questionnaires and toolkits follow the Campos-Pradhan approach (such as DFID 2001b), but

the main diagnostic instruments reviewed in this study have not been modified to reflect it. Such changes would require significant redesign.

## **WORLD BANK PUBLIC EXPENDITURE REVIEWS**

The PER—the oldest instrument reviewed in this study—is the World Bank’s traditional tool for analyzing public expenditure.<sup>3</sup> As noted, when the artificial distinction between development and nondevelopment expenditure was abandoned and adjustment lending was introduced, investment reviews expanded to assess the overall government spending that budget support helped finance.

Until the 1990s traditional PERs consisted mainly of an assessment of fiscal trends, an analysis of resource allocations between and within sectors, various annexes dealing with expenditure policies and programs in the major sectors, and sometimes a review of the fiscal relationship between government and public enterprises. The efficiency and operational effectiveness of public expenditure (let alone corruption issues) were rarely if ever addressed.<sup>4</sup> Thus, it is not surprising that ostensibly sensible recommendations in early PERs—say, to increase spending in priority social sectors, or to accelerate investment disbursements—were operationally hollow.

But in recent years, aided by the spotlight placed on corruption and public mismanagement by the East Asian crisis, PERs have increasingly added budget systems, implementation, and capacity building to their traditional areas of review.<sup>5</sup> The main emphasis is on the upstream phases of expenditure management: medium-term expenditure programming, annual budget preparation, and legislative approval.

Recent years have also seen the emergence in a few countries of government-led PERs, which are a continuous process rather than a one-off review, often built around the annual budget cycle. The government of Tanzania, for example, owns and leads the country’s diagnostic program for public expenditure management, the centerpiece of which is the PER. This program is closely integrated with the budget cycle and involves a broad range of stakeholders and close participation by donors. As a result the PER process has evolved from providing an external evaluation of budget management to supporting the development of a multiyear expenditure framework. Tanzania’s new approach has also improved donor coordination by ensuring that aid is consistent with budget objectives and priorities and increasingly integrated with the budget.

Tanzania's program for evaluating and reforming public expenditure management is designed to share donors' thematic and sector-specific experience with participating stakeholders, improve resource use by undertaking technical studies of budget issues, raise the profile of budget issues, and support donors in shifting the focus of aid from project to budget support. Several other countries that depend on aid and have limited capacity—such as Ethiopia and Uganda—have also been developing similar participatory, collaborative approaches to work on public expenditure management.

## **WORLD BANK COUNTRY FINANCIAL ACCOUNTABILITY ASSESSMENTS**

The CFAA is the Bank's main diagnostic tool for public financial management and accountability. It is designed to provide information about the financial management environment in which Bank (and other donor) funds may be disbursed. Thus it helps ensure that donor funds are used properly. The CFAA is not an audit that tracks individual spending, nor does it provide a pass/fail assessment of a country's financial management system or define minimum standards for system capabilities and performance. CFAAs do, however, provide recommendations and action plans.

Public financial accountability can be interpreted as covering the entire process of resource mobilization, allocation, use, and controls, as well as the interactions between the executive and legislative branches and civil society on fiscal and budget issues. Recognizing the need to set reasonable boundaries, CFAAs focus on describing and analyzing downstream financial management and expenditure controls, including expenditure monitoring, accounting and financial reporting, internal controls, internal and external auditing, and ex post legislative review. As noted, the upstream phases of public expenditure management are generally the domain of PERs, as are issues of expenditure efficiency and effectiveness.

Nevertheless, measures of fiduciary risk include the deviations between actual and budgeted expenditures that arise in many countries and the incomplete budget scrutiny that results from the use of extrabudgetary funds and other off-budget expenditures. Thus a good CFAA cannot entirely neglect the budget preparation process—no more than a good PER can neglect major problems in budget execution, accounting, auditing, and financial controls. In practice, this potential overlap tends to be

greatest in the area of budget execution. (As argued later in the study, the solution does not lie in better defining the scope, definitions, and boundaries of the two instruments, but in better integrating them.)

CFAAs—and the Bank’s other instruments for fiduciary economic and sector work—have become more important in recent years. The Bank requires that recent CFAAs be available for all its major borrowers by the end of fiscal 2004. While a CFAA is not a formal prerequisite for adjustment lending, such lending does require an *ex ante* fiduciary assessment (such as a CFAA, CPAR, or PER) of a country’s public expenditure, procurement, and financial management systems (World Bank 2003d).<sup>6</sup> The assessment is to be done in cooperation with the government and nongovernment stakeholders; partnerships with other development agencies are also encouraged. But the possible tension between country ownership and the role of CFAAs, CPARs, and PERs in assessing fiduciary risk has yet to be resolved.

## **WORLD BANK COUNTRY PROCUREMENT ASSESSMENT REPORTS**

The World Bank introduced CPARs in the mid-1980s to determine whether the procurement rules and practices of borrowing governments conform with Bank requirements. CPARs are the most focused of Bank instruments for fiduciary economic and sector work, though their emphasis has evolved from assessing procurement arrangements for Bank-financed projects to assessing national and subnational procurement laws, regulations, and procedures and encouraging dialogue with recipient governments (the current CPAR guidelines are described in World Bank 2002c). A CPAR is designed to:

- Provide a comprehensive analysis of a country’s procurement system—including legislation, organizational responsibilities, control and oversight, and procedures and practices.
- Assess institutional, organizational, and other risks associated with procurement—including identifying procurement practices that are not acceptable in Bank-financed projects.
- Develop a prioritized action plan for institutional improvements.
- Assess the domestic private sector’s participation in public procurement and commercial practices related to public procurement.



## IMF REPORTS ON THE OBSERVANCE OF STANDARDS AND CODES OF FISCAL TRANSPARENCY

Fiscal ROSCs originated from the IMF's Code of Good Practices on Fiscal Transparency, adopted in 1998 and revised in 2001. The IMF adopted this code in response to the East Asian and other financial crises of the late 1990s in the belief that focusing on fiscal transparency would provide strong market pressure for countries to improve public expenditure management. The code is intended to apply to all IMF member countries, but country participation in a Fiscal ROSC is voluntary.

Drawing on the four key requirements for fiscal transparency—clear roles and responsibilities, full provision of information, open budget preparation and execution, and assurances of integrity—a Fiscal ROSC:

- Describes country systems and procedures relative to the good practices identified in the fiscal transparency code and manual.
- Provides an assessment by IMF staff that prioritizes recommendations for possible improvements.

Fiscal ROSCs are formally limited to assessing fiscal transparency, although in practice other public expenditure management issues are also reviewed to a limited extent. They address the efficiency and effectiveness of expenditure processes and outcomes primarily from the viewpoint that lack of transparency contributes to weaknesses or difficulties in assessing these aspects. The exercise is carefully targeted and conducted in accordance with detailed instructions. It begins with the government filling out a standard questionnaire and concludes with the publication of the report (if the government agrees), which is based on a standard template.

Fiscal ROSCs are prepared as background for staff reports on the Article IV consultations that the IMF engages in with member countries as part of its regular surveillance, and are submitted to the IMF's Executive Board. Fiscal ROSCs inform the Board on the extent to which the fiscal transparency code is being observed and on progress over time. The reports also identify institutional constraints and guide IMF country programs and technical assistance.

Fiscal ROSCs are more closely linked to international surveillance of fiscal transparency and accountability than are the World Bank's three main instruments for fiduciary economic and sector work. But the institutional scope and coverage of Fiscal ROSCs are similar to those of the Bank instruments, particularly CFAs. Recognizing this, the IMF is taking steps to improve coordination

with Bank teams preparing CFAAs, and the two institutions are sharing information on mission schedules, undertaking occasional joint missions, exchanging draft reports for comments, and exploring the development of a joint questionnaire and a joint database containing information on fiscal institutions.

## **WORLD BANK–IMF PUBLIC EXPENDITURE TRACKING ASSESSMENTS AND ACTION PLANS FOR HEAVILY INDEBTED POOR COUNTRIES**

HIPC AAPs were developed in spring 2000, stemming from the Bank and IMF's desire to ensure that HIPC countries use resources freed by debt relief for poverty-reducing public expenditures based on full additionality—meaning that, because past aid levels would be maintained, debt relief would translate into additional real resources. Achieving that goal requires that HIPC countries track poverty-reducing expenditures, which requires a public expenditure management system capable of planning, executing, and reporting on spending. HIPC AAPs are innovative because, instead of assessing every aspect of public expenditure management, they take a systems approach: identifying important indicators that reflect a system's overall capability and performance.

HIPC AAPs started with a questionnaire on public expenditure management that resulted in the identification of 15 benchmarks. In fall 2000, joint Bank-IMF teams conducted desk reviews of the 25 HIPC countries that had reached their decision points or were expected to do so soon. A year later 24 AAPs were finalized, and in March 2002 the results were presented to the Bank and IMF boards. Missions for AAPs were often combined with ongoing work by country teams on, for example, Fiscal ROSCs, PERs, and CFAAs (World Bank and IMF 2002).

In spring 2003 the Bank and IMF boards reviewed a paper containing updates on progress in implementing HIPC action plans (World Bank 2003b). The updates, based on the 15 benchmarks for public expenditure management identified earlier, covered 21 HIPC countries and were prepared by Bank and IMF staff in consultation with country authorities using standardized formats. The updates indicated that many HIPC countries had improved their public expenditure systems and that a growing number were reporting on poverty-reducing spending. For example, more than three-quarters of the measures in HIPC action plans had been or were being implemented. Moreover, measures from the action plans had been incorporated in Poverty Reduction Strategy Papers (PRSPs), IMF-supported programs, and Bank adjustment operations. Still, the quality and performance of pub-

lic expenditure management systems, as measured by the 15 benchmarks, did not necessarily improve much. In late 2004 the Bank and IMF will deliver a thorough reassessment of HIPC's to their boards, following another round of comprehensive assessments starting in fall 2003.

## EC AUDITS

Until recently the European Commission's assessment instrument consisted of periodic ex post audits of whether its structural adjustment resources were used in line with the financing and implementation agreements signed with recipient governments. But with the evolution of EC support for structural adjustment, the purpose of and approach to audits have also changed. This methodology has developed gradually, building on the principles and methodology of the United Nations Development Programme's CONTACT guidelines and on lessons from previous audits, and has not been defined in a formal document.<sup>7</sup>

Since 1992 EC audits have been carried out in some 32 countries. For General and Sector Import Support Operations these audits focused on the legality and regularity of expenditures. For targeted budget support the audits were adjusted to recognize that counterpart funding became subject to national budget rules and procedures. Hence a more comprehensive approach to audits was developed that focused on an assessment of the legal framework and procedures for budget execution—including procurement and financial accountability and control—verified through sample financial audits. In addition, materiality checks were introduced to assess the value for money of expenditures.

Recognizing that the segregation of counterpart funds undermines effective budgeting in recipient countries (as well as the long disbursement delays engendered by that approach), the European Commission has proposed a new approach based on ex ante assessments and traditional ex post audits (EC 2002). General budget support will be programmed over multiple years and released annually in both fixed tranches (based on the recipient country's conformity with IMF conditions for macroeconomic management) and variable tranches (based on agreed indicators for social and public expenditure management). The proposed ex ante assessments would be based on:

- Reviews of diagnostic work on public expenditure management, drawn mainly from non-EC sources.
- Information from previous EC audits.

- EC reviews of government and donor action plans for improving public expenditure management.
- Analyses of gaps identified in existing diagnostic work that are to be addressed by follow-up work. Such follow-up work might include, for example, sector-specific sample financial audits used to establish indicators to measure progress in improving public financial management.

Though the new approach has broad coverage, the assessments will largely rely on recent diagnostic work by the Bank, IMF, and other agencies—complemented and validated by EC “compliance tests,” which use audit techniques to provide reasonable assurance that public expenditure management systems and procedures are implemented consistently, in line with relevant rules and regulations. (However, the European Commission has not produced an adequate description of compliance tests or guidelines for staff conducting them; see PEFA 2003). The proposed new approach emphasizes strengthening public expenditure and financial accountability and measuring progress using relevant performance indicators.

## **DFID ASSESSMENTS OF FIDUCIARY RISK**

The DFID approach to measuring and managing fiduciary risk, which is still in an experimental phase, is largely based on reports and analysis carried out by other agencies. Its goal is to ascertain whether it is reasonable to expect that DFID resources will be used for their intended purposes, accounted for properly, and represent value for money. The DFID approach is similar to that of HIPC AAPs in that it is based on a relatively small number of indicators focused on different aspects of public expenditure management.

The DFID assessments generally rely on World Bank and IMF information, including PERs, CFAAs, and other documents. In addition, DFID has collaborated with the Bank in carrying out some CFAAs. Whatever the source of information, a fiduciary risk assessment must be completed before DFID provides budget support (DFID 2002b).

## **QUESTIONNAIRES, CHECKLISTS, AND OTHER TOOLS**

Development agencies have developed a variety of questionnaires, checklists, and other tools for teams undertaking assessments. Fiscal ROSCs and

CPARs have detailed, well-structured questionnaires. HIPC AAPs also use a questionnaire. Though CFAA guidelines included a detailed questionnaire in the past, recently updated guidelines include only a few key questions (World Bank 2002b). The World Bank's Africa Region, however, has developed a detailed CFAA checklist that covers most aspects of budget execution, accounting, audit, and control. The Bank has also developed other tools to analyze public expenditure management and the impact of expenditures, including Public Expenditure Tracking Surveys (PETS), benefits incidence analysis, and anticorruption surveys.

Also deserving mention are the questionnaires and checklists linked to the Bank's Public Expenditure Management (PEM) Core Diagnostic, UNDP's CONTACT guidelines, and SIGMA's baseline assessments. (See also the questionnaires that appear as annexes in Allen and Tommasi 2001 and Schiavo-Campo and Tommasi 1999.) The PEM Core Diagnostic was developed to assist in the preparation of PERs, though it was never formally tied to them.<sup>8</sup> Because it was developed immediately after the Fiscal ROSC, it includes most of the components covered by the Fiscal ROSC in terms of the legal and organizational framework for expenditure programming and budget preparation. The PEM Core Diagnostic does not cover budget execution, accounting, or auditing, and directs users to CFAA and CPAR guidelines and questionnaires for information on these activities. (Recently updated CFAA guidelines call the PEM Core Diagnostic a "complementary toolkit"—see World Bank 2003a.)

UNDP's CONTACT guidelines provide comprehensive checklists covering most aspects of budget preparation and execution, while SIGMA's baseline assessments comprise questionnaires focused on the internal control, procurement, financial reporting, and audit aspects of public expenditure management. In addition, the PEFA program is preparing questionnaires on the management of government records in areas such as financial management and personnel issues, filling an important gap in the coverage of diagnostic tools.

Diagnostic instruments differ in the level of detail they seek through their questionnaires and checklists (table 1). Moreover, some questionnaires allow for multiple choice answers or are scaled in some way, while others require only yes or no answers.

**Table 1: Features of questionnaires and checklists used by various assessment instruments**

Instrument	Number of questions or indicators	Multiple choice?
World Bank PEM Core Diagnostic		
Summary Version	60	No
Master Version	252	No
World Bank CFAA	105	Yes
World Bank CPAR	235	No
IMF Code of Fiscal Transparency	84	Yes
Bank-IMF HIPC Public Expenditure Tracking AAP	15	Yes
DFID Fiduciary Risk Assessment	16	Yes
UNDP CONTACT (all modules)	605	No

Source: SIDA 2002.

## NOTES

1. Economic and sector work is the Bank's primary country-based analytical and advisory work, and includes these three instruments. For Bank policies on economic and sector work, see the Operational Manual and Policies O.P. B.P.2.11 (Country Assistance Strategy), O.P. 8.40 (Technical Assistance), and O.D. 8.60 (Adjustment Lending Policy) at <http://wbln0011.worldbank.org/Institutional/Manuals>.

2. This study does not substantively review similar instruments developed by other international organizations, government self-assessments (which do not follow standardized procedures), or donor analyses performed as part of technical assistance operations and aid proposals (such as IMF and World Bank support for treasury systems, debt management, and tax administration). Instruments developed by other organizations (and described in annex 1) include the United Nations Development Programme's Country Assessment on Accountability and Transparency (CONTACT) and by Support for Improvement in Governance and Management (SIGMA), a joint program of the European Commission and Organisation for Economic Co-operation and Development, used to assess

the public expenditure management and institutional capacity of Central and Eastern European countries applying for EU membership. In addition, the Asian Development Bank has developed an instrument—called Financial Management and Governance Issues in Selected Developing Member Countries—covering accounting, auditing, and other financial management issues, which has been applied in several countries; see [http://www.adb.org/Documents/Books/Financial\\_Mgt/Selected\\_DMCs/default.asp](http://www.adb.org/Documents/Books/Financial_Mgt/Selected_DMCs/default.asp).

3. Much of the information in this section was drawn from World Bank (2001).

4. The first PER with an explicit institutional dimension was World Bank (1989b). But by the late 1990s fewer than a quarter of recent PERs had paid serious attention to budget management or institutions; see World Bank (1999).

5. The new focus has not always been accompanied by a commensurate expansion in the technical skills required for such analysis. In some cases the previous neglect of expenditure management has given way to the far worse outcome of superficial analysis and bad recommendations—usually in a mechanical imitation of complex practices introduced in a handful of industrial countries.

6. A proposal has been made to revise the Bank's Operational Policy, OP/BP 8.60, such that "as a precondition for all development policy support lending, an ex-ante fiduciary assessment of the country's public expenditure management, procurement, and financial accountability systems is required. Key findings of the fiduciary assessment would be reported in the CAS [Country Assistance Strategy]" (World Bank 2002d, p. 28).

7. The EC approach to audits has been strongly criticized by the European Parliament and by the EC internal audit service for failing to adequately assess the weaknesses and risks of the public financial management systems for which the Commission provides aid; see EC (2001a, b).

8. The PEM Core Diagnostic has a 60-question Summary Version and a 252-question Master Version. Both can be found at <http://www-wbweb.worldbank.org/prem/prmps/expenditure/petoolkit.htm>.



# Methodology and Main Findings

## METHODOLOGY AND SOURCES

The study has “mapped” each instrument’s coverage of the various dimensions of public expenditure management, in order to reveal the core issues and identify unnecessary duplications or gaps in coverage. Describing and assessing public expenditure management systems generally calls for reviewing the legal and organizational framework and the stages, processes, and procedures of budgeting. In turn, the budgeting cycle is conventionally understood as comprising three parts: expenditure programming and budget preparation; budget execution and monitoring; and accounting, reporting, auditing, and external oversight. In addition, the state of administrative and financial management capacity at all stages of the public expenditure management cycle is fundamental to any assessment of financial systems and the prospects for their improvement. The mapping exercise breaks down these broad areas into 15 major components and 94 sub-components, as shown in box 2.

The major instruments described below have been “mapped” according to the extent of their coverage of the 94 subcomponents of the public expenditure management cycle. Annex 3 shows the detailed map, with an explanatory note. A summary map, covering the 15 major components, is in figure 1 below, in which the extent to which each instrument covers each of the public expenditure management components is shown as “high,” “medium,” or “low or none,” illustrated as black, gray and white, respectively.



## **Box 2**

### **Components of public expenditure management**

#### **Legal and organizational framework**

##### *Legal framework for expenditure management*

- Constitutional requirements
- Legal framework for budget and fiscal policy
- Fiscal management roles of the executive, legislative, and judicial branches

##### *Intergovernmental fiscal relations*

- Allocation of responsibilities between different levels of government
- Expenditure transfers to subnational governments
- Revenue authority and borrowing rights of subnational governments

##### *Relations between government and nongovernment entities*

- Scope of government fiscal targets and consistency with government finance statistics
- Central bank independence
- Clarity of distinction between government and public enterprises
- Clarity of reporting of government equity holdings
- Clarity and openness of formal regulation of private sector

##### *Government structure*

- Type of government (presidential, parliamentary, and so on)
- Cabinet arrangements (powers of prime minister, ministry of finance, and line ministries)
- Organizational structure of ministries and agencies with financial responsibilities
- Arrangements for civil service management
- Second-tier organizations (directorates, agencies, autonomous bodies)

#### **Expenditure programming and budget preparation**

##### *Budget coverage*

- Budget classification and consistency with government finance statistics
- Extrabudgetary funds and earmarked revenues
- Quasi-fiscal activities
- Contingent liabilities

- Tax expenditures
- User fees
- Donor funding
- Transfers to and from public enterprises

#### *Expenditure analysis*

- Fiscal sustainability
- Composition of expenditures
- Analysis of mandatory and discretionary spending
- Review of public investment programs
- Intersectoral analysis
- Intrasectoral analysis
- Efficiency and effectiveness of expenditure programs
- Expenditure incidence and poverty impact
- Analysis of deviations of actual from budgeted expenditures
- Assessment of payment arrears

#### *Fiscal framework and expenditure programming*

- Macroeconomic framework and fiscal outlook
- Revenue projections
- Donor funding projections
- Fiscal scenarios and sensitivity analysis
- Fiscal risks and contingent liabilities
- Independent scrutiny of macroeconomic models and assumptions
- Setting of aggregate revenue, spending, and deficit targets

#### *Budget preparation*

- Cabinet-level setting of policy priorities and expenditure ceilings
- Ministry-level setting of priorities and allocation of resources
- Level of detail in budget allocations (flexibility of ministerial spending)
- Expenditure classification (line item, program, and so on)
- Forward costs of ongoing programs
- Cost estimates for proposed programs
- Medium-term expenditure estimates
- Clarity of program objectives
- Process for preparing the draft budget
- Integration of capital and recurrent budgets
- Civil society participation in budget preparation

*(Box continues on the following page.)*

## **Box 2 (continued)**

- Feedback from program review and evaluation
- Approval of draft budget by the legislature

### **Budget execution**

#### *Treasury systems, cash management, and expenditure monitoring*

- Laws and regulations on treasury and cash management
- Organization of the treasury function
- Cash planning and forecasting
- Banking and accounting arrangements
- Rules and procedures for payments and cash allocations
- Flexibility for budget managers (virement rules, carryovers, and so on)
- Commitment control
- Verification of receipt of goods and services
- Monitoring and management of payables and arrears
- Payroll monitoring and management
- Reconciliation of fiscal and bank information

#### *Public procurement and management of physical assets*

- Procurement laws and regulations
- Organization of procurement functions within government
- Openness of procurement processes and procedures
- Tendering procedures
- Documentation and information systems
- Control and complaint review procedures
- Management of physical assets

#### *Internal control and audit*

- Internal control regulations, organization, and procedures
- Internal audit regulations, organization, and procedures

### **Accounting, reporting, and external audit**

#### *Accounting, reporting, and records management*

- Accounting policies and standards
- Accounting processes and responsibilities
- Government financial management information systems
- Internal reporting

- Scope and coverage of external financial reports
- Timeliness and quality of external financial reports
- Records management systems

#### *Debt and aid management*

- Debt and aid management laws and regulations
- Management, control, and reporting of government debt
- Management, control, and reporting of financial assets
- Management, control, and reporting of aid

#### *External audit*

- Legal framework for external audit
- Independence of supreme audit institution
- Jurisdiction of supreme audit institution
- Audit standards
- Timeliness and quality of audit reports
- Sanctions for irregularity
- Legislative review of audit reports
- Follow-up on audit recommendations

### **Administrative and financial management capacity**

#### *Personnel quality, capacity, incentives, and management*

The methodology gives an overview of the coverage and is thus useful in signaling possible gaps or overlaps in the scope and coverage of the instruments. However, as noted earlier, for each of the 94 subcomponents a binary choice must be made – coverage or no coverage. From such choice little can be inferred regarding the depth or relevance of the analysis – let alone its quality. Therefore, the study supplemented the mapping exercise by collecting information from reports, reviews, and other sources from a number of countries where the instruments have been applied.<sup>1</sup> Most important for judgments about the quality of the assessment, interviews were conducted with staff from the World Bank, IMF and other agencies and, to a more limited degree, government officials. Although still largely anecdotal and partial, this information complements the mapping of coverage and underpins the find-

**Figure 1: Assessment instruments' coverage of the main components of public expenditure management**

Component	PER	CFAA	CPAR	Fiscal ROSC	HIPC AAP	EC AUDIT
Legal framework for expenditure management						
Intergovernmental fiscal relations						
Relations between government and nongovernment entities						
Government structure						
Budget coverage						
Expenditure analysis						
Fiscal framework and expenditure programming						
Budget preparation						
Treasury systems, cash management, and expenditure monitoring						
Public procurement and management of physical assets						
Internal control and audit						
Accounting, reporting, and records management						
Debt and aid management						
External audit						
Personnel quality, capacity, incentives, and management						

Key: Level of coverage

■ = Complete or substantial coverage

■ = Partial or moderate coverage

□ = Little or no coverage

ings and recommendations advanced later in this study. A major qualification, however, should be advanced at the outset.

Nowhere in the above list of public expenditure management dimensions are the words “corruption” and “governance” mentioned. This is not an oversight. The risk of corruption, i.e., the misuse of public power for private gain, pervades every aspect of the public expenditure management cycle and cannot be handled as an item on a checklist. Recalling the earlier discussion on risk, corruption affects the very first component of fiduciary risk, namely, that the money provided for approved budgetary purposes ends up instead in private pockets. If the funds disappear, analyses of their allocation and efficient use are instantly irrelevant. Although a substantive discussion of corruption is outside the scope of this study,<sup>2</sup> public expenditure (and especially public investment), is known to offer some of the best opportunities for corruption, and not only in the procurement phase. As in other areas, while enforcement through internal control and other means is helpful, the most effective way to combat corruption is to reduce the opportunities and incentives for it – normally arising from over complex and opaque regulations – and to strengthen transparency and oversight mechanisms. The struggle against corruption must therefore be conducted by closing off corruption opportunities, through concrete improvements in specific aspects and procedures of public expenditure management. Most concrete improvements in one or another public expenditure management component tend to have, among other benefits, a positive impact in terms of reducing corruption. This explains why, although corruption does not appear as a separate item for assessment, the issue of financial integrity underpins almost every one of the components listed earlier.

Ideally, diagnostic reviews should go through each phase of the budget cycle to identify areas that are vulnerable to corruption, and recommend ways in which corruption risks can be addressed in the area concerned. For example, during budget formulation, hard budget constraints can be evaded by the use of Build-Operate-Transfer (BOT) mechanisms, which in turn can easily become a vehicle for hiding illicit transactions. During budget execution, corruption risks can be reduced by improving the procedures for award of large procurement contracts. And so on.

Also conspicuous for their absence from the mapping are the four pillars of governance – accountability, transparency, rule of law and participation. As in the case of corruption, however, this absence is only apparent. The four pillars of governance should be seen as guiding principles for the public expenditure management assessment, providing a prism through which

to scrutinize each part of the system. At each stage of the expenditure management cycle, one can go a long way toward building governance considerations into the “technical” assessment by asking the question of the extent to which the systems and procedures are transparent, and whether they provide for genuine accountability, predictability through application of the rule of law, and appropriate participation. It is especially important in this largely qualitative exercise to recognize the institutional reality that informal rather than formal rules may be the determining influence on people’s behavior and the effectiveness of the system. This recognition, in turn, leads directly to facing the key issue of incentive, and how to gradually provide stronger incentives for improved behavior, and disincentives for corruption and inefficiency. (Beyond this general principle, the extent to which institutional factors are taken into account in the guidelines and assessments of public expenditure management is discussed later).

## COVERAGE OF THE INSTRUMENTS

Figure 1 summarizes the coverage of the main instruments (the detailed map of all 94 components of public expenditure management is in annex 2). Even a cursory look at figure 1 shows that there is both substantial “specialization” in the various instruments, in the sense of a particular focus on certain issues or aspects of public expenditure management as well as significant overlap in their coverage. Recalling that the high, medium, and low (black, gray, and white) coverage of each of the 15 major components in the map has been measured according to the frequency of coverage of the sub-components, the main observations are as follows:

- The scope and range of PERs vary widely but generally focus on traditional areas of public expenditure policy and analysis—both at the macro level and in key sectors such as health and education. Many PERs provide substantial coverage of intergovernmental fiscal relations, government structure, budget coverage, fiscal framework and expenditure programming budget preparation, and treasury systems, cash management, and expenditure monitoring.
- CFAAs provide substantial coverage of budget coverage, budget preparation, treasury, cash management, and expenditure monitoring, internal control and internal audit, accounting, reporting, and records management, and external audit.

- Consistent with its focused objectives, CPAR coverage of nonprocurement aspects of public expenditure management is limited to occasional mention of relevant issues of budget preparation and execution, particularly internal control and audit.
- Fiscal ROSCs cover mainly the legal framework for expenditure management, relations between government and nongovernment entities, budget coverage, fiscal framework and expenditure programming, internal control and audit, and external audit (mainly from a fiscal transparency perspective).
- EC audits focus on downstream issues such as treasury systems, cash management, and expenditure monitoring, procurement, and accounting and reporting.
- None of the instruments provides more than limited coverage of administrative and financial management capacity (personnel quality, capacity, incentives, and management).

In countries where the World Bank is preparing or providing an adjustment loan, the functional equivalent of a PER is integral to the dialogue under the loan—but a formal PER is normally not done. Because expenditure reviews conducted in the context of adjustment lending tend to give greater weight to nuts-and-bolts problems of expenditure management than do formal PERs, their coverage of budget execution and financial control issues is greater, as is the overall scope of the instrument.

With the exception of PERs, the assessment instruments provide the most extensive coverage of budget execution, accounting, audit, and control. But within these areas there are substantial variations in coverage and approaches among PERs, CFAAs, Fiscal ROSCs, and EC audits—while seeming overlaps in coverage often mean little, and sometimes reflect different objectives and approaches. Moreover, figure 1 does not reflect differences in the quality and depth of analysis.

## **SIMILARITIES**

Just as the depth and breadth of coverage vary, so do the procedures for carrying out assessments—including the intensity of discussions with recipient countries. Still, all the instruments share common objectives and features. They all examine aspects of public expenditure and financial accountability systems,



diagnose strengths, weaknesses, and risks, and recommend action plans for improving functions and procedures, with monitorable benchmarks or indicators identified to gauge and guide such efforts.

The recommendations of assessment reports have become more important in recent years, and in most cases feed (directly or indirectly) into the development agency's country assistance strategy or its equivalent. These recommendations often also influence lending and other donor support, affecting decisions on the type and amount of assistance and sometimes resulting in specific projects or technical assistance to support improvements in public financial management.

For example, EC audits of the use of EC program aid provide useful information about the quality of underlying public expenditure management systems and procedures for control, procurement, and the like—though, for reasons noted above, the European Commission is moving to a new approach that sharpens its assessment work by combining compliance testing (a modified form of audit) and performance measurement. Although the IMF's Fiscal ROSCs are in principle voluntary, acceptance of their analysis and recommendations increases the probability that the governments assessed will receive IMF support and influences the content of the stabilization programs the reports are designed to support. Moreover, multilateral development banks and other development agencies pay serious attention to the findings of Fiscal ROSCs when designing their aid programs.

Similarly, a PER can be a self-standing diagnostic study, but—whether as a formal product or not—is considered essential for a World Bank adjustment loan. As noted, in the absence of a recent formal PER, its functional equivalent is carried out during the preparation of an adjustment loan. Rarely does a Bank adjustment loan or credit not include a substantial component for improving public expenditure programming and management. Similarly, CFAAs and CPARs are required in all countries where the Bank is considering adjustment support. It would be disingenuous to pretend that the Bank would not (rightly) insist on implementation of some CFAA or CPAR recommendations as part of the reforms supported by an adjustment loan. Moreover, many bilateral agencies have always paid attention to Bank PERs, and appear just as willing to rely on the findings of CFAAs and CPARs.

The assessment instruments also share several operational approaches and processes. First, they all emphasize the importance of ensuring that recipient governments own and participate in the analysis. PERs, CFAAs, and CPARs encourage government participation throughout the process,

Fiscal ROSCs begin with governments filling out a questionnaire, and DFID assessments of fiduciary risk strive to agree with governments on the main policy issues to be addressed and the basis for measuring and monitoring improvements.

Second, to reduce transaction costs for all parties, all the instruments encourage coordination and collaboration among development agencies in conducting the assessments. (See also the discussion below, in the section on issues for further consideration.)

Third, all the instruments encourage dissemination of the assessments and their findings—and sometimes participation by a broad cross-section of society in recipient countries—on the premise that better understanding of governments' fiscal and financial decisionmaking may increase pressures for change from civil society. To that end:

- PERs have increasingly incorporated consultation with nongovernment entities, and often rely on substantial cooperation from local universities and research organizations.
- Many governments have agreed to post their Fiscal ROSCs on the IMF website.
- A recent Bank-IMF paper discussing HIPC AAPs emphasizes that monitoring by civil society organizations can increase accountability (World Bank and IMF 2002).
- DFID plans to combine its support for public expenditure management with measures to encourage input from the private sector and civil society.

Finally, development agencies follow (with slight variations) a common sequence of actions in conducting assessments. The process starts with planning and desk studies, then moves to a concept paper, a review meeting, identification of peer reviewers and other arrangements for quality control, a field mission (or missions, if needed), multiple drafts of the assessment report and accompanying reviews, a government review, the final report, and public dissemination. Most decisions about whether and how to conduct assessments are driven by the needs of development agencies' country assistance programs and by the technical capacity of the countries concerned.

Priority tends to be given to countries for which development agencies are considering budget support and where agency rules require assess-

ments before providing such support. Government consent is always required, usually in the form of a formal “request” that the agency conduct the assessment—though, in reality, assessments are almost never genuinely requested by the governments concerned. Still, it is hoped that through open dialogue, host governments will come to value the assessments and own the results.

In conducting assessments, development agencies have often been criticized for sending multiple missions (both from the same agency and across agencies) seeking the same basic information and asking similar questions of public officials. Insufficient coordination across multiple missions and assessments creates several problems. It often results in a lack of coherence between the analysis and recommendations of different assessment reports. It can also lead to an excessive number of recommendations for strengthening governance of and tackling technical weaknesses and capacity gaps in public financial management. Such problems, for example, developed in Burkina Faso, where a CPAR, CFAA, and Fiscal ROSC were conducted in 2000–02 (box 3).

In response, agencies are taking steps to ensure that thorough desk reviews of all available information—from both donors and governments—are completed before defining the scope of assessments, and certainly before sending missions. As interest in assessment instruments has increased in recent years, so has their funding. Thus development agencies are paying more attention to quality control, though approaches vary.

Internal evaluations of these instruments have also contributed to their recent evolution, including significant changes in emphasis and increased standardization, rigor, and precision in their application. For example, the World Bank’s Quality Assurance Group conducted a major review of CFAAs and CPARs undertaken in 2000–01 (World Bank 2002e), and the Bank recently issued extensively revised guidelines for both. In addition, interim guidelines for PERs were developed in 2001, and the Bank is considering formalizing these guidelines as part of a joint review of Bank-IMF work on public expenditure (see below). Similarly, the DFID has produced a manual for staff on its approach to assessing public expenditure management (DFID 2001b). The European Commission is replacing its traditional audits with assessments that emphasize the development implications of the analysis and the importance of monitoring changes in public financial management. Finally, to improve their capacity to advise governments on public expenditure management, many development agencies are hiring more staff with expertise in these areas.

**Box 3****Multiple assessments result in myriad recommendations in Burkina Faso**

Burkina Faso recently went through a number of assessments in a short period. In 2000 a CPAR was completed, which led to reforms of public procurement. Soon after, the government conducted a broad analysis of its system for public financial management. As part of this analysis, questionnaires were distributed to various parts of the administration, with a focus on the Ministry of Finance. The information was then consolidated in a summary report.

In parallel, in the first half of 2001 the IMF conducted a Fiscal ROSC (with the final report published in 2002). Then in September 2001 a CFAA was launched to provide external verification of the government's findings in its analysis of public financial management. The CFAA was used as a pilot case for a multidonor assessment and drew on experts from a number of African donor agencies. In addition, the CFAA included an audit of government practices to confirm its findings. Also in 2001, several bilateral missions visited Burkina Faso to gather more information on the government's reform agenda for public financial management. Participating in these various assessments and receiving multiple missions in a short period imposed relatively high costs on the administration, especially given the Ministry of Finance's limited capacity.

The assessments may have helped provide a comprehensive view of the various aspects of Burkina Faso's system for public expenditure management. Moreover, the coverage of the assessment work—for example, on the responsibilities of banks and the government for budget execution and reporting in the Fiscal ROSC, and on revenue issues in the CFAA—was broader than in many other countries. But for some elements of the budget cycle, especially budget execution, there was clear duplication in the resulting recommendations. Moreover, none of the assessment reports refer to the recommendations of the others. As a result more than 280 recommendations were made. And though many have similar objectives, they sometimes propose different approaches to achieve them. These recommendations will need to be made consistent and coherent during the development of the overall reform plan—which will require significant government effort.

## DIFFERENCES

Even the most original assessment draws on findings from other studies. But even the simplest synthesis contains original elements—and an assessment of risk and development needs is always “original” to the agency concerned. The instruments surveyed fall into two broad categories: “primary” and “secondary,” with “primary” instruments undertaking original data collection and analysis and the “secondary” instruments relying mainly on the data, analysis, and findings of the primary sources.

The predominantly primary instruments are PERs, CFAAs, CPARs, and Fiscal ROSCs. The secondary instruments are DFID assessments and HIPC AAPs (though AAPs have included short field missions, sometimes combined with missions on PERs, CFAAs, and Fiscal ROSCs).<sup>3</sup> The new approach proposed for EC assessments and “compliance tests” falls in between, relying on the findings of other instruments but also carrying out some original analysis—as with the EC’s traditional *ex post* audits. As discussed, the instruments vary considerably in how they gather data and use questionnaires and diagnostic checklists. Coordination and integration issues mainly arise as part of the data collection and analysis performed for PERs, CFAAs, Fiscal ROSCs, and EC audits; they are less important for CPARs given their specialized focus.

The first main difference among the instruments is the level of uniformity in report approaches, scope, and coverage. Fiscal ROSCs are arguably the most uniform: they are applied using a focused, standardized questionnaire and supported by a detailed user manual and very specific format. HIPC AAPs share these characteristics, including the use of questionnaires, a single set of benchmarks and indicators, and a common format. Both are highly organized, carefully structured exercises carried out under tight schedules—another factor that contributes to their consistency. These features stem from one of the main objectives of these instruments: enabling cross-country comparisons of their results.

CPARs, while tailored to country characteristics and problems, also adopt a relatively standardized approach because of their focus on a single technical area. Their uniformity is also aided by the World Bank’s 15–20 years of experience in assessing procurement systems.<sup>4</sup>

CFAAs have evolved rapidly since early 2002, and the revised guidelines issued in May 2003 and recent applications have a more uniform scope and content than in earlier years, with a standard format and basic mandatory coverage. The European Commission and many bilateral agencies now

consider CFAAs a core product, particularly for fiduciary risk analysis. But the considerable overlap between CFAAs and other instruments—especially PERs and Fiscal ROSCs—requires clarification (for further discussion see the next section, on issues for further consideration).

Though all PERs contain certain core material (for example, on each country's macroeconomic and fiscal environment), their range and coverage vary much more than do the other instruments—an outcome that is probably inevitable given the instrument's wide scope. It is perhaps partly for this reason that the draft PER guidelines prepared in 2001 were not issued formally. PERs almost always discuss main fiscal issues and key expenditure issues in a country's major sectors (health, education, transportation, energy, and so on), but the choice of sectors, identification of problems, and depth of analysis differ considerably. For example, most PERs refer to the cost of public sector wages and pensions as part of their fiscal analysis, but only a few devote much attention to civil service or pension reform. Because of their wide reach, PERs take longer to complete and are conducted less often than the other instruments.<sup>5</sup>

Finally, despite common rhetoric, government ownership varies widely by instrument and by country and is very weak in some cases. It bears repeating that strong government ownership makes it far more likely that the results of any analysis will lead to realistic, sustainable reforms. In countries dependent on aid and with limited capacity, such ownership can be fostered by a government-led PER, which involves governments and development agencies in a continuing dialogue on improving the budget process and increasing local capacity (see the discussion above on Tanzania). In more developed countries with substantial capacity, government leadership ensures genuine ownership—as in Turkey, where the government set the agenda and defined the scope for an integrated approach to the assessment and reform of public expenditure.

## **INSTITUTIONAL AND GOVERNANCE CONTENT**

With the possible exception of the broad constitutional and legal descriptions of the state apparatus in PERs and Fiscal ROSCs, the instruments provide little guidance on defining and accounting for institutional factors in assessments. Nor do any of the guidelines recommend that assessment teams include staff with specific expertise in public management and governance. It seems to be assumed that in most cases economists and financial management and procurement staff can undertake any needed institutional analysis.

Not surprisingly, this approach has led to neglect of institutional considerations and lack of focus and coherence in preparing action plans and designing capacity building initiatives—and occasionally to major mistakes. A review of the guidelines for assessment instruments—and, to a lesser extent, current practices—points to numerous institutional and governance issues that require increased coverage, deeper analysis, or both.

The draft PER guidelines state that, as a first step toward improving budget preparation and execution, an institutional analysis should be undertaken of the key dimensions of public expenditure management, guided by three questions: What formal rules and institutions govern budget management? How effective are they? And how could they be improved or applied more effectively? Many PER reports also address the broad institutional and legal context: constitutional requirements for the budget and its management, the state's legal and institutional structure, and intergovernmental relations.

The draft guidelines do not explain how to perform such institutional analysis except to say that capacity issues need to be addressed in a highly participatory way. But PER teams often do not have the skills and experience required to conduct such work. As a result some PERs have confused organizational and institutional issues—and so have made recommendations for changing organizational responsibilities but paid little attention to the institutional necessity of changing the rules of the game and the incentives that lead to organizational forms and behaviors requiring modification.

The recently updated CFAA guidelines make little mention of institutions, yet the content and nature of these reports imply some degree of institutional and governance coverage (World Bank 2002b). In addition, the guidelines refer to “the legal framework and institutional arrangements for the country's public financial management.” Though the guidelines do not explicitly discuss corruption, evidence from corruption surveys, Transparency International assessments, World Bank Institutional and Governance Reviews (IGRs), and other reports can be used in CFAAs. The guidelines emphasize the importance of action plans that are “clearly justified and prioritized, [and] differentiated in terms of their short, medium and longer term impact.” Yet no guidance is given on the extent to which action plans should address the root causes—as opposed to the technical symptoms—of poor expenditure management.

The CPAR guidelines state that all aspects of a country's procurement system must be assessed, including its legal and organizational framework, procedures, tools, decisionmaking and control procedures, anticorruption initiatives, and contract administration (World Bank 2002c). Enforcement

of system requirements must also be scrutinized. The guidelines stipulate the need for “detailed institutional analysis of key government ministries and agencies in the actual performance of public procurement responsibilities, their strengths and weaknesses, priority capacity building needs, the governance environment in which they operate, and the incentives needed to improve performance.” Moreover, action plans should “carefully assess the political feasibility of the main recommendations.”

In addition, the CPAR checklist and questionnaires have a strong implicit focus on corruption in that most of the rules, regulations, and procedures are designed to ensure transparency and efficiency. The CPAR guidelines (along with those for EC audits) contain the most explicit, extensive references to institutional and governance issues of all the assessment instruments—though this does not mean that the issues are adequately reviewed in the field or fully reflected in assessment reports.

The treatment of institutional and governance issues by CFAAs and CPARs has evolved since the Bank’s Quality Assurance Group reviewed fiduciary economic and sector work undertaken in 2000–01 and recommended changes in their guidelines (World Bank 2002e). The review found that CPARs and CFAAs generally failed to identify how weaknesses in areas such as incentives, technical competence, and the governance environment contributed to poor performance. The reports studied also did not adequately address weak application and enforcement of formal laws, rules, and procedures for public expenditure management. More recent CFAAs and CPARs have paid more attention to institutional and organizational issues, including the extent to which rules and procedures are followed. Still, the instruments contain little analysis of the nature and possible causes of cases where they are not.<sup>6</sup>

Fiscal ROSCs cover broad institutional elements such as the structure of the public sector—including the roles and responsibilities of the executive branch, parliament, and supreme audit institutions—and touch on a number of governance issues. In particular, these reports examine:

- Whether commitments and expenditures of public monies are governed by comprehensive laws and openly available administrative rules.
- Practices for extrabudgetary expenditures and quasi-fiscal activities.
- Regulation of the private sector and whether public-private relations are conducted in an open manner.
- The degree of discretion in taxation and regulation.



- Whether procedures are in place to verify the accuracy of fiscal data.
- Whether internal controls are sufficient to safeguard public monies.
- The degree to which laws are observed in practice.
- Weaknesses of watchdog and oversight organizations.
- Whether recommendations from internal and external audits are followed.

Fiscal ROSCs also indicate whether corruption or poor governance is impeding the achievement of international standards for transparency, though they do not analyze the causes of such problems.

The guidelines proposed for EC audits emphasize the importance of examining the institutional and governance factors that affect public expenditure management, including the legal framework, arrangements for democratic oversight and control, anticorruption efforts, incentives of civil servants performing these functions, and organizational constraints (EC 2002). Based on the findings and other information and analysis, the guidelines urge the European Commission and the government concerned to agree on a corrective action plan.

The next section, on issues for further consideration, offers recommendations for remedying assessment instruments' neglect of institutional and governance considerations, including by preparing new and comprehensive guidelines on these issues.

## SUMMARY

The mapping of the assessment instruments has led to the following conclusions:

- Although the instruments reviewed in this study are often called assessments of public expenditure management, they include issues—such as forecasting government revenue and management of public debt—that are outside the expenditure domain. This broader concept should be used in streamlining and rationalizing the use of these instruments.
- There is overlap between the coverage of the instruments, especially between CFAAs and Fiscal ROSCs. The next section offers some proposals for rationalizing and simplifying these instruments.

- Though there are differences in the objectives of the instruments that may justify some overlap, they also result in a lack of clarity about how assessment information and analysis should be interpreted and used. For example, PERs have largely developmental objectives, while CFAAs and CPARs have both a fiduciary and developmental orientation—a mix that can reduce the clarity of their information and analysis as well as confuse relationships between the World Bank and client governments. Similarly, though Fiscal ROSCs are primarily concerned with assessing how well transparency and accountability arrangements match the IMF’s fiscal code, they can also be given a fiduciary interpretation. And while EC audits have traditionally had a fiduciary focus, the commission is increasing its emphasis on developmental objectives.
- Though there is overlap between PERs and CFAAs, especially in assessing upstream (and sometimes downstream) aspects of the budget process, in most cases it is more potential than real. This is because CFAA coverage of budget preparation is largely confined to issues of comprehensiveness, realism, and classification—and where such issues are covered by a PER, the recently updated CFAA guidelines make clear that the PER information should be used.
- HIPC AAPs provide a comprehensive summary of a country’s public expenditure management system, including key indicators of performance. So, while this instrument overlaps with the others, and attention needs to be given to integrating it with other diagnostic work, it adds value through its different approach and objectives and its explicit use of performance indicators.
- EC audits and compliance tests should be considered complementary to CFAAs, which do not use audit techniques. But as discussed below, greater efforts are needed to substantiate this complementarity, through stronger collaboration between the European Commission and the World Bank.
- Technical synergies between the instruments could be more fully exploited. For example, CPARs address issues—such as control and audit of procurement transactions, allocations of funds for capital investment projects, and procedures for cash disbursements—that also receive substantial coverage in some PERs, CFAAs, and EC audits. Addressing such cross-cutting issues requires taking a fresh look at World Bank (and IMF) business practices, including the skill mix of the teams of econo-

mists and specialists in financial management, procurement, and governance that conduct assessments.

The mapping also revealed important gaps in the instruments—both in their formal guidelines and in how those guidelines are interpreted when assessment reports are produced:

- None of the instruments provides broad, substantial coverage of the forecasting, collection, and administration of taxes and other government revenue, though many PERs address some of these issues and the recently updated CFAA guidelines include accounting and control aspects of tax administration. This oversight is surprising given that accurate revenue forecasts and efficient tax collection are crucial for sound public expenditure management.
- Although asset management is included in the updated CFAA guidelines, no CFAA has covered this issue—which also requires a wider perspective than financial management alone, including sound understanding of accounting, economic, and procurement issues.
- Debt and aid management are covered in PERs and CFAAs but, as with revenue forecasting, not systematically or comprehensively.
- Effective management of public records is an important element of public expenditure management but is hardly covered by the assessment instruments. The United Nations Development Programme's CON-TACT guidelines include a records management module, and the International Records Management Trust is developing—as a subprogram of PEFA—questionnaires covering management of government records in areas such as financial management and government payroll. Consideration should be given to combining the records management component with the main instruments, particularly CFAAs and CPARs.
- The instruments—particularly CFAAs and to a lesser extent PERs and CPARs—tend to focus on central government systems for public expenditure management. This approach is understandable given the expertise of development agency staff and the limited resources for conducting assessments. But while more attention is being paid to fiscal issues involving subnational governments, state enterprises, and agencies not funded directly by national budgets, it is often insufficient given the shift toward fiscal decentralization in many countries and recognizing that these can be areas of high fiscal risk.

These technical gaps in assessment instruments are in addition to the issues identified elsewhere in this study as needing more work—in particular, strengthening the treatment of institutional and governance issues, increasing dialogue with governments and other donors, developing realistic action plans, ensuring adequate follow-up work, and establishing robust systems for measuring the performance and results of public expenditure management systems.

## NOTES

1. These sample reports included the following countries: *CFAA*—Bangladesh, Benin, Bosnia-Herzegovina (BiH), Brazil, Mozambique, Philippines, Turkey, Uganda, Ukraine, Vietnam and Zambia; *CPAR*—BiH, Philippines, Russia, Turkey, Uganda, and Zambia; *PER*—BiH, Croatia, Ethiopia, Philippines, Uganda, the Philippines, Tanzania (and sector PERs on Agriculture, Health and Education), Turkey, Vietnam and Zambia; *Fiscal ROSC*—Bulgaria, Mali, Pakistan, and Turkey; *EC Audits*—Cameroon, Chad, Cote d’Ivoire, Ghana, Mozambique and Zambia.

2. For a helpful discussion, see *Helping Countries Combat Corruption: The Role of the World Bank* (Washington, DC: The World Bank, September 1997). See also *Anticorruption in Transition: A Contribution to the Policy Debate*, (Washington, DC: The World Bank, 2000). See <http://lnweb18.worldbank.org/eca/eca.nsf/General/D74DB51B2D46615D8525695B00678C93?OpenDocument>.

3. HIPC AAPs are conducted by Bank and IMF staff with considerable experience in addressing public expenditure management issues in the countries studied. Thus there is no need for long missions by staff new to the countries.

4. The Quality Assurance Group report on fiduciary economic and sector work found that 75 percent of CPARs were satisfactory with respect to internal quality and likely impact, compared with only 50 percent for CFAAs (World Bank 2002e). (PERs and other Bank public expenditure work were not assessed.)

5. In countries for which the Bank is preparing an adjustment loan, a review of public expenditure management is integral to loan preparation and supervision. In such cases formal PERs are unnecessary and not visible in work programs. Thus if adjustment support is being prepared or provided to a country, it is a serious mistake to assume that no attention is being

paid to public expenditure management simply because no PER has been conducted in recent years.

6. The Quality Assurance Group report also recommended a range of other changes in CFAA and CPAR guidelines, including strengthening business processes, revisiting skill mixes for financial management and procurement staff, strengthening partnerships, and enhancing knowledge management (World Bank 2002e).



## Recommendations and Issues for Further Consideration

Efforts to strengthen assessment instruments should focus on several pressing concerns—including increasing integration and improving coordination and cooperation, addressing institutional and governance considerations, strengthening follow-up and performance monitoring, and developing a programmatic and modular approach.

### **INCREASING INTEGRATION AND IMPROVING COORDINATION AND COOPERATION**

Development agencies' growing use of public expenditure and financial accountability assessments has brought to the fore the crucial link between good public management and effective aid. Since the late 1990s there has been broad consensus that the most pressing question for development is not whether aid has been effective, but where it has been effective and under what conditions (World Bank 1998a; Collier and Dollar 1999). It has become clear that aid is most effective when it supports sound policies implemented by legitimate governments. In a major advance, development agencies are now accountable for assessing the risk that aid resources will be stolen, allocated to activities other than those in government budgets, or simply wasted.

The problems of duplication and lack of coordination among assessment instruments pale in comparison with this advance. Still, as reported

by agency staff and confirmed by government officials, duplicated efforts and uncoordinated assessments impose high transaction costs on recipient governments—especially given these governments’ limited administrative and financial management capacity. (In some cases agencies do not even try to avoid scheduling missions when budgets are in the final stages of preparation—an extremely busy period for ministries of finance.) Moreover, this state of affairs has sometimes resulted in superficial, overlapping, or incomplete analyses and prevented the provision of coherent advice and systematic feedback to recipient governments and sponsoring institutions.

The Task Force on the Harmonization of Donor Practices—sponsored by the Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD)—recently commissioned a survey of the burdens that donors have placed on eight recipient governments. Although the survey did not focus on the instruments of concern to this study, several of its findings are pertinent. First, the overlapping, donor-driven, and often rushed approach taken by donor missions placed excessive demands on government officials, with different missions asking the same people similar questions again and again. Uganda, for example, hosted six missions at the same time, with four asking similar questions of the same people—and all were World Bank missions.

Second, multidonor missions can reduce such burdens, but not always. When all donors insist on direct involvement, it can result in unmanageable and incoherent missions. Thus there is a need for donors to accept analytical work conducted by other agencies. Third, in Bangladesh and Tanzania the survey found that donors demanded an unrealistic scale and pace of reform, based partly on insufficient understanding of country circumstances. This point underscores the need for better understanding of a country’s institutional and governance context when actions are proposed to address weaknesses in public expenditure, procurement, and financial accountability systems (University of Birmingham School of Public Policy 2002, p. 9).

Another recent study, sponsored by the Strategic Partnership with Africa (SPA), reviewed the experiences of several African countries (Burkina Faso, Malawi, Mozambique, Tanzania, Uganda) in undertaking participatory CFAAs. The study concluded that there was often poor coordination within CFAA teams and between CFAAs and other instruments, and sometimes insufficient government participation and collaboration. And while partic-

ipatory approaches are intended to lower transaction costs, that does not always happen. Although some of the CFAAs were carried out at the same time as PERs and Fiscal ROSCs, the different teams did not coordinate their interactions with government officials. As a result the administrative burden was the same (Reite 2002).

Thus, this study's first recommendation is perhaps the most obvious: no consideration should be given to creating or expanding assessment instruments until duplication and coordination problems are resolved to the satisfaction of all concerned.<sup>1</sup> Many of the study's other recommendations—based on the mapping exercise, reviews of assessment guidelines and reports, and interviews—also involve improving coordination within and between development agencies and partner governments. But before discussing ways to improve coordination, it is worth identifying constraints on harmonization and integration of the various instruments.

### **Constraints on harmonization and integration**

Because assessment instruments are products of individual development agencies, the issues covered and methods used naturally reflect agency objectives. These instruments will always reflect their origins, and there are many incentives to keep them separate products, including:

- Development agencies are overseen by boards, ministries, legislatures, supreme audit institutions, and other entities to which they are ultimately accountable.
- Boards and senior managers usually demand identifiable products with the stamp of the agency, oversight body, or both.
- The staff responsible for assessments often work in organizational “silos” and lack incentives to work collaboratively within their own organization or (to an even lesser extent) with other agencies.

There are also significant differences in the specific objectives for improving public expenditure management. For example, the rationale and objectives of EC audits may be partly driven by statutory imperatives, or in the case of both EC audits and DFID assessments by demands from legislatures, audit institutions, and other oversight bodies for better fiduciary assessments. Similarly, there is growing pressure from the boards of the World Bank and IMF for stronger coordination and collaboration between the two institutions on public expenditure management issues (World Bank



and IMF 2003). Moreover, the demands of managers and oversight agencies evolve from changes at the top, and “turf” considerations may also lead to a desire for separate products.

At the procedural level, arrangements for peer reviews and other quality control mechanisms vary considerably among development agencies, which reflects their managerial styles and administrative cultures. As a result, there may be genuine professional concerns (as opposed to efforts made for self-protection) about the quality of assessments produced by other agencies. Finally, as in all bureaucracies, groups within agencies fight for their turf and for maintenance of the status quo. Thus, even when boards or top managers announce policies intended to reduce overlap and turf battles within and between agencies, line managers and staff may be able to subvert or ignore such instructions for a considerable period.

These constraints have three important implications. First, to the extent that integration occurs, it is somewhat more likely to happen within than between agencies. Second, when a recipient government has enough capacity, clarity, and political power, it can usually compel coordination among development agencies. Third, thinking in terms of fewer instruments misses the point. Although further proliferation should be halted, some instruments can rely largely on the analysis of others without forsaking the agency’s independent judgment or desire to have its own separate product. Thus efforts to improve assessments should not focus on eliminating or merging instruments to reduce their number. Rather, they should focus on ensuring the substance and quality of analyses on which all concerned parties can rely, and on improving coordination and reducing costs for recipient governments. And as noted, there is scope for streamlining the scope and coverage of instruments to reduce unnecessary overlap and fill gaps—and possibly going further and developing a programmatic and modular approach, as discussed below.

### **Exchanging information and programming intentions**

Despite the risks and costs of duplication, there is no systematic exchange of information among agencies on their plans for conducting assessments. The issue here is not the need to create a reliable database on fiscal and budget issues shared by development agencies and recipient governments. That vast task is already being addressed through other donor coordination mechanisms. For example, a lot of information is available from IMF databases and statistical publications on government finance. In addition, the

OECD is preparing (with World Bank support) a new public expenditure database containing budget information for a range of countries, including some developing and transition economies.

Of concern here is the narrower but still important need of agencies to exchange systematic, timely information on their plans for conducting assessments, and to share the reports. This task should be aided by the Country Analytic Website being developed by the World Bank and other donors.<sup>2</sup> In addition, steps are being taken to give development partners online access to IMF and World Bank documents. Both efforts should make it easier to improve the sequencing of assessment instruments. But better programming also requires the cooperation of country project managers—and is achieved when a recipient government has sufficient capacity and political strength to take the lead in coordinating assessment work among agencies and instruments.

### **Coordination between agencies**

The nature of budget support provides a powerful incentive for donors to collaborate. Indeed, it was one of the forces driving the creation of PEFA. There are many examples of successful collaboration between multilateral institutions: the Bank and the IMF on HIPC AAPs, multilateral development banks (and several bilateral agencies) on CPARs,<sup>3</sup> and the Bank and the Inter-American Development Bank on CFAAs. Most donors must justify their provision of budget support using sound assessments of recipient governments' financial management and accountability systems.

But while aid agencies are generally unwilling to risk relying entirely on assessments conducted by other agencies, most bilateral agencies do not have the resources and skills required to conduct robust assessments. The obvious response would be to conduct joint assessments, but in most cases these are impractical.<sup>4</sup> Such assessments would result in multiagency teams of 20–30 people on three- or four-week missions—a managerial nightmare that would also force the recipient government to put aside its regular activities for a long period.

So what is the solution? This predicament creates an important avenue for coordination and raises an equally important corollary. Better coordination and lower transaction costs can be achieved if bilateral development agencies rely on the assessments of multilateral agencies equipped to perform them—normally the World Bank and, on fiscal transparency issues, the IMF. But these institutions must be far more open to cooper-

ation with each other and to suggestions, requests, and criticisms from their partners.

At a minimum, given that the quality of the analysis is paramount for improving public expenditure management and financial accountability, the IMF should strengthen its *ex ante* consultation with the Bank on the terms of reference for its Fiscal ROSCs, and the Bank should reciprocate for its PERs and CFAAs (once consistency between these two instruments has been assured, as proposed below).

The Bank and IMF already share some documents and information and request comments from one another. A broad division of labor has been established—beginning with 1981 guidelines for Bank-IMF collaboration—that has largely been respected, though not without friction. Peculiarities persist, especially in the separate public expenditure management activities of the Bank's Public Sector Governance Board and the IMF's Fiscal Affairs Department, sometimes leading to divergent results. There are also strong differences of approach between the areas and regions of the Bank and the IMF. The ongoing review of Bank and IMF collaboration on public expenditure issues should be used to propose changes and streamline work on both public expenditure and revenue management.

Bank-IMF collaboration also raises the issue of overlap between CFAAs and Fiscal ROSCs. Both institutions seem to accept that such overlap is substantial, particularly in assessing transparency and fiduciary risk. All the elements described as being central to assessing risk to Bank funds in the recent revision of CFAA guidelines are explicitly defined elements of the IMF's fiscal transparency code. So, in principle, if a ROSC has been completed, a CFAA may only have to deepen or broaden certain aspects of its analysis to achieve its fiduciary risk objective. And if the sequence is reversed, the ROSC should be able to apply CFAA findings directly to its assessment of public expenditure management rules and procedures.

Thus it should not require much effort to combine the collection and analysis of information, through joint teams and missions, using a combined questionnaire and database, and produce a joint report that satisfies both institutions' fiduciary and surveillance objectives. The two institutions could also use the information for other purposes—for example, the Bank could use it to feed into the dialogue with countries on reforms linked to Country Assistance Strategies and Poverty Reduction Strategy Papers.

The Bank and IMF have also suggested other changes to enhance cooperation: sharing more information on work plans and mission schedules, exchanging information between mission teams working in the same coun-

tries, arranging joint missions and sharing staff, and making more effective use of the Internet to share databases and internal Websites. Though these are steps in the right direction, they may not go far enough. Assessments suffer from several other problems related to cooperation and coordination, in particular:

- The somewhat divergent interests and objectives associated with the development of the instruments reviewed in this study means that they are similar but slightly different, and there is not necessarily agreement on the fiduciary protection provided in a particular country.
- Ensuring country ownership of the diagnostic process and open provision and exchange of information is likely to be much harder if a development agency appears to be setting the agenda or collecting information for fiduciary purposes or to set conditions for aid disbursement.
- None of the instruments provides an entirely satisfactory measure of fiduciary risk.
- The potential conflict between the need for government ownership and the robustness of an assessment is especially relevant to financial accountability assessments.

Against this background, it is recommended that:

- A common definition of fiduciary risk be agreed upon between governments and donors.
- The relationship between the role of the instruments in evaluating fiduciary risk and contributing to long-term development goals be clarified.
- Consideration be given to dividing the fiduciary and development aspects of diagnostic work into separate processes and reports and to creating a more independent process—with some element of joint ownership by donors and external quality control and validation—for carrying out assessments. Doing so would allow donors to develop stronger partnerships with countries, reduce the possibility of conflicts of interest, and strengthen the focus on development issues and capacity building.

In addition, important issues arise in the coordination of activities between the European Commission and the World Bank and IMF—particularly between EC audits and CFAs. The evaluation work related to EC budget support has moved away from traditional ex post audits, focused

on establishing the eligibility of expenditures financed by aid, to an approach based on learning from other institutions' diagnostic work, filling gaps where necessary, and conducting compliance tests and annual updates (using audit techniques) to establish whether public expenditure management systems are operating efficiently. Linked to this approach is an EC proposal to develop indicators for monitoring improvements in public financial management.

In principle there is close complementarity between EC compliance tests and CFAAs, because the CFAA is not an audit and the Bank has eschewed audit techniques. But more needs to be done to increase collaboration. For example, the European Commission and the Bank need more experience working together in the field (some joint work has already been done, especially in Africa), with case histories and lessons recorded from these experiences, and should work together with governments. Moreover, as noted, the methodology of EC compliance tests has not been fully defined and documented. The Commission should fill this gap, drawing on the experience and expertise of the consulting companies that conduct most EC audits and compliance tests—and consider how information deriving from this work can be linked with the development of performance indicators (PEFA 2003).

In addition, the Bank and IMF could seek input from the two or three largest partner development agencies in each recipient country, allowing them to influence the design of assessment work (for example, through consultations on initiating concept memorandums and terms of reference), consulting with them during assessments, and inviting them to participate in country dialogue (for example, through government and donor workshops) before assessments are finalized. Doing so would make partner agencies more inclined to rely on Bank and IMF instruments instead of conducting their own analyses, while enabling them to shape and share assessment results. As noted, the agencies involved would not relinquish their rights and responsibilities for independent judgments. But such judgments would be exercised through careful scrutiny and synthesis of other agencies' analyses—without necessarily carrying out multiple analyses or duplicating efforts.

Often, though, what aid agencies view as better coordination is seen by recipient governments as “ganging up.” This difference in viewpoint will persist as long as assessments are top-down exercises carried out by aid agencies with only superficial participation by recipient governments. For coordination to provide the benefits of scale economies, lower transaction costs, and better advice without the threat of heavier interference and “coordinated” leverage, assessments must be at least partly owned by recip-

ient governments. Similarly, dialogue on public expenditure management reform is more likely to achieve its desired outcomes if governments can be reassured that assessment results are generally accepted (if not formally agreed) by the donor community.

Two final points are worth mentioning. First, donor coordination issues also occur during efforts to implement assessment recommendations. Again, high transaction costs may arise for recipient countries if the supervision efforts of multilateral and bilateral donors are poorly coordinated. Two country examples show how this outcome can be avoided. In Mozambique, bilateral agencies conduct an annual joint review as part of joint budget support to implement the actions identified in the Poverty Reduction Strategy Paper. One of the review's main goals is to evaluate progress in improving public financial management.

Similarly, in Tanzania bilateral donors have combined their budget support under the Poverty Reduction Budget Support program. The donors have developed a matrix to assess progress in implementing the Poverty Reduction Strategy Paper, and public financial management is among the key areas assessed. Moreover, these donors are engaged in discussions with the World Bank to develop a common matrix for Poverty Reduction Budget Support and Poverty Reduction Strategy Papers, and to sponsor joint missions for evaluating progress.

Second, the OECD Development Assistance Committee's Task Force on the Harmonization of Donor Practices recently defined good practices for measuring performance in public expenditure management (DAC 2003; see also annex 2). These practices include planning and conducting diagnostic reviews, ensuring quality, sharing reports with stakeholders, engaging in follow-up activities, updating reviews, and monitoring performance. Donors should consider this guidance when conducting reviews and coordinating activities.

## **Coordination within the World Bank**

Internal coordination problems affect every large organization. But when it comes to assessment instruments, the people interviewed for this study and a review of existing guidelines indicate that the main ambiguities occur between the World Bank's Financial Management network, Poverty Reduction and Economic Management (PREM) network, and Procurement network. The first is responsible for CFAAs; the second for PERs and for leadership on adjustment lending in countries where such lending is

under way or being considered; the third for CPARs. Differences in perspectives have made it difficult to ensure good coordination of PER, CFAA, and CPAR processes. Planning and budgeting for these instruments are largely based on parallel exercises with separate teams, peer reviews, and the like, and teams usually do not include experts from the other areas—let alone are they integrated.

But there is encouraging evidence of a trend toward integration, or at least harmonization, of recommendations as the basis for a single dialogue with recipient governments (PEFA 2002). A recent Bank directive states that country teams can choose to prepare an integrated fiduciary assessment combining the CPAR, CFAA, and PER.<sup>5</sup> To qualify as an integrated assessment, the final product must comply with the guidelines for each instrument, and the sector boards responsible for each must agree on the content and on how the product will be presented to the client. Combined PERs, CFAAs, and CPARS are most common in the Bank's East Asia and Pacific Region, where they have become almost standard—partly in response to pressure from the region's governments. But separation and occasional dissonance between PERs, CFAAs, and CPARs remain common.

Some argue that a clearer division of labor is needed between PERs and CFAAs. In that view PERs should focus on upstream public expenditure management issues—expenditure programming, policy-budget links, sectoral resource allocations, and budget preparation—and CFAAs should focus on downstream issues—budget execution, accounting, audit and control, and executive accountability to the legislative branch. The current division of labor is far less clear. CFAA guidelines include budget preparation in the scope of work, but this process has long been covered by PERs due to its direct link to expenditure policy, medium-term programming, and the overall macroeconomic framework. The executive's accountability to the legislature is also part of CFAA guidelines, yet it should be analyzed from an overall governance perspective, not just from a narrow budget and public accounting perspective.

To some extent such difficulties arise from the absence of published guidelines for PERs. As noted, the broader the scope of an exercise, the harder it is to define its scope and coverage. This makes it difficult to clearly define the terms of reference for an exercise like a PER, which necessarily has a wide scope but needs to be tailored to the problems of the recipient country. But while the breadth of the issues to be covered (such as institutional and governance concerns) can justify more indicative guidelines for PERs than for, say, CPARs, it cannot justify the continued absence of any

guidelines. The time has come to formulate PER guidelines, reach Bank consensus on them, receive feedback from other development agencies and sample recipient governments, and formally promulgate the guidelines. Thus the recent decision by the Bank's Public Sector Governance Board to prepare such guidelines is encouraging.

But the challenges of coordination go beyond the need for separate guidelines, particularly since individual assessments of public expenditure management should be seen as parts of an integrated whole. The World Bank would never advise a recipient government to set rigid organizational boundaries between budget preparation and budget execution. In every country the ministry of finance is responsible for both preparing a realistic budget that reflects government policy priorities and for facilitating and monitoring its execution. In addition, institutional and governance issues, including corruption, emerge at every stage of public expenditure management—not just in upstream or downstream phases.

Different elements and phases of the budget cycle have multiple interdependencies, and integrated approaches can create important synergies that improve assessment work (box 4). Thus the Bank's assessment instruments should strive for increased integration and cooperation, not further separation. Yet some respondents believe that the organizational boundaries between CFAAs and PERs have become more rigid in recent years.

Short of creating a single office in the Bank to advise on all phases of the public expenditure management cycle and financial accountability—which is not a realistic possibility at this point—ways should be found to bring the PER, CFAA, and CPAR processes closer together. At the same time, efforts should ensure that the guidelines for these instruments are consistent, facilitate integrated approaches, and provide stronger guidance for institutional and governance work. The recent PEFA paper on integrating these instruments concludes that “the potential benefits of integration can outweigh the costs, if the process of integration is managed effectively, and is adapted to the country circumstances. A review of the Bank's internal rules and procedures may be necessary to support the development of integrative and collaborative work” (PEFA 2002, p. ii). The paper also identifies good practices to guide country teams in adopting integrated approaches and sharpen the Bank's operational procedures. These good practices include:

- Recognizing the key role of country directors and country economists, working with sector managers, in designing and implementing diagnostic and reform work—which should be closely linked to Country Assis-



**Box 4****How an integrated approach can strengthen assessments**

By focusing on the complete cycle of public expenditure management and bringing together multidisciplinary teams—including economists, accountants, auditors, procurement experts, and public management specialists—integrated approaches can generate important synergies:

- A comprehensive picture of public expenditure management, without gaps or overlaps.
- A consistent analysis of public expenditure management performance.
- Recommendations that are consistent, prioritized, and reflect government capacity.
- Greater force to arguments for systemic reform of public expenditure management, by broadening the range of government agencies and other stakeholders involved in the dialogue.

Integrated approaches can also identify interdependencies between upstream and downstream phases of the budget cycle and provide better understanding of problems such as:

- Unrealistic budgets, which can lead to unpredictable cash flows, divergences between budgeted and actual expenditures, and procurement delays caused by funding shortages.
- Problems in procurement contracting, which can lead to low completion rates and inadequate returns for investment projects.
- Inefficient information systems for public expenditure management, which can fail to link the different stages of the budget cycle in a comprehensive, unified accounting and reporting framework.
- Incomplete audit trails, which can fail to take into account all relevant financial records on cash releases, procurement tenders and contracts, payroll management, and the like.

tance Strategies, Poverty Reduction Strategy Papers, and related lending and technical assistance operations.

- Being aware that this work may cover several years and a series of inter-related missions and reports.
- Establishing a core team with appropriate skills and experience to manage and conduct the work, with additional teams created as required to carry out specific analytical tasks.

- Developing a single concept memorandum for the work.
- Strengthening peer review.
- Ensuring the fullest possible participation and leadership of recipient governments.
- Promoting the full exchange of information and analysis between project teams throughout the work, and coordinating the missions and work programs of these teams as much as possible.
- Sequencing and prioritizing recommendations and action plans for implementing agreed reforms that reflect the capacity of the recipient country.

One approach would be to combine PERs—or at least their public expenditure management components—and CFAAs into a single product. But while this idea has theoretical attractions, it also raises practical difficulties. Combining the two instruments would increase the scope and length of an already lengthy report (unless PERs were split into components based on a sequence of activities spread out over time by use, for example, of the government-led approach described above for Tanzania). Moreover, separating the public expenditure management components of PERs from the expenditure analysis and policy components would effectively revert to a long-discarded approach to PERs, and would lose the essential connections between assessing policy options, preparing budgets, and delivering effective public services.

Still, the idea of integrating PER and CFAA processes has merit. It would ensure that economists, public management specialists, and financial management specialists work together more closely and that PERs and CFAAs are seen more as a single process of assessment work, reaching toward a common goal, than as separate products with few connections. Thus the recommended approach is to foster such coordination and collaboration by preparing consistent (or perhaps consolidated) guidelines and questionnaires, and changing Bank rules and procedures to facilitate the joint planning of PER and CFAA activities, joint missions, and, where appropriate, joint products.

A first (minimal) step in the right direction appears to be feasible. The terms of reference for PERs and CFAAs, with sufficient detail on key issues and proposed approaches, should require formal reciprocal clearance by the relevant sector directors in the Financial Management network and Poverty Reduction and Economic Management network, respectively. (Subse-

quently, as proposed earlier, these terms of reference should be subject to formal comments by the IMF—which should reciprocate with Fiscal ROSCs—and then be submitted to recipient governments for consideration and approval.) The goal should be to make the two exercises start from a common basis, and not attempt *ex post* reconciliation, amalgamation, or dilution of their findings.

Informal consultations on the two instruments, though common, have often been insufficient. In some cases a PER and a CFAA have been carried out in the same country, sometimes even during the same period, with no substantive interaction between the two and only perfunctory recognition of the other's results in the eventual reports. Formal reciprocal clearance, with its concomitant responsibility, could do much to resolve coordination problems upfront without requiring major organizational changes or pre-empting more comprehensive long-term solutions.

For CPARs, which have a relatively well-defined and narrow focus, coordination requirements are less demanding. The review, however, should be conducted with full awareness of a country's corruption and governance problems rather than as an exercise that considers government procurement an isolated function. But this approach is already implicit in CPAR guidelines and can be achieved by adding a governance expert to CPAR teams, by engaging in consultations on terms of reference with the appropriate unit in the Poverty Reduction and Economic Management network (without formal clearance by sector directors), or by doing both. It is also important that PERs reflect the findings of previous CFAAs and CPARs. Thus the PER concept note should always include reference to procurement issues, and the PER process should incorporate CPAR findings and recommendations. These practices, already common, should be made explicit in CPAR and (eventual) PER guidelines.

A recently launched review of the Bank's public expenditure work should help draw together the issues and concerns discussed above and propose practical solutions. The central concepts underpinning the review—that public expenditure work should be country-focused and country-driven, linked to Poverty Reduction Strategy Papers (where they exist) and donors' aid and technical assistance programs, and cover all relevant components of the public expenditure management cycle—are the same as those advocated in this study (for further details, see the section below on the proposed programmatic approach).

A final minor but important point involves Bank terminology for the initial documents for fiduciary economic and sector work. There are initiat-

ing memorandums, concept papers, concept notes, issues papers, issues notes, and initiating concept memorandums referring to the same basic documents. The use of these different terms sometimes causes confusion inside and outside the Bank. The Bank might consider reserving “initiating memorandums” for a structural adjustment loan (as has been done since the late 1980s) and settling on one of the remaining terms for PERs, CFAAs, and CPARs.

## **INSTITUTIONAL AND GOVERNANCE CONSIDERATIONS**

All the assessment guidelines should include a brief definition of institutional and governance issues and explain their relevance to analyses of public expenditure management. The generally accepted definition of governance is found in World Bank (1992, p. 1):

The exercise of authority, control, management, power of government. A more relevant definition for Bank purposes is “the manner in which power is exercised in the management of a country’s economic and social resources for development.” The Bank’s main concern with sound development management thus extends beyond building the capacity of public sector management to encouraging the formation of the rules and institutions which provide a predictable and transparent framework for the conduct of public and private business and to promoting accountability for economic and financial performance.

Governance is essentially about decisionmaking and implementation processes and the capacity underpinning these processes. What makes governance good or bad is the level of transparency, accountability, predictability, and participation. But as noted, it is difficult to use these four characteristics to assess the overall governance of public expenditure management, and much easier to do so for a specific area such as procurement, audit, or internal control. The extent of transparency, accountability, predictability, and participation is determined by the underlying rules of the game—that is, institutional arrangements. Thus one can assess these dimensions by observing the rules in action.

When analyzing a specific area, staff could be encouraged to ask whether information and decisionmaking are transparent, how individuals are held accountable for their actions, if regulations and rules are enforced effectively and uniformly, and the extent to which appropriate participation is

built into information gathering, decisionmaking, and implementation. Similarly, guidelines should include a brief explanation of the key concept of institutional economics—that behavior is governed by the (formal and informal) norms and rules prevailing in an organization and can be changed only by altering those rules, especially those concerning material and non-material individual incentives.

The intention is not to create ersatz institutional specialists, but simply to make the assessment teams aware of the systemic factors affecting efficient and effective public expenditure management—and hence to know if and when to ask for help and advice. To the extent possible, assessments should draw on existing information from sources such as anticorruption surveys and the Bank's Institutional and Governance Reviews (IGRs) that have been carried out in some countries. There is no reason for every instrument to have the same approach or extent of coverage in this area. Indeed, it is far better for instruments to be focused on their key objectives—as with CPARs and Fiscal ROSCs—than to attempt superficial and probably misleading institutional analyses that would best be carried out by other means. If it is decided that institutional or governance problems are central to the assessment, the relevant expertise should be added to the team. Moreover, though institutional and governance considerations are relevant to every assessment and instrument, they are best handled by PERs due to their broad scope and links to the macroeconomic environment and public administration effectiveness.

But putting the onus on PERs is not an entirely satisfactory solution. Stronger efforts must be made to analyze the political and governance underpinnings of the budget process, and doing so requires good understanding of the political economy of the countries concerned. It may be difficult to obtain such an understanding by inserting governance components into PERs, which are already overloaded. More fundamental, thorough analysis is required. Resources and time permitting, IGRs could be used to conduct such analysis, with the findings then incorporated into other instruments. Politics and governance arrangements usually do not change much over the medium term, so such reviews would only need to be done every five years or so.

In response to concerns about overloading missions and overburdening governments, these reviews could be combined with PERs (as with Turkey's recent Public Expenditure and Institutional Review and a similar review in Bolivia). Moreover, successive IGRs would not have to be as extensive as the first. To support this development, consideration should be given to

developing guidelines for IGRs that identify the main concerns of the budget cycle and propose remedies to address them. Doing so would establish a closer link between IGRs and assessments of public expenditure management. If this approach were taken, it would also be critical to form the right team of specialists for IGRs—including political scientists (or political economists) with knowledge of the countries reviewed.

## **FOLLOW-UP AND PERFORMANCE MONITORING**

As noted, the recommendations and action plans in assessment reports are often weak. If assessments gave greater emphasis to institutional and governance analysis, in the ways suggested above, action plans would have a stronger basis in reality and be more valuable in promoting reform and building capacity. In addition, many countries often pay insufficient attention to implementing the recommendations made in assessments. Thus experiences with joint donor reviews in countries such as Cambodia, Mozambique, and Tanzania, linked to the budget cycle or the Poverty Reduction Strategy Paper process, could be a useful model for other countries.

A related issue involves the need for assessments to develop a framework for setting benchmarks and measuring performance and monitoring improvements in public expenditure management over time. This gap has partly been filled by HIPC AAPs, which use 15 indicators to evaluate public expenditure management. (DFID is piloting a similar framework to evaluate fiduciary risk.) Further work is being done by the Bank under the Governance Operations Progress Indicators (GOPIs) program to develop, among other things, public expenditure management indicators and test them in selected countries. In addition, the HIPC AAP indicators are being updated by the Bank and IMF with PEFA support, and new indicators—for example, on procurement—are being introduced for the round of HIPC assessments in fiscal year 2003. The OECD's Development Assistance Committee is interested in following up on its good practice paper on conducting diagnostic assessment and measuring performance (see DAC 2003 and annex 2). Among the questions that need to be addressed in such work are:

- What are the primary objectives in measuring the performance of public expenditure management? Risk assessments, long-term development requirements, or both?

- What conceptual framework should be used to capture the required dimensions of public expenditure management performance? Should political economy factors and issues such as corruption be explicitly included, or are measures of systems, institutions, and budget outcomes adequate?
- Should there be a standard set of indicators that can be applied to many countries, or should the aim be to develop a larger menu of indicators that can be drawn on by governments and their partners in developing national frameworks for measuring performance?
- International standards and codes exist for issues such as accounting (IFAC), external and internal audit (IIA and INTOSAI), fiscal classification (IMF), and fiscal transparency (IMF). Should international standards be developed for other issues, public procurement for example, and if so what bodies could be given responsibility for taking forward such work?
- How should a widely accepted set of performance indicators be developed? And how should the information be collected—for example, from World Bank and IMF assessments and EC audits and compliance tests?

## WHO ASSESSES THE ASSESSORS?

In the end the teams that conduct assessments and ensure their quality are more important than the content of any guideline. The research and interviews conducted for this study suggest that assessment teams do not always have the right skills—or sufficient restraint to focus on the issues most relevant to the instrument in question. This problem seems to be most severe for PERs, CFAAs, and Fiscal ROSCs.

Some PER teams have engaged recipient governments in discussions about complex accounting or performance budgeting issues without any team member having significant international experience in these areas or understanding of the technical issues involved. In addition, there have been several instances of recommendations that were either wrong or advanced without a sense of proper sequencing and practical requirements. If such recommendations are adopted, the damage can be—and sometimes has been—considerable.

Similarly, some recent CFAA teams have ranged far from their core competencies, especially into budget preparation and expenditure pro-

gramming issues, and have sometimes urged purely technical solutions devoid of a sense of the systemic fiscal management and public administration factors involved in their implementation. For example, a recommendation in the previous version of CFAA guidelines to foster public access to financial information was misinterpreted by one CFAA team leader as encouraging the introduction of freedom of information legislation—a far broader issue than its financial information aspect, with significant governance and public administration implications, and on which the team did not have all the necessary skills.

When assessments are conducted in a purely advisory capacity without direct links to future assistance, unrealistic recommendations or inconsistencies can usually be ironed out through subsequent dialogue. But when a Fiscal ROSC (theoretically purely advisory), a PER (theoretically diagnostic), or a CFAA (theoretically not an audit) is carried out as part of preparations for IMF support, World Bank assistance, or both, it is important to ensure that recommendations are correct, realistic, and consistent. In addition to the measures for stronger coordination recommended earlier, careful attention needs to be paid by the responsible managers to staffing assessment teams, identifying competent and independent peer reviewers, and ensuring constructive interaction among teams carrying out fiduciary assessments. In such cases Quality Enhancement Reviews (QERs)—mechanisms that ensure robust, independent vetting of Bank projects while they are being prepared—should be the rule rather than the exception to improve quality at entry.

A related issue is how to provide quality assurance in assessments involving several development agencies. The Bank has mechanisms such as the Quality Assurance Group (QAG), but these are mostly internal. Agencies should consider establishing a quality assurance procedure that applies to all participants in multidonor assessments.

## **DEVELOPING A PROGRAMMATIC AND MODULAR APPROACH**

In the late 1980s, in response to the growing length, complexity, and repetitive content of some PERs, it was suggested that the Bank develop a modular PER that offered standard coverage and formats for each module but that was adapted to country circumstances by including only the relevant areas and issues, as represented by modules. Though attempts were made in that direction, however, they did not succeed.



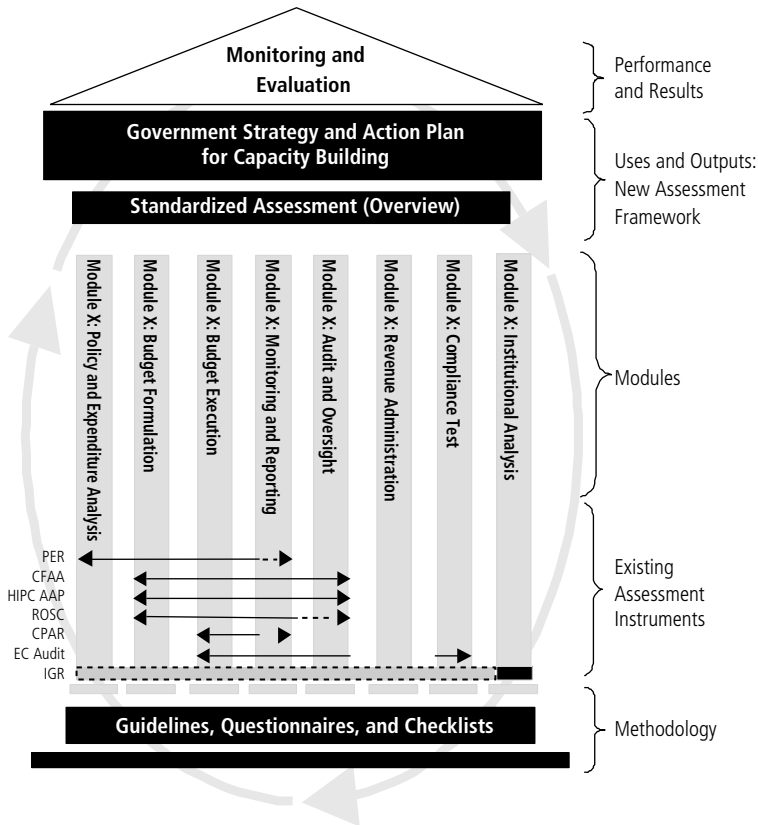
Similar suggestions have recently been advanced in response to the overlap between assessment instruments. One suggestion, previously noted, is to fully integrate existing fiduciary assessments to ensure consistency and exploit synergies—though this approach poses difficulties. Another option is the “programmatic” approach: reorganizing existing instruments into a set of modules, with each module representing a component of public expenditure management. This approach would eliminate the overlap between instruments, fill gaps, help avoid sending multiple missions to collect similar data, and allow countries and development agencies to focus on problems most relevant to each country.

A modular approach already exists for the questionnaires, checklists, survey instruments, and other tools that assist the fact finding on which assessments are based. The UNDP’s CONTACT guidelines, for example, are essentially a set of linked questionnaires. As noted, there are also useful checklists and questionnaires for the Bank’s PERs and other fiduciary economic and sector work. Similarly, the IMF’s Fiscal ROSC can be considered a module assessing the transparency and accountability of budget institutions and processes.

To support teams conducting assessments, it may be worth consolidating the various questionnaires and other tools into the modules created for each component of public expenditure management. These modules could be based on the classifications in box 2, supplemented by additional modules covering the revenue side of the budget and possibly other issues outside the scope of existing instruments and questionnaires.

A more radical approach would be to establish a framework for public expenditure assessment and reform that is both programmatic and modular. Here “programmatic” means a sequenced program of diagnostic and capacity building activities, rooted in a strategy that the recipient country agrees to with donors and other stakeholders. Such an approach is illustrated in figure 2, where the columns—representing the proposed modules—are equivalent to the main categories in box 2, complemented by a few other areas of concern (such as institutional analysis).<sup>6</sup> The programmatic, modular approach is not intended as a blueprint for reform, but rather as a conceptual framework that can be used to gradually move away from existing instruments without having to fully integrate fiduciary assessments.

Relevant to such efforts is the working group created in July 2003 by the Bank and IMF, with PEFA support, to examine options for improving the robustness, relevance, and cost-effectiveness of public expenditure work. This working group was established partly in response to the February

**Figure 2: A new public expenditure assessment framework**

2003 Bank-IMF paper on collaborative public expenditure work (World Bank and IMF 2003), partly in response to the strong interest of other donors and stakeholders, and partly in response to PEFA's work on this study. The following paragraphs offer some preliminary thoughts on the main issues involved and describe the conceptual and practical questions that need to be answered.

Under a programmatic and modular approach there would be strong emphasis on examining the public expenditure management system as a whole and identifying links and relationships between its parts. Each country would be encouraged to develop a strategic plan for reforming public expenditure management, linked to its Poverty Reduction Strategy Paper

and agreements with donors for financial and technical support. Table 2 summarizes along various dimensions the main differences between the currently dominant and proposed new approach to public expenditure work. It would be important to ensure that the use of modules does not fragment assessment work and thus run directly counter to the basic idea of integration.

**Table 2: Alternative approaches to public expenditure diagnostics and reform**

	Current approach	New approach
Entry Point	Donor-required diagnostic.	Country-led process.
Vehicle	Donor-financed report.	Donor-financed expertise supporting country process.
Champion	Donor.	Senior policy official initially, and technical staff as well.
Timing	Commonly provided off-cycle or after opportunity for maximum impact has passed.	Advice as requested, feeding into country process and schedule.
Output	Single, large report; numerous recommendations, frequently neither sequenced nor prioritized.	Separate reports or papers to meet client needs.
Engagement	Discontinuous, frequently with wide variety of donor counterparts at the technical level.	Continuous, frequently with same advisor or donor counterpart.
Priorities	Donor driven, frequently following fashion of the day (environment, gender, decentralization, empowerment, private sector, social safety nets, debt sustainability, etc.).	Country-determined, though donors may provide advice.
Credit for success	Donor.	Client.
Capacity building	Limited to involvement in data gathering and report production.	Direct capacity building through processes, on-the-job training, and participation.
Ownership	At best, country co-production of report; frequently, client plays passive, secondary role in process, if at all. Prescriptive solutions supplied to client.	Direct through country formulating recommendations and making choices, or joint development of conclusions and reforms.

**Table 2: (continued)**

	<b>Current approach</b>	<b>New approach</b>
Reform strategy	Donor determined; feasibility externally assessed, frequently ignoring limits of political economy. Client may object to some recommendations on feasibility grounds, but donors may counter with pressure for "tough measures."	Country specified; feasibility inherent in government priority and strategy setting.
Follow-up	Technical advice through loans, grants, trust funds, or staff time; frequently stand-alone operations. Loan conditionality, including triggers for release of aid funds.	Country determined; donor support provided where country requests; donors can evaluate success or progress through annual process. May feed into investment loan conditionality or trust-fund financed support, but as requested by government.
Participation	Disconnected participation of power ministries, line ministries, as report scope dictates; may involve civil society. Frequently focuses on technical staff, and Ministry of Finance as primary counterpart; frequently leaves out policy officials, or cabinet as collective decision-making body.	Government-wide through budget process (e.g., core ministries and sector ministries); encompassing policy officials (via cabinet or equivalent as a collective entity), and line staff. May involve civil society dialogue.
Donor coordination	Through participation in report production, or commenting on report; or separate donor coordination group.	Through participation in process; ascribing to outcome of government-led process.

*Note:* The authors are grateful to Bill Dorotinsky, World Bank, for suggesting and preparing this table.

The goal of integrated assessments could be achieved by using the modules to prepare a standardized overview of public expenditure management issues—one that brings together relevant technical analysis and is seen by donors as a comprehensive assessment of the environment in which they are providing budget support. Standardized assessment overviews would be equally valuable to recipient countries, providing authoritative information on strengths and weaknesses in public expenditure management and a foundation on which to develop and implement action plans for reforming

legal and institutional structures and building capacity. Standardized assessments could be updated periodically and could also include performance indicators, like those in HIPC AAPs, that could be monitored.

Under such an approach existing fiduciary assessments (through PERs, CFAAs, CPAR, and Fiscal ROSCs) would be replaced by streams of work—part diagnostic, part capacity building—tailored to country requirements, sequenced over time, and satisfying donors' fiduciary requirements. To illustrate: a country's five-year strategy for public expenditure management might include, in addition to preparing and regularly updating a standardized assessment, assistance from the Bank, IMF, or other donors in conducting a detailed assessment of accounting and audit in the first year of the strategy and of procurement practices in the second, advice on establishing a modern treasury and financial management information system and a review of institutional and governance issues in the first or second year, assistance in strengthening the management of government financial and personnel records in the first to third years, and assistance in training finance officials in the second to fifth years.

In developing this new programmatic approach, many important issues will need to be addressed, including:

- The scope and nature of the approach and of the standardized assessment overview, and their relationship with existing instruments and approaches.
- The extent to which the scope and content of the data collected and analyzed would be standardized or tailored to country circumstances and requirements, and the frequency of data collection.
- The agreements under which donors would collaborate in providing information and analysis—for example, the relationship between the Bank's work on budget execution (through CFAAs and CPARs) and EC compliance tests.
- How the transition to the programmatic and modular approach would be designed and managed.
- The operational, budget, and staffing implications of the approach for the Bank and other development agencies, and how these should be managed.
- The strategy and modalities for disseminating information on the new instruments, operational procedures, and assessment reports to governments, donors, and other stakeholders.

- The quality control mechanisms for standardized assessment overviews, involving both donors and recipient governments, perhaps using QAG as a basis for conducting quality reviews.

## NOTES

1. Despite the questionable need for them, three new instruments have recently been proposed. The first is an IMF Fiscal Management Assessment that would focus on emerging economies and that has already been piloted in Turkey. The second is a country-led peer review mechanism under the New Partnership for Africa's Development (NEPAD), which is to cover all aspects of governance. In addition, the World Bank is piloting a Fiduciary Review that focuses on corruption in Bank-financed projects but also overlaps with CFAAs, CPARs, and Institutional and Governance Reviews (IGRs).

2. See <http://wbln1023.worldbank.org/Caw/CawCover.nsf/homepage?OpenForm>.

3. An agreement between multilateral development banks to use CPAR as the basic tool for conducting assessments is contained in World Bank 2002c.

4. There are a few exceptions. For example, the IMF–World Bank Financial Sector Assessment Program (FSAP) was created after the East Asian financial crisis in the late 1990s. The program conducts financial sector assessments using joint teams and producing joint reports. HIPC expenditure tracking is another example of successful IMF–Bank collaboration, though on a more modest scale. Another is Bank–IMF collaboration on Poverty Reduction Strategy Papers.

5. In the World Bank, “Core Economic and Sector Work” is the primary country-based analytic and advisory work, and includes the three instruments under discussion (PER, CFAA, and CPAR). See the World Bank's Operational Manual online at: <http://wbln0018.worldbank.org/institutional/manuals/opmanual.nsf/textonly>. The integration of fiduciary assessments is also enunciated in the “Country Financial Accountability Assessment: Guidelines to Staff.” Operations Policy Core Services Network, Financial Management Sector Board (Washington, D.C.: The World Bank, May 27, 2003).

6. Figure 2 shows the programmatic/modular approach as a linear structure, running neatly from bottom to top. In practice the process of assess-

ment and reform is repetitive and interactive, with multiple feedback loops and iterations between the government, donors, and other stakeholders. Assessment work and related technical assistance and capacity building are generally not carried out as single blocks of activity, but rather in stages—sometimes within a coherent overall reform strategy and work program that build on and reinforce each other through dialogue between government and donors. The circle around figure 2 illustrates this point.



## A Concluding Word

This study and its findings and recommendations are intended to set in motion a debate between the partners in the PEFA program, other development agencies and international organizations, client governments, and other stakeholders. Because a well-managed budget process is essential for the efficient use of public resources, effective delivery of public services, and reduction of poverty, the views of all stakeholders should be taken into account at an early stage.

If the study's findings and recommendations are accepted, there will be a need to translate them into changes in the operational rules, practices, and procedures of the agencies concerned. Organizational structures, management processes, staffing requirements, training mechanisms, budget allocations and internal incentives will need to be reviewed, as will arrangements for increasing cooperation and coordination between development agencies, governments, and other stakeholders. As noted, some potentially important reforms in these areas are already being considered by the World Bank, IMF, and other agencies—including proposals for enhanced collaboration between the World Bank and IMF on public expenditure work, reform of the Bank's procurement assessment function, and stronger collaboration between the Bank and the European Commission on CFAAs and compliance tests. It is hoped that this study will make a useful contribution to these and other emerging reforms.







# Scope and Application of the Main Instruments

This annex expands on the summaries in the main text—providing a more complete description of the main instruments that development agencies use to assess public expenditure, procurement, and financial accountability systems in client countries.

## **WORLD BANK PUBLIC EXPENDITURE REVIEWS**

Public Expenditure Reviews (PERs) are the World Bank's traditional and best-known public expenditure instrument, and they have a long history. In the 1970s, when the Bank provided only investment lending, Public Investment Reviews were its main analytical instrument. In the early 1980s PERs were introduced, and their use accelerated in the mid-1980s after the Bank began providing nonproject lending. Because this new type of lending was effectively budget support, the Bank considered it mandatory to examine the complete budget in recipient countries.

The first PERs emphasized analyzing the quantity of expenditure and its sectoral and economic allocations. In addition to examining macroeconomic issues and the budget, many of these PERs focused on specific sectors (such as education or health) or significant expenditures (such as the civil service wage bill). Recommendations were made about issues such as

the composition of investment spending, the share of education expenditure, and the size of the wage bill.

In the 1990s the emphasis of PERs began to shift to the efficiency of expenditure and to the quality of budgeting and financial management, reflecting the Bank's increasing focus on governance and corruption. Campos and Pradhan (1996) and the Bank's *Public Expenditure Management Handbook* (World Bank 1998b) contributed to the incorporation of institutional and governance issues in PERs. Thus PERs began studying whether formal rules and procedures for financial and economic management are actually applied. They also began examining institutional constraints to rigorous, transparent budgeting and financial management. The growing influence of institutional economics and of the so-called new public management played a significant role in this evolution of the Bank's thinking (see World Bank 1997a, b).

PERs may address a range of issues and may serve many objectives. The World Bank's Website describes them as "comprehensive macro reports with a mandate to focus on the efficiency and effectiveness of resource allocation." While they typically review a country's public expenditure policy and management, they also tend to address macroeconomic issues such as fiscal sustainability and may include significant coverage of government revenue.

PERs have two main objectives. The first is to strengthen budget analysis and processes to achieve a better focus on growth and poverty reduction. The second is to assess public expenditure policies and programs to meet donor requirements and provide recipient governments with an external review of their policies. The balance in emphasis on these objectives depends on the country. In addition, PERs may address the efficiency of expenditure in major sectors such as health or education, or issues such as civil service reform, fiscal decentralization, and service delivery.

The Public Sector Governance Board is responsible for the overall development of PERs. In management terms, country directors and PREM sector managers in the Bank's regions are responsible for the quality of individual PERs. As with all of the Bank's economic and sector work, task managers must make provisions for quality assurance—including peer reviews—when planning PERs. The peer review process has an important influence on the design and coverage of PERs.

PER preparation and approval begins with a concept note describing the review's substantive focus and content—including how the proposed activity fits into the overall strategy for addressing the quality of the budget and related public resource management issues. This description typically includes a detailed statement of the issues to be reviewed, an outline of the

report, the target audience and dissemination strategy, the participatory approach to be followed and the involvement of stakeholders, the role of other external partners, data issues, criteria for evaluating the success of the activity, and proposed quality assurance measures. The reporting and dissemination strategy is determined by the type of PER and the nature of the involvement by the government and other stakeholders.

The multipurpose function and adaptability of PERs are reflected by the fact that there are no formal guidelines for them, though draft guidelines are proposed in World Bank (2001). The draft guidelines reflect current thinking about PERs and their uses at a time when the Bank is seeking increased participation by clients and other stakeholders—in both public expenditure work and sector work more generally. As part of the development of a proposed new approach to public expenditure work, the Bank's Public Sector Governance Board recently decided that these guidelines should be revised and issued formally.

The draft guidelines propose three prototype PERs involving different approaches to client participation:

- In-house PERs, for which the Bank and consultants do the data gathering and analysis. Interaction with clients is limited and focuses on follow-up to the final product.
- Bank-led participatory PERs, for which the Bank manages the process with substantial government participation in the analysis. Other stakeholders and donors may also be involved.
- Joint or government-led PERs, with active Bank participation.

The first and second prototypes would look much like traditional PERs. The third would be less traditional—consisting, for example, of a summary assessment of the budget management process. Most PERs today fall into the second or third category, and the draft guidelines stress that while client-led efforts may be of lower quality, they are likely to have a greater impact if they respond to client concerns. The guidelines also state that traditional in-house PERs are justifiable only in special circumstances, such as when a client with sound public expenditure management seeks independent advice or when the Bank is familiarizing itself with a new client or reengaging in a country where it has been inactive.

Perhaps the best example of the third type is the annual PER that has been conducted by the government of Tanzania since fiscal 1998 (other African countries that have adopted a similar approach, or are considering doing so,

include Ethiopia, Kenya, and Uganda). In this case the two main objectives of the PER are to support the budget process through macroeconomic and sectoral studies and to provide the government with a peer review of fiscal issues. The review is led by the Bank and covers macroeconomic and fiscal developments, strategic allocation issues, and budget management questions. Many other donors and stakeholders are involved in the process, receive the findings, and participate in review meetings and seminars. In addition, Tanzania's annual consultative group meeting is part of the budget preparation and PER process. This type of government-led PER is radically different from the traditional approach in that it becomes an integral part of the annual budget cycle and is driven by government priorities and concerns.

## **WORLD BANK COUNTRY FINANCIAL ACCOUNTABILITY ASSESSMENTS**

Country Financial Accountability Assessments (CFAAs) are the Bank's main diagnostic tool for public financial management and accountability. Their objective is to enhance the Bank's knowledge of financial accountability arrangements in client countries. The assessments support both the Bank's:

- Fiduciary responsibilities, by helping to identify risks in the use of Bank funds.
- Development objectives, by designing and facilitating—in close cooperation with the national authorities—programs to improve financial accountability.

Given the growing share of adjustment and programmatic lending in the Bank's overall lending, the Bank must have a sound understanding of the financial accountability environment in which its funds are spent. Such knowledge enables the Bank to better assess risks and advise countries on how to strengthen financial management. CFAAs also provide guidance on whether a country's expenditure management system can be used to manage Bank-supported projects.

Formal guidelines for CFAAs were issued to Bank staff in July 2000 and updated in May 2003. Like all economic and sector work, CFAAs are subject to requirements for formal review and clearance—in this case by the anchor of the Financial Management Network, network advisers in the Bank's regions, and country directors. The updated guidelines include a

section on quality and also refer staff to the internal quality section of the Quality Assurance Group's questionnaire for economic and sector work. As with all such work, task managers must make provisions for quality assurance, including peer reviews, when planning CFAAs.

The updated guidelines define fiduciary risk in greater detail than do the existing ones. They indicate that a CFAA does not try to assess value for money in public spending, nor does it assess the level of financial or sovereign risk—that is, the risk that Bank funds will not be repaid on time or at all. Rather, a CFAA's concern is whether Bank funds are spent on authorized or intended purposes, as expressed in the country's budget. The key components of this type of risk are that the budget is not implemented as passed and that the budget does not cover significant areas of government activity.

Like related sector work, such as PERs, the context and processes for preparing CFAAs have evolved and now give more attention to consultation and collaboration with recipient countries. CFAAs are closely linked to Country Assistance Strategies (CASs), and Bank policy requires a thorough discussion of fiduciary issues. Information from CFAAs significantly influences decisions reflected in CASs about the amount and nature of lending to individual countries. This link can create tension between the need to promote country ownership of CFAAs and their use as a fiduciary instrument by the Bank.<sup>1</sup>

The Bank has decided that current (less than five years old) diagnostic assessments should be completed for all major borrowers by the end of fiscal 2004. Moreover, Poverty Reduction Support Credits require *ex ante* fiduciary assessments—and this is interpreted as a *prima facie* requirement for CFAAs. It is expected that the forthcoming revised guidelines for adjustment lending will make *ex ante* fiduciary assessments, including CFAAs, a prerequisite for such lending.

Between fiscal 1996 and 2001 about 20 CFAAs were completed. In fiscal 2002 another 21 were completed. The anchor of the Financial Management Network is preparing a program that will ensure that CFAAs are carried out in all client countries on a regular basis. Some will be done every two years, some every three years.

CFAAs are carried out by Bank staff in cooperation with country officials, and the revised guidelines encourage the involvement of civil society, the private sector, and other nongovernmental partners. The guidelines describe in detail the process that staff should follow in planning CFAAs, including finding the resources, establishing the role of the client and other donors, performing initial desk studies, conducting the planning mission, preparing an initiating memorandum or concept paper, and conducting the review meeting.

CFAAs are increasingly being carried out as combined or parallel products with related Bank diagnostic instruments—for example, with PERs (as in Mozambique, the Philippines, and Turkey) and Institutional and Governance Reviews (as in Bolivia and Peru). There is also increasing collaboration and coordination with Country Procurement Assessment Reviews (CPARs).

In addition, a growing number of CFAAs are carried out in collaboration with other development partners, which reflects the international harmonization agenda being promoted by the Task Force on the Harmonization of Donor Practices (sponsored by the OECD's Development Assistance Committee) and the Harmonization Group (sponsored by multilateral development banks). This collaboration should reduce the transaction costs for client countries of multiple donor assessments.

For example, CFAAs in the Bank's Latin America and Caribbean Region are generally carried out jointly with the Inter-American Development Bank. Other development partners that collaborate on CFAAs include the United Nations Development Programme, the African Development Bank, the Asian Development Bank, the European Community, and the Strategic Partnership with Africa, as well as bilateral donors such as the U.K. Department for International Development, the Norwegian Agency for International Development, and the Swedish International Development Authority. It is expected that the Bank's development partners will increasingly use CFAAs as a basis for their decisions on budget support. CFAAs can also increase the depth of work on public expenditure management—for example, by using EC audits and compliance tests as complementary sources of information (see below).

The guidelines review other Bank and International Monetary Fund (IMF) instruments relevant to CFAAs and emphasize that the level of analysis in CFAAs will vary, reflecting country circumstances and the timing, scope, and coverage of other planned or recently completed analytical work. They also stress that the Bank is moving toward integrated fiduciary assessments and that this will increasingly affect the sequencing and timing of products.

At present CFAAs are not public documents and are not released except with the agreement of the government concerned. However, governments are encouraged to disseminate CFAA reports.

The guidelines stress that staff preparing a CFAA should strive to obtain empirical evidence of what is happening on the ground—as opposed to what is contained in formal rules and regulations—and that conducting this reality check is difficult. Discussions with the national audit agency and the use of questionnaires are recommended. The anchor of the Financial Management Network is developing a standard questionnaire for CFAAs.

A CFAA typically reviews the following issues in the public sector:

- Budget preparation procedures—particularly comprehensiveness, realism, and classification.
- Budget execution and monitoring (including cash management and internal control).
- External fiscal reporting and transparency.
- External auditing and legislative follow-up.
- Financial management staffing capacity.

Past CFAAs have also reviewed corporate governance and financial reporting in the private sector, including the accounting profession. In the future it is expected that these issues will instead be addressed through IMF Reviews of Standards and Codes (ROSCs) for private sector accounting and auditing. But issues related to the accounting profession may be covered in CFAAs if they are relevant to the public sector's need for accounting professionals and to the reporting and accountability of state enterprises.

The Bank considers follow-up an integral part of the CFAA process. The updated guidelines stipulate that from the outset the Bank and the government should agree that the CFAA is targeted at remedial action. The document should include an action plan of sequenced activities, and should define the resources and technical assistance required. Specific benchmarks or indicators should be developed to assess performance. The action plan should be agreed by the government and its key elements reflected in the CAS.

CFAA guidelines suggest that other Bank instruments, especially PERs and Institutional and Governance Reviews (IGRs), should be the primary source of information for institutional and governance aspects of public expenditure management. But the guidelines also recommend that CFAAs include a section on the legal and institutional framework for public expenditure management (annex A, p. 17) and identify aspects of the public expenditure management system that might facilitate corruption or in which improvements might reduce it (annex C, p. 30).

## **WORLD BANK COUNTRY PROCUREMENT ASSESSMENT REPORTS**

Country Procurement Assessment Reports (CPARs) were introduced in the late 1980s. In 1998 their focus and objectives were redefined when the assess-



ment process was redesigned to reduce the focus on procurement in development projects and increase the emphasis on diagnosing national procurement systems and generating dialogue with governments about needed reforms. The main purpose of CPARs is to determine the need for and develop action plans to improve procurement systems. Specific elements include:

- Providing a comprehensive analysis of public sector procurement systems—including the legal framework, organizational responsibilities, and control and oversight capabilities.
- Conducting a general assessment of the institutional, organizational, and other risks associated with procurement—including identifying procurement practices that are unacceptable in Bank-financed projects.
- Developing a prioritized action plan to bring about improvements.
- Assessing local private industry's participation in public procurement and the adequacy of commercial practices related to it.

To ensure country ownership, CPARs are launched with the agreement of the government concerned and often involve its active participation. The guidelines for CPARs suggest techniques for demonstrating the benefits that can arise from the procurement review and thereby foster government support. In addition, assessment teams should strive to involve the business community and other nongovernmental partners.

The timing and scope of other diagnostic instruments help determine the content of individual CPARs. The World Bank plans to increasingly integrate its economic and sector work on accountability, risk assessment, and public expenditure and to better coordinate these analyses with those of other donors to avoid duplication, overlap, and high transaction costs. Joint efforts have already been undertaken, for example, in Bosnia and Herzegovina, the Philippines, and Turkey. Because sound procurement systems are a priority interest for all donors, the Bank encourages its staff to collaborate with other agencies, and the CPAR guidelines spell out the various forms that such partnerships may take.

A country's CPAR, like its PER and CFAA, is closely linked to its CAS. Bank policies indicate that CASs should include thorough discussions of fiduciary issues.<sup>2</sup> The CPAR is the Bank's primary product for procurement issues. The Procurement Board is responsible for the overall development of CPARs, and the anchor of the Procurement Network reviews initiating concept memorandums and may provide other assistance. Country directors

and regional procurement advisers work together to schedule CPARs based on country needs and regional priorities. These staff are also responsible for the quality of individual CPARs. CPAR guidelines include a section on quality and emphasize the need to base the analysis on a strong analytical framework and rigorous empirical evidence; they also refer staff to the internal quality section of the Quality Assurance Group's questionnaire on economic and sector work. As with all such work, task managers must make provisions for quality assurance, including peer reviews, when planning CPARs.

CPAR guidelines describe in detail the main steps for developing initiating concept memorandums and for conducting review meetings and peer reviews. They also explain how to ensure adequate staffing and resources and define the dual purposes of the exercise: analyzing a country's procurement system with a view to proposing concrete measures for improvement and identifying risks to the Bank's loan portfolio.

The Bank encourages governments to involve a wide range of stakeholders in the preparation of CPARs, to disseminate CPAR findings to these stakeholders, and to involve them in the design of follow-up action plans. Governments are also encouraged to circulate draft CPARs widely before giving their reactions. World Bank policy is that CPARs are publicly disclosed unless governments object.

CPAR guidelines consider the follow-up phase critical to determining the report's impact. They stipulate that the Bank and the government should agree before launching a CPAR that its findings will form the basis for remedial actions in the case of significant deficiencies. The review should lead to agreement on the actions to be taken, a timetable for implementation, and responsibilities for executing the program, and these three elements should be incorporated in the CAS. Procurement reform typically involves activities such as adjusting the legal framework, strengthening institutions, providing training, and improving records management. The action plan should be monitored by the government and donors using performance indicators for the public procurement system; CPAR guidelines give examples of suitable indicators.

## **IMF REPORTS ON THE OBSERVANCE OF STANDARDS AND CODES OF FISCAL TRANSPARENCY**

The IMF adopted a Code of Good Practices on Fiscal Transparency in 1998 and approved an updated version in March 2001 (see IMF 2001). The code is based on several key requirements for transparency:

- Government roles and responsibilities should be clear, including the legal and administrative framework for fiscal management.
- The government should provide the public with complete information on its past, present, and projected fiscal activities.
- Budget preparation, execution, and reporting should be conducted in an open manner.
- Fiscal information should meet international standards for data quality and be subjected to independent assurances of integrity.

The code describes the principles and practices that governments should follow to meet these requirements. Guidance on implementation of the code is provided by a manual on fiscal transparency and by a questionnaire that helps gauge country practices relative to the standards of the code. Reports on the Observance of Standards and Codes (ROSCs) have been developed as part of a World Bank–IMF initiative to promote standards and codes. ROSCs provide information on implementation of standards to assist the IMF’s regular surveillance (Article IV) consultations with member countries.

The report on fiscal transparency—the Fiscal ROSC—has two main components. The first is a description of country practices relative to the good practices defined for each of the 37 elements of the code. The second is a staff commentary, giving the IMF’s overall assessment and recommending possible improvements. Completion of a Fiscal ROSC is voluntary. Once a government decides to participate, it fills out the questionnaire. Based on the answers and on discussions with the authorities, IMF staff prepare a draft ROSC, which is discussed with the authorities before being finalized. This approach strives to stimulate government ownership of and interest in the process and its results.

Participation in a Fiscal ROSC helps national authorities identify weaknesses. Government approval and publication demonstrate commitment to increasing fiscal transparency. Published results are useful for preparing and updating other fiduciary instruments used by donor agencies. They may also be used by the IMF and the Bank in the development of their lending and technical assistance programs.

A Fiscal ROSC is a carefully targeted instrument with a very specific focus, as reflected in the detailed instructions in the manual on fiscal transparency. The manual emphasizes that a Fiscal ROSC should be limited to fiscal transparency issues and should not deal with the efficiency or effec-

tiveness of fiscal management (though this stipulation is not always strictly observed in practice). Fiscal ROSCs should, however, refer to relevant laws and indicate the extent to which these laws are observed.

To the extent possible, the IMF coordinates the preparation of Fiscal ROSCs with that of CFAAs and other World Bank products. Most coordination has involved the exchange of information on mission schedules and the exchange of draft reports for comment. In addition, some experimental missions have been conducted involving coordinated field work (as in Bangladesh and Mauritania).

If country authorities agree, the final assessments of Fiscal ROSCs are made publicly available on the IMF Website. By July 2003, 59 Fiscal ROSCs had been completed—meaning that they had been finalized with the authorities and sent to the IMF Board—and 52 had been published on the Website.

The section of Fiscal ROSCs containing the IMF staff commentary identifies priorities and offers recommendations for improving fiscal transparency. Fiscal ROSCs usually do not develop action plans, though they have occasionally done so with participation from country authorities. Where transparency weaknesses appear to have significance for IMF programs or IMF country policy analysis, improvements in these areas may be included in program conditionality. Improving transparency in the agreed areas often requires addressing underlying institutional weaknesses over the medium to long term. The IMF or other agencies may provide technical assistance to address transparency and underlying institutional weaknesses.

Once a Fiscal ROSC is completed, IMF policy is that brief updates should be undertaken as part of regular surveillance consultations. These updates are also published on the IMF Website. Thus Fiscal ROSCs allow for continual monitoring of countries' implementation of the fiscal transparency code. In addition, it is envisaged that Fiscal ROSCs will periodically be completely revised and new assessments published.

## **WORLD BANK–IMF PUBLIC EXPENDITURE TRACKING ASSESSMENTS AND ACTION PLANS FOR HEAVILY INDEBTED POOR COUNTRIES**

In 1996 the Bank, IMF, and numerous bilateral donors introduced the Heavily Indebted Poor Country (HIPC) initiative to reduce the external debt of the world's poorest, most indebted countries.<sup>3</sup> Following a 1999 review, the initiative was enhanced to provide faster, deeper debt relief to

more countries. Of the 42 countries that qualify for the initiative—as determined by their debt sustainability—26 have received debt relief.<sup>4</sup> The enhanced HIPC initiative emphasizes that recipient countries should have sustained implementation of integrated programs for poverty reduction and economic reform (see <http://www.worldbank.org/hipc/about/hipcbr/hipcbr.htm>).

In spring 2000 the boards of the Bank and the IMF asked the institutions' staff to address concerns about how resources freed under the initiative are used. (Such funds are intended to be used for poverty reduction, augmenting—not substituting for—a country's spending in this area.) In response a joint initial desk assessment was conducted in fall 2000 on 25 HIPCs that had reached the decision point or were expected to do so soon. Joint Bank-IMF teams developed a questionnaire to assess the countries' ability to track poverty-reducing public spending, including funds freed by debt relief. The questions were designed to identify weaknesses in public expenditure management to guide the development of performance indicators. HIPC tracking is innovative because, rather than assessing every aspect of public expenditure management, it takes a systems approach—identifying important indicators that reflect a system's overall capability and performance.

If a country scored poorly, its system for public expenditure management may be unable to plan, execute, or accurately report poverty-reducing public spending. By defining minimal standards for public expenditure management, the assessment helped prioritize needs in upgrading capacity. The findings were summarized through 15 benchmarks covering budget formulation, execution, and reporting. The focus was not on the use of targeted debt relief (HIPC initiative) funds but on the quality of public expenditure systems for all budget resources. The March 2002 Bank-IMF board paper concluded that 15 of the 24 HIPCs assessed required substantial upgrading in their public expenditure management systems, 9 required some upgrading, and none would be able to carry out satisfactory tracking with a small amount of upgrading (World Bank and IMF 2002).

The initial desk assessments were finalized in fall 2001. The boards asked Bank and IMF staff to continue close coordination, to help country authorities develop action plans for the short and medium terms, to identify gaps in donor assistance supporting those plans, to ensure that all gaps were filled by the Bank, IMF, or other donors, and to provide periodic progress reports to the boards.

The March 2003 board paper (World Bank and IMF 2003b) reiterated that the HIPC process would be conducted based on four main principles:

- Ultimate responsibility for tracking poverty-reducing spending lies with the countries.
- All poverty-reducing spending should be tracked.
- Poverty Reduction Strategy Papers provide the basis for identifying all relevant poverty-reducing programs.
- Where systems are weak, countries should establish short-term “bridging” mechanisms to facilitate medium-term tracking.

HIPC AAPs are becoming accepted practice and provide a useful complement to the Bank’s other economic and sector work (PERs, Public Expenditure and Institutional Reviews, CFAAs, CPARs). All the HIPCs have endorsed AAPs, and Bank and IMF staff are encouraging country authorities to incorporate tracking of poverty spending into their Poverty Reduction Support Credits and thereby mainstream the approach.

The formal requirements for HIPC AAPs involve process requirements, which are evolving (see below), and instrument requirements, which are made up of the guidelines, the questionnaire, and a set of action plans.

While the revised guidelines are still being finalized by the Bank and IMF, the 2001 and 2002 board papers reviewed progress and led to general agreement on the approach. The boards requested that new tracking assessments be carried out for all new or planned HIPCs and that an updated table be included in all adjustment loan documents going to the boards of the Bank and IMF showing the status of the action plans. HIPC AAPs are not designed to be self-assessments; as with Fiscal ROSCs, the questionnaire and short-form report could be sent in advance of the related mission. HIPC assessments are not audits but rather strive to help countries manage their resources well and overcome a key constraint: lack of capacity that undermines effective public expenditure management, including the ability to track poverty-related expenditures.

Bank and IMF staff agreed that the organization and conduct of the agreed assessments be evenly divided and led by joint Bank-IMF missions following the guidelines issued in April 2001.

The Bank-led HIPC AAP missions were carried out by the Bank’s Regions and combined with other missions. For the IMF-led missions, draft procedures were prepared for combined ROSC-HIPC missions, and missions were either by IMF’s Fiscal Affairs Department or area departments. Given the tight schedule imposed to finish the final assessments in 2001 and report to the boards by March 2002, systematic and disciplined

planning and implementation were undertaken, with progress reviewed every two weeks. This time pressure meant that while Bank-IMF cooperation was very close, it was usually not possible to involve bilateral agencies in these assessments.

Follow-up is an integral part of the exercise, and the Bank, IMF, and country authorities should seek agreement on:

- A draft schedule over the next three years for upgrading tracking capacity in light of planned technical assistance and the country's absorptive capacity.
- An agreed action plan for improving public expenditure management, including identification of existing or additional technical assistance.

Another comprehensive round of assessments is planned before the end of 2004 and will be used to prepare a joint Bank-IMF board paper. New draft guidelines have been prepared and circulated for comment. Updates will be required on an ongoing basis, while assessments of new countries should be completed by mid-2004. Updates and new assessments will need to be agreed with the governments concerned and between the Bank and IMF. In most cases the updates and assessments can be conducted as part of missions already planned.

## EC AUDITS

Structural adjustment support provided by the European Commission has traditionally been subject to ex post control through an audit procedure. With the recent shift to providing aid through direct budget support, greater emphasis has been given to ex ante assessment of public expenditure management systems in beneficiary countries and to monitoring and evaluating improvements over time.

EC audits of the use of its program aid must be viewed in the context of the evolution of its structural adjustment support. During the 1990s the European Commission provided structural adjustment support in two forms: in 1991–96 through general or sector import programs under the 7<sup>th</sup> European Development Fund, and in 1996–2000 through structural adjustment support introduced under the 8<sup>th</sup> European Development Fund. Although general and sector import programs remained an important source of EC program aid, structural adjustment support quickly became a key source of EC assistance.

While general and sector import programs were designed to strengthen weak balance-of-payments positions, structural adjustment support provided budget aid to support sound macroeconomic management and implementation of economic and social reforms. The funds were targeted and made available in two steps. First, a tranche in the relevant foreign exchange was deposited into a government account at the central bank. Second, funds were converted into local currency and deposited in a treasury double-signature account. Use of the funds required the authorization of the head of the EC delegation and the government official nominated as the national authorizing officer. Counterpart funds generated by structural adjustment support are considered targeted budget support aimed primarily at protecting social expenditures in the face of stabilization programs developed by the World Bank and IMF.

Although counterpart funds are the property of the beneficiary country and responsibility for their management and use lies with the national authorizing officer, the European Commission has a control responsibility through its co-signature on the account containing the funds. These roles and responsibilities are set out in broad terms in financing agreements and implementation agreements, with further details provided in a memorandum of understanding, implementation agreement, or framework of mutual obligations signed by the European Commission and the national authorizing officer. Financing agreements, signed by the EC commissioner and the national authorizing officer, constitute the legally binding bilateral agreement, while implementation agreements define responsibilities for managing, monitoring, and controlling counterpart funds. The use of EC structural adjustment support has traditionally been audited annually by independent auditing firms.

The purpose of these audits is to determine whether the use of funds is consistent with their objectives, as set out in the financing agreements and implementation agreements. With the evolution of EC structural adjustment support, the purpose of and approach to auditing and controlling the use of EC resources have also evolved. Since 1992 EC audits have been carried out in 32 countries, including audits of General Import Programs, targeted budget aid (including food support), and internal debt and institutional assessment of financial control procedures and agencies in some African, Caribbean, and Pacific countries. In the case of general and sector import programs the audits focused on the use of foreign exchange and generated counterpart funds, particularly the legality and regularity of expenditures. Many audit results were used to impose corrective measures



and sanctions on the countries concerned, including suspensions of structural support, based on identified irregularities in managing the foreign exchange or counterpart funds.

With the shift toward targeted budget support, EC audit procedures were adjusted to reflect the fact that use of generated counterpart funds became subject to national budget rules and procedures. Hence a more comprehensive approach to audits was developed to provide a broad evaluation of beneficiary governments' public financial management systems, with a focus on the legal framework, budget execution, procurement, and financial accountability and control. In addition, materiality checks were introduced in EC audits to assess the value for money of the expenditures concerned. The methodology of the EC audit approach developed gradually, building on the principles and methodology of the UNDP CONTACT instrument (see below) and on lessons from previous audits. However, the evolved EC audit methodology has not been recorded in a formal document.

In response to proposals by the European Parliament on the use of EC development resources, the European Commission committed to carrying out a series of special multiyear audits of budget support and food aid in various African, Caribbean, and Pacific countries. These audits were managed by the Commission's Internal Audit Service and conducted under contract by the French firm 2AC between 1998 and 2002. The audits were based on methods developed since 1996 in auditing the use of generated counterpart funds in line with national budget rules and procedures. 2AC examined whether the counterpart funds held in double-signature accounts were used as agreed in the financing agreements and implementation agreements in terms of "eligibility" in line with mutually agreed purposes and "conformity" with government budget rules. Follow-up audits were carried out using a sample of transactions to test the initial assessments of countries' public expenditure management systems.

In conducting these audits, the Commission started by examining the quality of the systems in place and the legal framework (systems audit), analyzed transactions based on a representative sample (financial audit), and looked at the efficiency and effectiveness of the systems (performance audit). The audits identified major weaknesses in public expenditure management in the beneficiary countries that had not been apparent before, including a lack of conformity with prevailing rules, excessive payments for goods and services procured, weak administrative arrangements for records management, and inadequate institutional arrangements for internal control and external audit. If ineligible expenditures were found and agreed by

the Commissions and the country, the amounts involved were redeposited into the double-signature account and kept for use during the next budget cycle—subject to confirmation that progress was being made in implementing an action plan of corrective measures. The emphasis was on fiduciary aspects: the eligibility and conformity of expenditures, and materiality (for example, whether planned investments were made and goods and services were procured as intended).

This approach had several weaknesses. Because memorandums of understanding included preconditions for disbursements, the release of funds was sometimes severely delayed. Although the annual audits produced action plans to correct identified weaknesses, the Commission was not systematic in its follow-up—so progress was not carefully tracked by subsequent audits. And there was little positive development impact.

The Commission recently adopted a new approach for providing budget aid. Within the context of the Poverty Reduction Strategy Paper, untargeted budget support is being made available on a multiyear basis, subject to annual assessments of progress against performance indicators identified in the paper's priority areas—including the quality of public expenditure management. Annual budget support is divided into two tranches: a fixed tranche that reflects conformity with IMF conditions for macroeconomic management and a variable tranche based on agreed performance indicators for public expenditure management and social sectors.

To support this new approach, the Commission has developed guidelines for a new instrument, called the Public Financial Management Assessment, that consists of:

- A desk review of existing diagnostic work on public expenditure management—usually Bank and IMF reports (PERs, CFAAs, CPARs, HIPC AAPs, Fiscal ROSCs) and previous EC audits. This review includes identifying gaps in the existing work that should be addressed in follow-up work, including an EC compliance test (see below), and defining performance indicators to measure progress over time.
- A compliance test that provides empirical evidence on the performance of the public expenditure management system, to supplement the findings and recommendations of the ex ante diagnostic work. For example, weaknesses in public expenditure, procurement, and financial accountability identified in CFAAs and CPARs could be verified based on a sample audit in priority areas (such as health and education). The results of a compliance test can also provide a baseline for measuring progress over time.

- A review of government and donor action plans to strengthen public expenditure management and monitor improvements.
- Establishment of performance indicators—in the context of national action plans or country assistance programs—that are monitored and evaluated with beneficiary governments and other donors. Annual updates of the compliance tests will contribute to this process (EC 2002).

## DFID ASSESSMENTS OF FIDUCIARY RISK

The U.K. Department for International Development (DFID) recently decided to channel more of its resources through direct budget support. But while it is highly committed to this initiative, DFID realizes that in many cases the conditions are not yet appropriate. As a result only about a quarter of DFID funding takes the form of direct budget support or sectorwide approaches.

To improve its ability to conduct fiduciary risk assessments, DFID has prepared a series of internal papers, including “Managing Fiduciary Risk When Providing Direct Budget Support” (March 2002). The purpose of this paper and related documents is to provide guidance to DFID staff—many of whom are not specialists in financial management—on how the public expenditure elements of fiduciary risks should be assessed and managed when DFID provides funds directly to recipient governments to be spent as part of their budgets. The paper also sets out DFID’s approach to using additional safeguards to ensure that such budget support focuses on poverty reduction, and proposes directions for future collaboration with other development agencies to harmonize approaches.

A fiduciary risk assessment must be completed before DFID can provide budget support. Thus such assessments are key inputs into DFID decision-making about many of its client countries. The timing of an assessment is determined by the needs of the relevant country desk.

DFID assessments of fiduciary risk are mainly derived from data and analysis gleaned from other instruments such as CFAAs, CPARs, HIPC AAPs, and Fiscal ROSCs. The 2002 DFID paper defines fiduciary risks and states that assessments should focus on whether it is reasonable to expect that transferred resources will be used for the intended purposes and properly accounted for and that the expenditures will represent value for money. The paper recognizes that in many of the poorest countries that DFID supports, financial management and accountability systems fall below internationally accepted standards

but that direct budget support may be the most effective way to deliver assistance—provided that a thorough evaluation of fiduciary risk has been undertaken, the government has a credible program to improve public expenditure management, the potential development benefits outweigh the risks, and the risks are explicitly recorded as part of DFID’s decisionmaking process.

As noted, DFID’s assessments rely heavily on the results of CFAAs, CPARs, and Fiscal ROSCs, and in some countries (such as Malawi) it has collaborated with the Bank in carrying out CFAAs. (DFID has also produced an interim guide for staff on the conduct and uses of CFAAs; see DFID 2001a.) DFID staff are given a list of good practice principles and related benchmarks for assessments. Monitoring should be closely tied to the government’s budget cycle, linked to the government’s poverty reduction strategy, and shared with other donors.

In Uganda, for example, the government and DFID have reached an understanding on how fiduciary risk will be monitored over time based on four information sets: one annual expenditure tracking survey per sector, an annual review of the government’s audited accounts, the outcomes of PER updates, and technical assistance and dialogue built around the government’s public expenditure reform program.

DFID expects that in most cases its fiduciary risk assessments will show that governments are working to address their weaknesses in financial management. In such cases DFID is prepared to complement its budget support with long-term capacity enhancement programs—including, in close collaboration with other donors, provision of technical assistance and training. DFID will also combine such support with efforts to address some of the root causes of poor accountability and transparency, such as by emphasizing the importance of “voice” mechanisms in the private sector and civil society, enhancing civil service incentives, and fighting corruption. DFID is undertaking political economy research to explore these issues further. In addition, DFID is increasing its resources for public expenditure management by training staff and hiring more advisers with relevant professional skills and experience.

## **EC AND OECD SUPPORT FOR IMPROVEMENT IN GOVERNANCE AND MANAGEMENT IN CENTRAL AND EASTERN EUROPE**

Support for Improvement in Governance and Management (SIGMA) in Central and Eastern Europe—a joint initiative of the European Community

and OECD financed mainly by the Community—involves two separate instruments: baseline assessments and peer reviews. Baseline assessments use defined criteria to measure changes in public expenditure management systems, with the results used by the European Commission in its monitoring of Central and Eastern European countries' progress toward achieving the necessary conditions for EU membership. Peer reviews help supreme audit institutions and ministries of finance meet requirements for EU membership by developing their institutional capacity.

### **Baseline assessments**

Baseline assessments describe and analyze changes in public management systems as a contribution to EC progress reports on countries that are candidates for joining the EU. The assessments also offer recommendations on areas where systems require further strengthening. Baseline assessments have been carried out every year since 1999 and cover:

- Civil service and administrative frameworks.
- Public expenditure management.
- Public internal financial control, including internal audit.
- External audit.
- Policymaking and policy coordination.
- Public procurement.
- Efforts to combat fraud (in 2001 only).

The baseline assessments were designed for the 10 EU candidate countries in Central and Eastern Europe (Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia, but in 2000 it was also applied in two additional Balkan countries (Albania and the Former Yugoslav Republic of Macedonia) and may be extended to others in that region.

The methodology used in preparing the annual baseline assessments has three parts. First, an agreement is reached with the European Commission on the conditions that a country must meet to satisfy accession criteria for the subject areas listed above. These conditions—including legal, operational, and institutional capacities—are based on the *acquis communautaire* and common European practices and take into account any

changes in the *acquis* since the previous year. The conditions are supported by detailed guides and questionnaires, specific to each subject area, used to measure administrative capacity in ministries, government agencies, and other public sector institutions.

The questionnaires are completed with officials in the relevant government institutions and form the basis for the second part of the assessments: intensive information gathering missions carried out by SIGMA staff in preparing the assessment reports. The third part occurs after the reports have been drafted, when they are submitted to the countries concerned for factual verification. The reports are then reviewed and calibrated by SIGMA staff to ensure consistency across countries and subject areas. The final reports are sent to the European Commission for use in preparing their annual reports and often inform decisions on pre-accession financial support and technical assistance provided by the Commission to support capacity building.

### **Peer reviews of supreme audit institutions**

Peer reviews of supreme audit institutions began in 1998 when SIGMA was becoming increasingly involved in efforts by Central and Eastern European supreme audit institutions to develop their activities in line with good European audit practices. The first reviews—for Slovenia (1998), Latvia (1998–99), and Estonia (1999)—were conducted by SIGMA staff and expert practitioners from EU member states (usually in a team of three peers) and covered all aspects of each audit institution's functions. Since 1999 seven more peer reviews have been conducted.

A peer review provides an independent assessment of the issues that a supreme audit institution needs to address to become more effective, prepare for EU accession, and adapt to EU auditing standards and good practices. The emphasis is on providing practical recommendations for change and on helping the institution and other interested parties understand the need for institutional development in the context of negotiating EU accession.

A supreme audit institution must take the initiative to request a peer review, which has seven phases:

- Determining the review's organization and stages.
- Forming the review team.
- Preparing the review.
- Arranging for two one-week fact-finding missions.

- Writing the report and engaging in consultations.
- Finalizing the report.
- Identifying next steps.

Annexes to the peer review guidelines explain how information should be collected (mainly through interviews and file examinations) and the technical analysis to be carried out. Questionnaires have been developed—for example, on parliamentary audit committees—to help obtain all necessary information. The SIGMA project manager is responsible for ensuring high-quality work, editing the final report, and preparing a summary that accompanies the report.

The intended results include endorsement of peer review recommendations by the supreme audit institution and agreement on further steps such as revising the audit law, establishing a strategic development and action plan, identifying requirements for further technical assistance, and introducing specific benchmarks and standards.

### **Peer reviews of public internal financial control systems**

All EU candidate countries must develop comprehensive, reliable systems for public internal financial control. Legislative frameworks have to be implemented, together with secondary legislation providing for the implementation of new internal control capabilities that ensure the functional independence of internal auditors. These efforts are essential for strengthening internal financial capacity prior to receiving pre-accession financial support and for receiving EC structural support after accession. Against this background, SIGMA conducts peer reviews of public expenditure and financial accountability systems in candidate countries.

These reviews provide practical suggestions to help candidate countries establish adequate systems for public expenditure management and control as well as for public internal audit. The reviews conduct independent assessments of existing systems, report the findings, and make focused, practical recommendations for change.

This type of peer review is requested by the candidate country's ministry of finance, often at the suggestion of the European Commission and SIGMA. The review team is composed of expert practitioners from EU member states. The process is similar to that used for peer reviews of supreme audit institutions and includes two one-week information gather-

ing missions and preparation of a detailed report submitted to the ministry of finance for consideration. The report is also reviewed within SIGMA and benchmarked against successful SIGMA reviews for other candidate countries. The final stage is the presentation of the report's key findings and recommendations to the relevant authorities in the country concerned and to the European Commission.

The intended results are endorsement of the peer review's recommendations by the ministry of finance and the Commission and, after appropriate consultations, agreement on next steps for the ministry—such as pursuing changes to relevant laws and regulations, issuing a paper on the strategic development of relevant agencies and organizational structures, and identifying further technical assistance needs.

## UNDP CONTACT GUIDELINES

The United Nations Development Programme (UNDP) developed the Country Assessment in Accountability and Transparency (CONTACT) to provide the international development community with a comprehensive tool for assessing national systems for financial management, accountability, and financial integrity. Guidelines setting out the approach and methodology were issued in 2001 (UNDP 2001).

CONTACT is a comprehensive set of generic guidelines that help:

- Governments conduct self-assessments of the strengths, weaknesses, needs, and priorities of their financial accountability and integrity systems.
- Consultants hired by bilateral and multilateral development agencies to assess these systems. Consultant work is intended to support governments (at their request) in their self-assessments and to review the feasibility of cooperation with governments (for example, through a brief mission to identify strengths and weaknesses of public expenditure management prior to a full-scale programming mission by the UNDP, World Bank, or another agency).

CONTACT provides stakeholders with a tool to support quality control, measure performance, and offer recommendations at desired stages of the accountability cycle. It is a dynamic, continuously evolving instrument that requires regular updates based on best practices and pilot tests. Pilot



tests of CONTACT have been carried out in several countries, and training in its use conducted in almost 30 countries in Asia and Africa.

The CONTACT methodology includes guidelines and checklists covering 12 areas: accounting infrastructure, information management, expenditure planning and budgeting, internal control and audit, financial reporting, external audit, revenue administration, debt management, project and foreign aid management, procurement and asset management, corruption prevention and control, and public cash management.

CONTACT guidelines have much broader coverage than the other instruments reviewed in this report—particularly their treatment of the management of government records, revenue administration, debt management, project and foreign aid management, and corruption issues. And unlike in World Bank assessment instruments, asset management is linked with procurement rather than treated as an expenditure management issue.

## NOTES

1. See BP (Bank Procedure) 2.1.1, annex A (January 1995), as amended, at <http://wbln0018.worldbank.org/Institutional/Manuals/OpManual.nsf/whatnewvirt/F773411614919ECF8525672C007D080A?OpenDocument>.

2. Ibid.

3. This section draws heavily on World Bank and IMF (2002).

4. For the status of countries covered by the HIPC initiative, see [http://www.worldbank.org/hipc/progress-to-date/status\\_table\\_Sep03.pdf](http://www.worldbank.org/hipc/progress-to-date/status_table_Sep03.pdf). Of the 28 countries that have received debt relief, 20 countries have reached the “decision point” (reached after a country has established a three-year track record of appropriate policies and reforms), and eight have reached the “completion point” (reached after a further period of strong policy performance, where the Bank, IMF, and other donors commit to provide sufficient relief to reduce a country’s debt to a sustainable level).



# Measuring Performance in Public Financial Management—Guidance from the Development Assistance Committee

## KEY ISSUES

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. Diagnostic reviews in public financial management are a growing source of information to both governments and donors. They reflect the state of public financial management systems, the risks and constraints that these pose to the implementation of development programmes and the use of donor resources (Box A2.1).<sup>1</sup> Diagnostic reviews and performance meas-

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*Note:* This annex contains the text of chapter 3 from *Harmonizing Donor Practices for Effective Aid Delivery*, a volume published in 2003 by the OECD's Development Assistance Committee.

ures assist governments in creating strategies that improve management of public finances.

Diagnostic reviews provide information on the strengths and weaknesses of the public financial management systems of partner countries. They support country efforts to improve the performance of their public financial management systems, and so contribute to improved development outcomes. They also provide information to allow donors to consider the risks that their funds may not be used for agreed or appropriate purposes. Thus, partner country governments and donors have a shared interest in high quality diagnostic reviews.

In recent years, the proportion of development funds made available through government financial systems has increased significantly. Efforts by donors to improve their understanding of the functioning of these systems have brought about the risk of an uncoordinated development of different diagnostic reviews. For developing countries, this means that a disproportionate amount of scarce administrative resources may be spent fulfilling multiple donor requirements. For development agencies, it may lead to unnecessary duplication of work. Thus there is considerable value, for donors and partner countries alike, in harmonising different diagnostic reviews and placing them in the context of a coherent, sequenced programme of work to strengthen public financial management. This, in turn, should be an integral part of participating donors' strategies for country assistance and the country's own poverty reduction strategy.

### **Box A2.1**

#### **What is a diagnostic review?**

A diagnostic review examines a partner country's public financial management system and practices. Diagnostic reviews are generally not audits and do not track individual items of expenditure. Nor do they provide a pass or fail assessment of a country's public financial management system in terms of its adequacy for managing external funds. Rather, they provide donors and governments with information on:

- The strengths and weaknesses of public financial management systems.
- The risks to which funds channelled through governments' systems may be exposed.
- The government programmes aimed at improving these systems.

Diagnostic work records the state of public financial management at a point in time. Partner countries and donors have a shared interest in being able to monitor progress over time in improving public financial management systems. A performance measurement framework—and an associated set of reform measures—assist them in this by building on the information set out in diagnostic reviews.

Much of the formal diagnostic work in the area of public financial management is still evolving. A number of diagnostic tools are used. The main instruments with a brief description of their purpose are listed in Box A2.2. In addition to these formal reviews, important diagnostic work is often carried out through specific technical assistance projects or as part of the preparation and implementation of donor financed activities.

## PURPOSE

The purpose of this paper is to put forward a set of good practices on how donors and governments can collaborate to make diagnostic reviews and measurement of performance in public financial management more effective. In pursuing this goal it seeks to achieve four specific objectives:

- *Maximise developmental benefits*—Diagnostic reviews are a valuable input to government efforts to improve public financial management systems. Their quality and impact can be improved by encouraging stronger country ownership and in-country consultation, and by integrating the reviews into both government and donor decision-making cycles, programmes of country assistance and poverty reduction strategies.
- *Make information more readily available*—Sharing the information and knowledge they provide with both donors and partner governments enhances the impact of diagnostic reviews.
- *Rationalise diagnostic reviews*—Diagnostic reviews should provide full coverage of public financial management issues without unnecessary duplication. Donors should reduce the burden on developing countries through fewer and better co-ordinated diagnostic reviews.
- *Provide a framework for performance measurement in public financial management*—Partner countries and donors have a shared interest in being able to monitor progress over time in improving public financial management systems, as reflected in diagnostic reviews. This paper provides

## **Box A2.2**

### **Current diagnostic tools**

#### *Country Financial Accountability Assessment (World Bank)*

CFAAs are a diagnostic tool designed to enhance knowledge of public financial management and accountability arrangements in client countries.

#### *Public Expenditure Review (World Bank)*

PERs analyse the recipient country's fiscal position, its expenditure policies—in particular the extent to which they are pro-poor—and its public expenditure management systems.

#### *Country Procurement Assessment Review (World Bank)*

CPARs examine public procurement institutions and practices in borrower countries.

#### *HIPC Expenditure Tracking Assessment (World Bank & IMF)*

These assess the ability of the public financial management systems in highly indebted poor countries (HIPC) to track poverty-reducing expenditures, using fifteen public financial management benchmarks.

#### *Fiscal Transparency Review (IMF)*

This is a module of the Reports on Observance of Standards and Codes (ROSC) which uses the Code of Good Practices on Fiscal Transparency adopted by the IMF in 1998.

#### *Diagnostic Study of Accounting and Auditing (Asian Development Bank)*

These examine financial management and governance practices in the public and private sectors of borrower countries.

#### *Ex ante assessment of country financial management (European Commission)*

Traditionally, the EC has carried out audits of its “targeted” budgetary support with a view to determining expenditures “eligible” or “ineligible”. For future budget support, however, it is developing a new approach using ex ante PFM assessments based on a mix of diagnostic work completed by other donors/governments and a “compliance test” to provide an empirical evidence of performance of the PFM systems.

#### *Country Assessment in Accountability and Transparency (UNDP)*

CONTACT is a toolkit to assist governments and consultants in conducting missions to assess public financial accountability systems.

broad guidance on how donors might address this emerging issue in individual partner countries.

The practices set out in this paper are consistent with those described in the Good Practice Paper entitled *Country Analytic Work and Preparation of Projects and Programmes*.

## GUIDING PRINCIPLES

### Diagnostic work

The following principles guide the elaboration of good practices in diagnostic work in this paper:

- *Partner country governments should be fully involved in and have ownership of diagnostic reviews*—There is scope for partner governments to be increasingly involved in the conduct of diagnostic reviews and this paper suggests a number of good practices to that end. This should improve the quality of these reviews and provide greater incentives for donors and partner governments to strengthen public financial management systems.
- *Harmonised diagnostic reviews alleviate the burden on partner countries*—Donors should rationalise the scope, timing and conduct of diagnostic reviews so as to avoid unnecessary duplication of work, and should rely as far as possible on other donors' diagnostic reviews to satisfy their requirements.
- *Harmonisation does not mean standardisation*—In many countries receiving development assistance, public financial management systems may fall well below international good practices. This does not mean that financial assistance should not be provided to these countries: each donor must decide what level of risk it accepts in providing funds through the partner country's budget, in relation to developmental benefits. Thus, different donors may make different decisions on the basis of the same diagnostic review.
- *Diagnostic reviews should be responsive to country development context*—Improvement in public financial management systems is part of the overall development agenda, driven by the partner country and supported by donors. Undertaking of diagnostic work will be influenced by and

feed into the overall country support strategies. Diagnostic studies should be regarded as part of a process, not as a single product, and sequenced over time.

- *Diagnostic reviews should be conducted according to open and transparent processes*—There should be full consultation with all stakeholders before completion. There should be “no surprises” when the final report is published.
- *Understanding the institutional and governance context*—Reviews of public financial management systems are not simply “technical” exercises. They require a full understanding of the underlying governance arrangements in a country, the informal rules and incentive structures, and the factors that can undermine efficient and effective delivery of public services through waste, mismanagement and corruption.

## Performance measurement

The following principles guide the elaboration of good practice in performance measurement:

- *The measurement framework needs to encompass the critical aspects of public financial management*—covering budget formulation, execution, reporting, and review—and be fully integrated with diagnostic reviews and processes.
- *The measurement framework should encompass internationally agreed codes and standards*—which represent the target for public financial management systems—where appropriate. This leads to two specific requirements:
  - Codes and standards need to be developed to fill existing gaps in coverage.
  - Developing countries should fully participate in the development and formulation of codes and standards.
- *Performance measures should be comprehensive with respect to the critical areas to be covered without being excessively numerous.* They should be readily understandable, cost effective, and capable of being calibrated to cover different stages of development and monitored on a regular basis. They should be acceptable to both partner countries and donor agencies and, where appropriate, consistent with current and proposed relevant international codes and standards.
- *While there can be no single overall measure of public financial management performance, it is necessary to avoid having too many indicators.* In addition to indi-

cators of the overall effectiveness of the system, it can be useful to have more detailed indicators of specific aspects or areas of public financial management, e.g., public procurement, internal control and external audit.

## GOOD PRACTICES IN DIAGNOSTIC WORK

### Planning the review

As far as possible donors should seek to satisfy their requirements by relying on the diagnostic reviews that are already available, or that will be made available within a reasonable period of time.

Where individual donors' requirements are not satisfied by available diagnostic reviews, they should seek to limit unnecessary duplication of work by collaborating with other donors and stakeholders and sharing the results of their reviews.

All donors should promptly share information on plans for carrying out diagnostic work in a particular country.

The reasons for conducting the review and its relationship with the overall country development strategy and the strategies of participating donors should be clear to, and accepted by, all participants at the beginning of the review.

Collaboration between partner country and donors is as important as collaboration between donors. Collaboration may take a number of forms:

- *Joint undertaking of a diagnostic review*—With work being undertaken by staff or consultants of any number of development partners, including the partner country.
- *One or some partners undertaking the study*—This may include the partner country undertaking a self-assessment, with appropriate review by donors, or one or more donors carrying out work on behalf of a wider group, with others providing funding or specific technical resources or indicating their intention to use the results of the study.

### Conducting the review

The nature and extent of collaboration should be agreed and documented at the start of the planning process. This should include:

- The role of the partner country in the work.



- Whether there is to be a joint or separate reports for different donors. Whether there is to be a joint report, and the preparation of a joint initiating memorandum.
- Which donors may be lead-participants, and which may take a more secondary role. Where there are many donors interested in a diagnostic study it may be necessary to limit the direct participation of some so as to keep the process cost-effective. This would be achieved through mutual agreement.
- The staffing contribution and division of labour and costs between the participants.
- Processes for communicating conclusions with other stakeholders.

Obtaining objective information on the quality of the public financial management system requires consultation with all stakeholders in the partner country. Apart from central ministries such as Ministry of Finance, these include spending ministries, parliaments, the business community and civil society.

Progress and emerging conclusions should be shared with all participants during the course of the review through regular meetings. The partner country should be encouraged to share draft conclusions with other country stakeholders before finalisation.

### **Quality assurance**

All participants have a shared interest in achieving a quality diagnostic review. Where joint reviews are carried out, quality assurance arrangements should be agreed at the planning stage and recorded in a jointly owned paper. These arrangements will normally provide for a regular review of work done by each participating organisation, and for clearance by others before the report is issued.

### **Sharing the review report**

All review reports will be shared to the fullest extent, observing individual participating donors' disclosure policy and the prior agreement reached with the partner country.<sup>2</sup>

### **Follow-up activity**

Donors will work to develop an understanding with the partner country that the review is intended to bring about improvements in the public

financial management system. This should lead to the elaboration of an agreed action plan and follow-up activity.

Collaboration on follow-up is important and should also involve identification of capacity development needs and provision of technical assistance where necessary. The partner country should co-ordinate this process and avoid donor competition.

### Updating of the review

Consistent with the review's role as a knowledge tool, the information needs to be kept up to date. While a full diagnostic review may be undertaken only every three to four years, updating of the overall assessment should be undertaken every year. This includes using appropriate public financial management performance indicators. Desirably, this should take place through a joint mechanism agreed between the partner country and donors and built into the country's budget cycle.

#### **Box A2.3**

##### **Improving public oversight of public expenditures**

*Bangladesh*—During 1999-2000, a Country Financial Accountability Assessment was conducted by the World Bank and UNDP with participation from the Ministry of Finance, line ministries, parliamentary oversight bodies and private firms of accountants. The assessment focused on the quality of financial accountability and transparency in Bangladesh, and made recommendations for improvements. The financial management standards and practices of agencies using public funds were compared to international good practices as well as those of external oversight agencies—nine Audit Directorates of the Comptroller and Auditor General's Office, parliamentary committees concerned with public expenditure, donor agencies and the media. It included an assessment of the steps that would be needed to support a shift by donors from projects to budget support and sector programmes. Among the responses of the government is the creation of an independent Public Expenditure Review Commission, headed by a retired Comptroller and Auditor General. The Commission will review all aspects of public expenditure on an annual basis and report to the government and to Parliament.

**Box A2.4****Partners support government-led diagnostic process in Tanzania**

The Government of Tanzania owns and leads the diagnostic work program in public financial management—and that is what accounts for its success. The programme, of which the centrepiece is the annual Public Expenditure Review (PER)—is closely integrated into the government’s budget cycle and involves a broad cross-section of stakeholders, and close partnership with donors. The PER process has evolved from its traditional role of external evaluation of budget management to support the government’s programme to improve budget management within a medium term expenditure framework. It supports better donor co-ordination by ensuring that aid is consistent with budgetary objectives and priorities and increasingly integrated in the budget. More recently, the PER has been supplemented by the Country Financial Accountability Assessment (jointly undertaken by the World Bank and DFID, published as a government document, and shared with all donors) and the Country Procurement Assessment Review, which look at critical aspects of budget execution. The programme has the following benefits: (a) donors share their sector specific or thematic experience, to the benefit of all who participate, (b) more effective use of resources in undertaking technical studies on budget issues, (c) a higher profile of budgetary issues in the work of all parties, and (d) a platform to support the shift from project to budget support by several donors.

**GOOD PRACTICES IN PERFORMANCE MEASUREMENT**

Given the emerging nature of work in this area, good practices have yet to fully emerge. However, based on work to date, the following appear important:

- Partner country governments and donors should collaborate in the setting and monitoring of country-specific performance indicators in public financial management.
- Donor collaboration should take place within a government-led strategy for improving the overall management of public finances that sees performance measurement fully integrated with diagnostic work and capacity building efforts. Common performance indicators can avoid governments being presented with an excessive number of—potentially conflicting—targets, and can serve to co-ordinate donor capacity building efforts.

- Given the absence of a comprehensive, internationally accepted performance measurement framework in public financial management, donors should support work on the development of such a framework. They should also ensure that developing country conditions and voice are reflected. Where available, donors should be guided by existing international standards, codes and approaches in formulating country-specific performance targets, as appropriate to country conditions (see Box A2.5 below).
- Indicators of public financial management performance assist donors in assessing risks to their programmes. While donors should collaborate in the formulation of performance indicators in individual countries, donors decide individually on the nature and level of resource transfers in a given set of circumstances. They will take into account previously agreed measures.

### **Box A2.5**

#### **Elements of a performance measurement framework**

Among the elements of an emerging international framework for performance measurement in public financial management are:

*International standards*, such as the International Public Sector Accounting Standards (IPSAS) of the International Federation of Accountants and the auditing standards of the International Organisation of Supreme Audit Institutions (INTOSAI). Work is also commencing on IPSAS for development assistance and budget reporting.

*Codes of good practice*, such as the IMF's Code of Good Practices on Fiscal Transparency and budget classification procedures promulgated by the IMF (Government Finance Statistics) and United Nations (COFOG).

*Current benchmarks*, such as the set of 15 performance benchmarks in public financial management used by the IMF and World Bank in tracking poverty reducing expenditures in Heavily Indebted Poor Countries (HIPC). An updated set of these benchmarks will be available in 2003. In addition, UK DFID has developed a set of public financial management performance benchmarks in the context of managing fiduciary risk when providing direct budget support.

**Table A2.1: Indicators of good practice in measuring performance in public financial management**

Good Practices	Indicators	Sources of Information
Diagnostic coverage without duplication	Reduction in number of diagnostic reviews that address the same area	Country Analytic Work Website
	Reduction in number of donor missions	
Higher impact of diagnostic work	Proportion of reviews carried out in the context of country strategy	Information on country programmes and Country Analytic Work Website
	Proportion of reviews carried out through agreed collaborative mechanisms	
Enhanced partner country capacity in public financial management	Government/donor community consensus on public financial management performance benchmarks	Announced government/donors programmes, and progress reports thereon
	Agreed approach to building public financial management capacity	

## NOTES

1. 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. The broad objectives of public financial management are to achieve overall fiscal discipline, allocation of resources to priority needs, and efficient and effective allocation of public services.

2. See the Country Analytic Work Website at [www.countryanalytic-work.net](http://www.countryanalytic-work.net), also referred to in the Good Practice Paper *Country Analytic Work and Preparation of Projects and Programmes*.



## Technical Map of the Assessment Instruments

Table A3.1 shows the coverage of public expenditure management issues for the six main assessment instruments—PERs, CFAAs, CPARs, Fiscal ROSCs, HIPC AAPs, and EC audits—summarized in the main text of the study and described in more detail in annex 1. Each instrument's coverage is mapped in five broad areas: the legal and organizational framework, expenditure programming and budget preparation, budget execution, accounting, reporting and external audit, and administrative and financial management capacity. The 15 main components of these five areas are shown in bold text, and each component is divided into subcomponents—94 in all.




The findings in table A3.1 are based on the guidelines for the instruments, reviews of a sample of assessment reports, and discussions with experts on each instrument.<sup>1</sup> (For PERs, which do not have formal guidelines, the findings are based on the coverage of actual reports.) Three levels of coverage are shown for the 15 main components: complete or substantial, partial or moderate, and little or none. For the 94 subcomponents a decision was made about whether each instrument covers or does not cover each subcomponent. A double check-mark (✓✓) indicates that the subcomponent is covered by the instrument's guidelines and regularly featured in assessment reports. A single check mark (✓) means that the subcomponent is not covered by the guidelines but is often featured in reports. No judgments were made about the depth of the coverage or the technical quality of the instruments' analysis.

As explained in the main text, transparency, accountability, participation, and rule of law are critical cross-cutting issues that apply to all areas of public expenditure management. So, while they are not shown in table A3.1, they are implicit in every component. For example, transparency is a key criterion for assessing budget coverage and external audit. Similarly, some instruments, such as CFAAs, have a strong focus on accountability—while others, such as Fiscal ROSCs, focus on fiscal transparency. Although corruption is not explicitly covered in the table, financial integrity issues are fundamental to the assessment of most components of public expenditure management.

## NOTE

1. These sample reports included the following countries: *CFAA*—Bangladesh, Benin, Bosnia-Herzegovina (BiH), Brazil, Mozambique, Philippines, Turkey, Uganda, Ukraine, Vietnam and Zambia; *CPAR*—BiH, Philippines, Russia, Turkey, Uganda, and Zambia; *PER*—BiH, Croatia, Ethiopia, Philippines, Uganda, the Philippines, Tanzania (and sector PERs on Agriculture, Health and Education), Turkey, Vietnam and Zambia; *Fiscal ROSC*—Bulgaria, Mali, Pakistan, and Turkey; *EC Audits*—Cameroon, Chad, Cote d'Ivoire, Ghana, Mozambique and Zambia.

**Table A3.1: Technical mapping of the assessment instruments**

<b>Key</b>		Instruments
Level of coverage		PERs = Public Expenditure Reviews (World Bank)
	= Complete or substantial	CFAAs = Country Financial Accountability Assessments (World Bank)
	= Partial or moderate	CPARs = Country Procurement Assessment Reports (World Bank)
	= Little or none	Fiscal ROSCs = Reports on the Observance of Standards and Codes of Fiscal Transparency (IMF)
		HIP AAPs <sub>3</sub> = HIPC Public Expenditure Tracking Assessments and Action Plans (World Bank-IMF)
		EC audits = European Commission audits
✓✓	= Subcomponent is covered by the instrument's guidelines and regularly featured in assessment reports	
✓	= Subcomponent is not covered by the instrument's guidelines but is often featured in assessment reports	

Component/subcomponent		PERs	CFAAs	CPARs	Fiscal ROSCs	HIPC AAPs	EC AUDITS
<b>I. Legal and organizational framework</b>							
<b>Legal framework for expenditure management</b>						<sup>a</sup>	
Constitutional requirements		✓	✓	✓	✓		✓
Legal framework for budget and fiscal policy		✓✓	✓✓	✓	✓✓		✓
Fiscal management roles of the executive, legislative, and judicial branches		✓✓	✓✓	✓	✓✓		✓
<b>Intergovernmental fiscal relations</b>							
Allocation of responsibilities between different levels of government		✓✓	✓✓		✓✓ <sup>b</sup>		



**Table A3.1:** (continued)

Component/subcomponent	PERS	CFAAs	CPARs	Fiscal ROSCs	HIPC AAPs	EC AUDITs
Expenditure transfers to subnational governments	✓✓	✓✓	✓		✓✓	✓
Revenue authority and borrowing rights of subnational governments	✓✓	✓	✓	✓		
<b>Relations between government and nongovernment entities</b>						
Scope of government fiscal targets and consistency with government finance statistics	✓✓			✓✓		
Central bank independence				✓✓		
Clarity of distinction between government and public enterprises	✓✓		✓	✓✓		
Clarity of reporting of government equity holdings	✓✓	✓✓		✓✓		
Clarity and openness of formal regulation of private sector			✓	✓✓		
<b>Government structure</b>						
Type of government (presidential, parliamentary, and so on)	✓✓	✓	✓	✓		✓
Cabinet arrangements (powers of prime minister, ministry of finance, and line ministries)		✓				
Organizational structure of ministries and agencies with financial responsibilities	✓✓	✓✓	✓			✓
Arrangements for civil service management	✓✓		✓			
Second tier organizations (directorates, agencies, autonomous bodies)	✓✓		✓			✓
<b>II. Expenditure programming and budget preparation</b>						
<b>Budget coverage</b>						
Budget classification and consistency with government finance statistics	✓✓	✓✓		✓✓	✓✓	✓

Extrabudgetary funds and earmarked revenues		✓✓	✓✓	✓	✓✓	✓✓	
Quasi-fiscal activities		✓✓	✓✓		✓✓	✓✓	
Contingent liabilities		✓✓	✓✓		✓✓	✓✓	
Tax expenditures		✓	✓✓		✓✓		
User fees		✓✓	✓✓		✓✓	✓✓	
Donor funding		✓✓	✓✓	✓✓	✓✓	✓✓	✓✓
Transfers to and from public enterprises		✓✓	✓✓	✓	✓✓		
<b>Expenditure analysis</b>							
Fiscal sustainability		✓✓					
Composition of expenditures		✓✓				✓✓	
Analysis of mandatory and discretionary spending		✓✓					
Review of public investment programs		✓✓					✓
Intersectoral analysis		✓✓					
Intrasectoral analysis		✓✓					
Efficiency and effectiveness of expenditure programs		✓✓			✓✓		
Expenditure incidence and poverty impact		✓✓				✓✓	
Analysis of deviations of actual from budgeted expenditures		✓✓	✓✓		✓✓	✓✓	
Assessment of payment arrears		✓✓	✓✓			✓✓	✓
<b>Fiscal framework and expenditure programming</b>							
Macroeconomic framework and fiscal outlook		✓✓	✓		✓✓	✓✓	
Revenue projections		✓✓	✓✓				

**Table A3.1:** (continued)

Component/subcomponent	PERS	CFAAs	CPARs	Fiscal ROSCs	HIPC AAPs	EC AUDITs
Donor funding projections		✓			✓✓	
Fiscal scenarios and sensitivity analysis	✓✓			✓✓	✓✓	
Fiscal risks and contingent liabilities	✓✓	✓✓		✓✓	✓✓	
Independent scrutiny of macroeconomic models and assumptions	✓✓			✓✓		
Setting of aggregate revenue, spending, and deficit targets	✓✓	✓		✓✓		
<b>Budget preparation</b>						
Cabinet-level setting of policy priorities and expenditure ceilings	✓✓	✓✓				
Ministry-level setting of priorities and allocation of resources	✓✓	✓				
Level of detail in budget allocations (flexibility of ministerial spending)	✓✓	✓✓		✓		✓
Expenditure classification (line-item, program, and so on)	✓✓	✓✓		✓✓	✓✓	✓
Forward costs of ongoing programs	✓			✓✓	✓✓	
Cost estimates for proposed programs	✓✓	✓		✓✓		
Medium-term expenditure estimates	✓✓	✓✓		✓✓	✓✓	
Clarity of program objectives	✓✓			✓✓		
Process for preparing the draft budget	✓✓	✓✓				
Integration of capital and recurrent budgets	✓✓	✓✓		✓✓	✓✓	
Civil society participation in budget preparation		✓✓				
Feedback from program review and evaluation	✓✓			✓✓	✓✓	
Approval of draft budget by the legislature	✓✓	✓✓		✓		

### III. Budget execution

Treasury systems, cash management, and expenditure monitoring					
Laws and regulations on treasury and cash management	✓✓	✓✓			✓✓
Organization of the treasury function	✓✓	✓✓			✓
Cash planning and forecasting	✓✓	✓✓			✓
Banking and accounting arrangements	✓✓	✓✓		✓	✓✓
Rules and procedures for payments and cash allocations	✓✓	✓✓	✓		✓
Flexibility for budget managers (virement rules, carryovers, and so on)	✓✓	✓✓		✓	✓
Commitment control	✓✓	✓✓		✓	✓✓
Verification of receipt of goods and services			✓		✓✓
Monitoring and management of payables and arrears	✓✓	✓✓		✓✓	✓✓
Payroll monitoring and management	✓✓	✓✓		✓✓	✓✓
Reconciliation of fiscal and bank information	✓✓	✓✓		✓✓	✓✓
<b>Public procurement and management of physical assets</b>					
Procurement laws and regulations	✓		✓✓	✓✓	✓✓
Organization of procurement functions within government	✓		✓✓		✓✓
Openness of procurement processes and procedures	✓		✓✓		✓✓
Tendering procedures			✓✓		✓✓
Documentation and information systems			✓✓		✓
Control and complaint review procedures			✓✓		
Management of physical assets		✓✓			✓

**Table A3.1:** (continued)

Component/subcomponent	PERS	CFAAs	CPARs	Fiscal ROSCs	HIPC AAPs	EC AUDITs
<b>Internal control and audit</b>						
Internal control regulations, organization, and procedures	✓✓	✓✓	✓✓	✓✓	✓✓	✓✓
Internal audit regulations, organization, and procedures	✓✓	✓✓	✓✓	✓✓	✓✓	✓
<b>IV. Accounting, reporting, and external audit</b>						
<b>Accounting, reporting, and records management</b>						
Accounting policies and standards	✓	✓✓		✓✓		✓
Accounting processes and responsibilities	✓	✓✓	✓✓	✓✓		✓✓
Government financial management information systems	✓✓	✓✓			✓	✓
Internal reporting	✓✓	✓✓		✓✓	✓✓	✓
Scope and coverage of external financial reports	✓✓	✓✓		✓✓	✓✓	✓✓
Timeliness and quality of external financial reports	✓✓	✓✓		✓✓	✓✓	✓
Records management systems		✓✓	✓			✓✓
<b>Debt and aid management</b>						
Debt and aid management laws and regulations	✓					
Management, control, and reporting of government debt	✓	✓✓		✓✓		✓✓ <sup>c</sup>
Management, control, and reporting of financial assets	✓	✓✓		✓✓		✓ <sup>c</sup>
Management, control, and reporting of aid	✓	✓	✓✓	✓✓	✓✓	✓

<b>External audit</b>					
Legal framework for external audit	✓	✓✓		✓✓	✓
Independence of supreme audit institution	✓	✓✓	✓	✓✓	✓✓
Jurisdiction of supreme audit institution	✓	✓✓	✓	✓✓	✓
Audit standards	✓	✓✓			
Timeliness and quality of audit reports	✓	✓✓	✓	✓✓	✓
Sanctions for irregularity	✓	✓✓		✓✓	
Legislative review of audit reports	✓	✓✓		✓✓	✓✓
Follow-up on audit recommendations	✓	✓✓		✓✓	
<b>V. Administrative and financial management capacity</b>					
<b>Personnel quality, capacity, incentives, and management</b>					
Personnel quality, capacity, incentives, and management		✓✓	✓✓	✓	

a. HIPC AAPs follow a system's approach, identifying sentinel indicators that are indicative of overall public expenditure management capacity.

b. Fiscal ROSCs cover transfers and revenue assignments as they relate to restraints on local borrowing.

c. The European Commission has performed a number of special audits on internal arrears but they do not cover external debt.





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## About the Authors

**Richard Allen** is a senior staff member of the World Bank and Head of the Public Expenditure and Financial Accountability (PEFA) Program. He was previously a senior official at HM Treasury (the British Ministry of Finance), the OECD and the Asian Development Bank, a UK government diplomat in Washington, D.C., and a board member of the European Investment Bank. He holds degrees in economics from the Universities of Edinburgh and York.

**Salvatore Schiavo-Campo**, a former senior staff member at the World Bank, Asian Development Bank, IMF, and USAID, and previously Professor and Chairman of Economics at the University of Massachusetts at Boston, is currently an international consultant, including as Senior Advisor for the PEFA Program. With a Ph.D. in economics and a Master's degree in international affairs from Columbia University, and an LL.D. from the Università di Palermo, he is the author of a dozen books and many articles in public sector management and economic development.

**Thomas Columkill Garrity** is a consultant to the World Bank and the PEFA program on governance-related issues. He holds a Master's degree in social anthropology from the University of St. Andrews, Scotland; a Master of Business Administration degree from Hult International Business School; and a Master of Arts in Law and Diplomacy degree from the Fletcher School of Law and Diplomacy, Tufts University.





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This study compares and contrasts the various instruments and approaches used by these organizations to assess and reform public expenditure management systems in developing and transitional countries. It finds weaknesses in these instruments, including overlap and duplication in their technical scope and coverage, as well as insufficient or inconsistent coverage in some areas. In addition, countries often are subjected to multiple assessments and multiple missions by the donors, which can impose heavy transactions costs on government agencies. Furthermore, the instruments have a variety of objectives—fiduciary, surveillance, and capacity building—which are divergent and potentially conflicting.

This study recommends a new approach that is country led, multidonor, medium term in orientation, focused on better management of the budget, and supplemented by donor aid funds, as a key mechanism to reduce poverty and attain other policy goals. It provides concrete and practical recommendations for achieving four important objectives:

- Streamlining the coverage of instruments to avoid unnecessary duplication
- Enhancing collaboration between donors, governments, and other stakeholders
- Providing a more complete, accurate, and timely assessment of fiduciary risk
- Improving the ultimate development impact of assessment and reform work

This book will be of interest to development practitioners in the area of public finance, finance ministers, policy analysts, and students and scholars of international development.



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