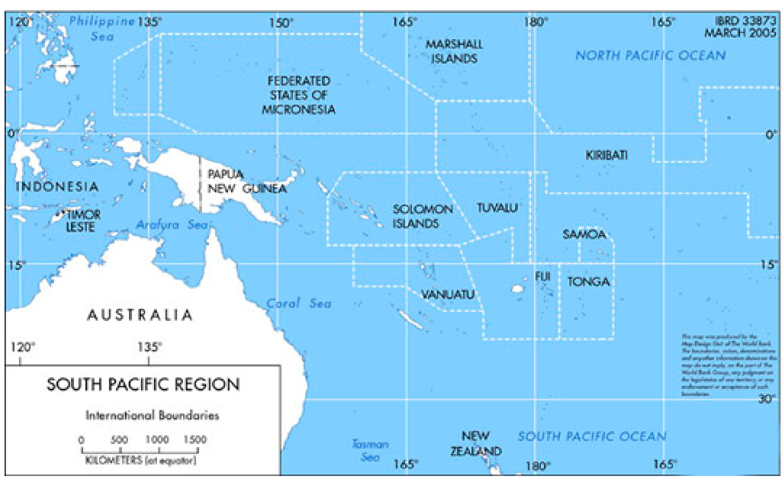
PFTAC Regional Papers

A Public Financial Management Roadmap for Forum Island Countries



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I. EXECUTIVE SUMMARY

Forum Island Countries (FICs) need to improve their public financial management to encourage growth and reduce poverty. An effective public financial management (PFM) system is essential to the functioning of government. It covers planning, collection, spending, reporting and audit of public monies and involves systems and staff in every agency of government. Governments need a strong PFM system to deliver the macroeconomic stability vital for sustainable growth and to enable efficient and effective service delivery.

PFM reforms will allow increased and better quality development partner support. Development partner financial support is more effective when delivered through government systems, as recognised by the Cairns Compact, Pacific Principles on Aid Effectiveness, and Paris/Accra Declarations. Improved PFM systems provide development partners the confidence to increasingly channel their assistance through the budget while maintaining accountability to those who provide their funding.

Successful PFM reform is a complex, long-term process. It requires ongoing commitment by government, at both political and technical levels, and the application of significant financial, capacity building, and human resources over an extended period of time. There is no one size fits all solution. Reform plans need to be developed executed and monitored at country level taking into account local priorities and constraints. Government leadership is essential and should include commitment to communicating reform objectives, and subsequent outcomes, to the public.

FICs should focus on establishing a well-functioning, basic PFM system. It is important to get the basics right across the PFM system before moving too far on advanced reforms in isolated areas. However, it is equally important not to unduly restrain progress where opportunities and political support do exist.

A broadly common PFM reform process could improve outcomes and enhance development partner support. The proposed roadmap is a simple focused set of principles and practices applicable across the region. It aims to help countries and partners jointly understand the strengths and weaknesses of PFM systems (the starting point), develop appropriate reform objectives (the destination) and to ensure development partner support is coordinated behind government priorities (the journey).

The starting point: PEFA Assessments every 3-4 years

Regular assessments should form the core of FICs reform processes. Periodic—every 3 to 4 years—assessments of the PFM system allow progress against reform objectives to be tracked and priorities to be reassessed. They also provide a basis for productive dialogue with development partners.

PEFA assessments require careful implementation and interpretation. The Public Expenditure and Financial Accountability (PEFA) framework is the most widely accepted assessment tool, but it is not comprehensive or infallible. International experience suggests that it is important for the assessment process to be transparent and have strong government ownership and participation. Success is more likely if the assessment and its results are not linked to fulfilling a specific development partner requirement. PEFA assessments do not, however, provide a comprehensive analysis of the PFM system and should be supplemented with other tools and processes as appropriate. In particular, public expenditure reviews, procurement assessments and analytical work undertaken as part of reform projects can enhance PEFA assessments.

The destination: Practical, shared action plans derived from PEFA Assessments.

PEFA assessments should be accompanied by an update of governments' PFM reform strategies. An assessment can only contribute to improvements in PFM if the reform process takes account of its findings and development partner support adapts to any resulting changes in priorities. A strategic assessment of reform priorities should therefore be explicitly linked to the PEFA process and updated action plans developed. The assessment needs to be government led, taking into account political and institutional dimensions. Action plans could include explicit targets relating to the anticipated change in PEFA markings, with additional actions that would be designed to enable this objective to be reached. The conclusions also need to be shared by development partners who are supporting the reforms with financial and technical support.

The journey: Dedicated regional PEFA resources and coordinated donor support.

Regional support should be made available for regular PEFA assessments. The current ad-hoc process for PEFA assessment could be strengthened by establishing a central point for supporting the PEFA assessment process in the Pacific probably based in the Pacific Financial Technical Assistance Centre (PFTAC). That resource would build and disseminate good practice in Pacific PEFA assessments, coordinate and help execute assessments, including through participation, review and assistance in the development of PFM reform strategies.

Regional experience should be utilised wherever possible. In addition to regular discussion at FEMM meetings, regional associations and initiatives could be valuable for sharing lessons learned.

Development partners should make every effort to work within countries' reform structures. Action plans should clearly articulate the development partner support and capacity building that is required to achieve their objectives. Development partners should ensure that they can make changes to existing projects to align with new priorities. Development partners should not require or undertake separate monitoring of PFM reform progress. The progress reports that a PFM reform process generates should form the core of joint monitoring. These reports could be presented and discussed amongst peers at the FEMM and annual meetings of the Pacific Islands Financial Managers Association (PIFMA), where relevant alongside other Cairns Compact initiatives.

II. INTRODUCTION

Why is Public Financial Management so important?

Government relies on the public financial management (PFM) system. The PFM system determines how money enters the government system and how it is used for the benefit of the population. It covers all elements of a country's budget process, from decisions in parliament to the purchase of supplies for rural services. It covers planning, collection, spending, reporting and audit and involves systems and staff in every agency of government.

Strong PFM systems are needed to allow governments to deliver the macroeconomic stability vital for sustainable growth. Decision makers need to understand the impact that budgetary decisions have on macroeconomic variables such as growth, inflation, money supply, debt and the balance of payments. They also need to be able to monitor that revenue and spending during the year are in line with budget assumptions and adapt plans accordingly if they are not.

Efficient service delivery and effective poverty reduction rely on a well functioning PFM system. Effective service delivery requires much more than strong PFM, in particular it relies on sensible sectoral policies and human resources, but once policies and resources are in place it does require systems that deliver funds reliably and on time.

Reliable procurement processes are needed for efficiency and accountability purposes. Ensuring that public funds, including funds provided by development partners, are used appropriately requires sound and transparent procurement of goods and services with public money. The information produced by PFM system on revenue, expenditure and procurement is also vital for public accountability.

The PFM system is also important for the monitoring and evaluation of public sector policies and projects. Policy makers need to understand the cost of the policies they adopt, for planning and evaluation purposes. This is not possible without an effective PFM system. However, to fully evaluate the effectiveness of policies and projects requires information from beyond the PFM system.

Strong PFM systems also enable partners to deliver more financial assistance through government systems. Actions to improve PFM systems provide development partners the confidence to increasingly channel their assistance through the budget while minimising fiduciary risk. Funds channelled through government systems reduce the administrative burden on country authorities of gaining financial support for sound policies and increase the likelihood of effective reform. PFM reform is therefore a fundamental requirement of achieving the aims of the Cairns Compact, Pacific Principles on Aid Effectiveness, Paris Declaration and Accra Agenda for Action.

Improved revenue performance is critical for increasing the public resources available for development. This requires reforms in policy, including in response to reforms in taxation arising from global and regional trade agreements, and enforcement.

These issues are considered in a companion paper[1] and so are not addressed in detail in the PFM roadmap.

How will the roadmap improve PFM in the Pacific?

The roadmap aims to build consensus around good practices for PFM reform and partner support. The roadmap is a key component of the Cairns Compact and is consistent with other regional and international agreements and declarations (Annex A). By distilling and communicating experience from within and outside the region the roadmap aims to assist the development of appropriate and achievable PFM reform programs in FICs. It also seeks to develop consensus amongst countries and development partners about how to coordinate support and monitoring of these programs.

By doing so the roadmap hopes to contribute to improvements in PFM systems in the Pacific. This will, ultimately, contribute to improved economic management and public service delivery. It should also help make development assistance more effective by accelerating the use of government systems by development partners.

Reform plans need to be developed, executed and monitored at country level. All FICs already have PFM reform processes at various stages of progress and complexity. The roadmap attempts to add value at the regional level to these reform processes; it will not replace or duplicate them and will not set out reform priorities or targets for individual FICs.

The roadmap seeks wherever possible to build upon existing practices, mechanisms and institutions. The existing toolkit and range of supporting institutions does not require supplementation. The aim of the roadmap is to ensure that there is a common understanding of tools and roles, that tools are adapted to the Pacific environment and implemented taking into account the burden they place on the resource constrained public administrations of the Pacific.

III. PFM REFORM IN THE PACIFIC

What has international experience taught us?

PFM reform is an art not a science—there is no step-by-step guide to success. Many decades of reform across the world have shown that achieving success requires ongoing commitment by government and the application of significant resources over an extended period of time. It, amongst other things, requires technical expertise, careful planning and monitoring, institutional coordination, and adaptation to the local environment.

Above all, PFM reform needs broad political support. While ostensibly a technical issue—reform of the system of planning and allocating public funds—PFM reform has

[1] Improving Revenue Collection and Capacity in Forum Island Countries. FEMM 2010 paper (forthcoming).

outcomes that have a very high political content. It therefore cannot succeed without backing at the highest level.

Human capacity building is also critical. Successful PFM reform relies on public servants throughout the government and not just in the Ministry of Finance. Special steps therefore need to be taken to ensure that suitably skilled staff are employed, trained on a sustainable basis, remunerated appropriately and held accountable in the performance of their duties. This is in most cases, dependant on a parallel process of civil service reform.

In principle, there is a hierarchy of PFM reforms. This sequenced approach to PFM reform is grounded in the overriding priority of taking good care of the public's money—reinforced by the fact that receiving other countries' money (development assistance) confers additional importance on ensuring overall control of public monies. It also reflects that it is difficult to run before you can walk. For example, a system that cannot accurately forecast resources on an annual basis is unlikely to be able to have success at planning a number of years into the future; knowledge of basic cash accounting is required before implementing accrual accounting. This "getting the basics right" philosophy, popularised by Alan Schick (see Box 1), has been codified into a reform process known as the platform approach, used in Cambodia and Kenya which packages groups of activities or measures in a logical sequence.

A rigorous sequential approach to reform is, however, difficult to achieve in reality. For example, where platform approaches have been attempted, PFM reform has had the same problems as in more traditional environments. It has not prevented premature sequencing of major reforms, for instance implementing an IFMIS before effective accounting systems and treasury functions have been established. It has also tended to be frustrated by the need to demonstrate progress leading to premature declaration of reaching a certain platform. In reality, the political economy of reform is that it is often important to progress issues and items that have momentum and political capital even if other issues are lagging.

Box 1 : Getting the basics right

In elaborating his argument for "Getting the Basics Right," Alan Schick states:

- The government should foster an environment that supports ands demands performance before introducing performance or outcome budgeting.
- Control inputs before seeking to control outputs.
- Account for cash before accounting for accruals
- Establish external controls before introducing internal control
- Establish internal control before introducing managerial accountability
- Operate a reliable accounting system before installing an integrated financial management system.
- Budget for work to be done before budgeting for results to be achieved.
- Enforce formal contracts in the market sector before introducing performance contracts in the public sector.
- Have effective financial auditing before moving to performance auditing.
- Adopt and implement predictable budgets before insisting that managers efficiently use the resources entrusted to them

Source: Public Expenditure Management Handbook. World Bank. 1998

What does this mean for PFM reform objectives in the Pacific?

PFM systems in the Pacific are quite diverse. There is a wide range of sophistication both between countries and between different elements of each country's PFM system. Annex B and table 1 provide detail on relative strengths and weaknesses across FICs. While there are exceptions, on the whole countries in the Pacific tend to be relatively stronger in budget predictability and weaker in accounting and reporting areas.

Many countries, however, have significant shortfalls from a well functioning core PFM system. There are many examples of successful reforms across the Pacific (see Annex C) and although most FICs meet or exceed the requirements of a basic PFM system in many areas, many fall short in some key areas. Nevertheless, some countries have embarked on advanced reforms like performance budgeting and accrual accounting. Focusing reforms narrowly, or to "best practice" in a small area without consideration of problems in other parts of the PFM systems, often leads to disappointment. The PFM system is ultimately an interdependent set of sub-elements, the connections between each element can be stretched but not broken. One element may be more advanced than others, but for sustained success reforms should show steady, ongoing progress in each area, rather than developing pockets of sophistication in a narrowly focused area.

FICs should aim to ensure a well functioning basic PFM system, making progress where appropriate on more advanced reforms. FIC reform plans should incorporate the principles of getting the basics right while acknowledging that in reality a pragmatic approach that takes account of political and capacity constraints is required.

The roadmap proposes some indicators that can guide countries' reform plans. These are detailed in Annex D which sets out a sequence of actions in four key areas—budget framework and formulation; budget execution; accountability and control, and; audit—that FICS should aim to achieve. The actions do not represent the end of a PFM reform process, but achieving them would represent a solid foundation for advancement and should provide development partners the opportunity to increase the use of government systems for aid delivery. Many of these core characteristics have already been achieved by several countries, which are now progressing towards more advanced levels of reform.

The indicators are not, however, a sequential or comprehensive list of reform steps. It is beyond the scope of a regional roadmap to provide specific steps that can be transplanted effectively to a given country. Each country would need to develop its own reform path, depending on its circumstances.

Staff turnover and loss of experienced staff is a major inhibiting factor in the Pacific Island Countries. Sponsoring training and certification programs and moving capable junior staff into progressively more responsible positions are good ways to build human capital. However, once the staff are trained and seasoned they are subject to being recruited by others. This is common and should be expected as a normal challenge in regional human resource development in the Pacific. Techniques for dealing with the situation include establishing career development paths, mentoring, certification programs, rotational assignments, team building and civil service reform. It is also indicative of a constant need to invest resources in training.

IV. A Reform Roadmap for countries and development partners

While the components of each country reform plans will always differ, a broadly common reform process across the region could contribute to improved outcomes. This section proposes some broad principles of a reform roadmap that could help FICs raise economic growth and development and improve the use of national and development partner resources.

The starting point: PEFA Assessments every 3-4 years.

Periodic assessments of the PFM system are a critical element of the reform process. They allow policy makers to get a snapshot of the strengths and weaknesses of their PFM system and, when repeated, allow progress against reform objectives to be tracked and priorities to be reassessed.

FICs should aim to undertake PEFA assessments every 3-4 years. The PEFA framework (described in Box 2) is the most widely accepted assessment tool. It is, however, only an overview and in selecting high-level indicators it cannot capture the fine detail of a system including the institutional and governance environment that is critical to the improvement of budgetary systems.[2] Care should be taken in its use, particularly in a comparative sense, as the PEFA framework is not designed to provide robust cross-country comparisons. Despite these caveats, the PEFA framework has broad acceptance as the best available summary assessment of PFM systems.

PEFA assessments require supplementation with other tools. The PEFA framework does not involve the fiscal or expenditure policy analysis that is required to determine the sustainability of fiscal policy, or whether expenditure programs will be effective in addressing the MDGs. It can be supplemented with other more detailed assessments, such as procurement assessments, fiscal transparency assessments, and with supplementary tools such as Procurement Assessments, Public Expenditure Tracking Surveys and Public Expenditure Reviews.

Development partners increasingly look to the existence of a PEFA assessment as a precondition for budget support. PEFA assessments provide a benchmark to monitor progress against and, along with a resulting reform programme, can provide an indicator of the authorities' commitment to PFM reform. The fact that PEFA provides a means to increase use of government systems by development partners, while also providing substantive benefits to the reform process, makes the process critical to the success of the Cairns Compact and other donor harmonisation initiatives.

[2] The Challenge of Reforming Budgetary Institutions in Developing countries- R. Allen, IMF working paper WP/09/96, May 2009

Box 2: The PEFA Framework

PEFA is a diagnostic framework developed by a group of development partners including the EU, IMF and World Bank. It aims to support integrated and harmonised approaches to assessment and reform in the field of public expenditure, procurement and financial accountability. It applies a series of standard tests for:

- **credibility of the budget**—the budget is realistic and is implemented as intended
- **comprehensiveness and transparency**—the budget and the fiscal risk oversight are comprehensive and fiscal and budget information is accessible to the public
- **policy-based budgeting**—the budget is prepared with due regard to government policy
- **predictability and control in budget execution**—the budget is implemented in an orderly and predictable manner and arrangements are in place to exercise control and stewardship in the use of public funds
- **accounting, recording and reporting**—adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes
- **external scrutiny and audit**—arrangements for scrutiny of public finances and follow up by the executive are operating
- **development partner practices**—elements of these practices which impact on the performance of country systems.

Source: Tracking Development and Governance 2009, AusAid.

An effective PEFA assessment generally has a number of features. With over 150 PEFA assessments now having been undertaken world wide, there is increasing consensus over what actions are needed for the assessments to be robust, accepted and acted on by policy makers (Box 3). In summary,

- Strong government ownership of and participation in the process is essential.

- The process needs to be transparent and sufficiently patient to allow consensus to be achieved.

- A successful assessment is also more likely if it is not linked to fulfilling a specific development partner requirement.

- The assessment team should contain a mix of international and regional expertise and include at least one government representative.

- Repeat assessments should not be undertaken too frequently to allow progress to be made—expectations of progress between assessments should not be over-optimistic.

PEFA assessments have had a mixed reception in the Pacific. Some finance ministries have found the assessments a useful snapshot, while others were less satisfied judging that they understated progress. This reflects in part occasional shortfalls in the quality of the process, which tended to be limited to the assessment itself, without being integrated from the beginning with an approach to supporting reforms. Participants from Forum Island Country (FIC) finance ministries in a 2009 PEFA workshop agreed that PEFA assessments were an important tool for the region but emphasised that care needed to be taken to improve the process, learning from experience in other regions. They also called for additional technical support to be available within the Pacific.

Where to go: Practical, shared action plans derived from PEFA assessments.

A PEFA assessment will only lead to improved PFM if the reform process takes account of its findings and development partner support adapts to any resulting changes in priorities. A PEFA assessment only provides a snapshot and, on repeat, evidence of progress. It is only the response to the assessment that can provide improvements in PFM.

PEFA assessments should therefore be accompanied by a strategic review of PFM reform priorities. For countries in the early stages of a reform process, this may be the first comprehensive articulation of a reform plan, for others it will be an update of the content and priorities of the existing reform plan. The key is to explicitly include a strategic assessment of reform priorities in the PEFA process. That assessment needs to be government led, taking into account political and institutional dimensions. The conclusions also need to be shared by development partners who are supporting the reforms with financial and technical support (or may begin to support the reform process).

The development of reform priorities should take into account other assessments, where available. In particular, procurement assessments and public expenditure tracking surveys that provide detailed information on how funds are used can be vital elements of a well-formulated action plan.

Action plans should set out clear achievable aims. A 3 to 4 year interval between PEFA assessments is a good time frame for setting reform targets—it provides enough time for intermediate actions to be achieved while requiring actions tangible enough to be monitored. Action plans could include explicit targets relating to the anticipated change in PEFA markings, with additional actions that would be designed to enable this objective to be reached.

Box 3: PEFA Assessments: Lessons Learned

To optimise the benefits of a PEFA it is important to ensure that certain basic criteria are met. A study assessing of the impact of PEFA[3] identifies the critical aspects of an effective PEFA assessment as:

a) short assessments with back up support as part of Government-donor dialogue

b) Active , wide-spread and transparent Government and donor participation

c) not explicitly linked to fulfilling a specific donor requirement

The study emphasises the importance of involving government stakeholders over "independent assessments" to ensure success of the PEFA process and recognizes that the way assessments are undertaken can have an effect both on the quality of Government participation in the PEFA exercise and on any subsequent PFM monitoring using PEFA. The study recommends a number of strategies to this end, primarily focusing on the importance of Government stakeholders role in all aspects of the PEFA assessment. The report also mentions the need to broaden the benefits of PEFA assessments to agencies beyond the central agencies, especially to external scrutiny institutions, like legislatures. An important issue the report mentions is the difficulties in implementation, especially capacity constraints- an issue of concern around the Pacific- and the resulting slow progress.

The study points to a need to recognise that various constraints may make progress slow and therefore the need to manage the expectations of impact of PEFAs. Above all, it emphasises that national governments must lead, and be intimately involved with the PEFA process, for it to be successful. Donor anxiety to speed up the process, by independently undertaking desk studies, or taking a lead in the process, may well undermine it and actually result in slower progress, if at all.

A recent study by the PEFA Secretariat[4] recommends that PEFA assessments should not be undertaken too frequently and recommends an interval of at least three years between two PEFA assessments. It also recommends that the ToRs for repeat assessments be sufficiently detailed, with access to documentation and that the lead agency of the previous assessment should be a part of the reference group for the next assessment. The study also identifies advantages in using the same team. The study also gives detailed guidelines for assessors focusing on preparation, fieldwork and drafting of reports.

[3] Assessing the Impact of the PEFA Framework- A Study for the PEFA Steering Committee- Synthesis Report- June 2008.

[4] Good Practice when Undertaking a Repeat Assessment – Guidance for Assessment Planners and Assessors- PEFA Secretariat- February, 2010 .

Action plans need to take into account capacity constraints. Each country's PFM reform strategy must be designed keeping in mind its institutional and governance structure and, particularly in the Pacific, the human resource constraints. With the limited institutional capacity in many Pacific island countries, these actions should be relatively limited—it would be unrealistic to expect progress to be made on all fronts in a 3-4 year period. Action plans should, if possible, prioritise actions that enable the basics of Annex D to be put in place, across the whole system. Nevertheless, if reform momentum is strong on one particular area, for instance budget preparation, it should not be halted in favour of opening entirely new fronts.

Regular monitoring of progress will be required between PEFA assessments. The main reason for this is so that managers, policy makers and development partners can identify areas that are lagging and take remedial action where required. A secondary reason is to maintain the evidence of progress on reforms that donors, particularly those engaged in budget support, need to maintain the predictability of aid flows. Monitoring should take place on an annual basis and be built into reform action plans so that it is generated from within the government and the conclusions are shared between the authorities and development partners.

How to get there: Dedicated regional PEFA resources and coordinated donor support.

Regional support should be made available for regular PEFA assessments. At present PEFA assessments occur on an ad hoc basis, often generated through development partner projects supporting PFM reform. There is scope for regularising this process by establishing a central point for supporting the PEFA assessment process. This is in line with the conclusions of regional consultations with finance department officials in 2009, which proposed such a resource that would:

- **Build and disseminate good practice in Pacific PEFA assessments** – the unit would build strong links with practitioners and the PEFA secretariat in Washington so that it can act as a knowledge base, for countries and development partners on PEFA assessments in the particular context of the Pacific. It would organise occasional training events on a regional and sub-regional basis.

- **Coordinate and help execute assessments in countries** – the unit would maintain a database of planned and executed PEFA assessments. It would advocate regular assessments and attempt to ensure resources are available to execute them. It may, if finance were available, maintain a funding resource specifically for PEFA assessments which would, if large enough, enable the assessments to be divorced from the projects that support PFM reform, thus increasing their independence.

- **Participate in PEFA assessments –** given the expertise that would be housed in the unit, its staff would be expected to lead or participate in many assessments in the region. However, this would not necessarily be the case for all assessments or countries. The resource would be expected to at least review all draft reports.

The resource could be established in PFTAC. This would build both on the initial inroads made through the World Bank expert based in PFTAC; the expressed desire of Forum Island Countries and some development partners for PFTAC to play an active coordinating role in the PEFA process and the IMF and PFTAC's long experience in providing independent, high quality technical PFM advice to FICs. It is envisaged that the unit would be financed as an additional activity under the core PFTAC funding for its next funding cycle beginning May 2011. The program document of this next funding cycle will detail the additional resources needed and their use. Given the linkage between PEFA assessments and other Cairns Compact mechanisms, for example peer review processes, it is expected that the regional PEFA support will ensure that assessments are co-ordinated with the various Compact initiatives led by the Forum Secretariat.

The development of action plans on the basis of the PEFA assessment would draw on development partner expertise. PFTAC would be well placed to assist FICs in this process, where requested. However, the adoption of reform priorities and targets will need to be a country-led process that takes into account advice from a broad range of stakeholders, particularly the development partners that are financing ongoing or proposed projects to support PFM reform. These efforts would need to be take account of other relevant Cairns Compact activities.

Regional experience should be utilised wherever possible, particularly drawing on reforms that have had success in other FICs. The 2009 Forum Economic Ministers' Meeting (FEMM) recognised the central role of Economic and Finance Ministers in strengthening PFM systems, and their increasingly significant role in aid coordination as part of budget coherence, and agreed that a standing agenda item on the Cairns Compact be included at future FEMM meetings, to amongst others, help with sharing of experiences and lessons learned. Regional associations and initiatives such as PIFMA, PASAI and PITAA could also provide valuable for sharing lessons learned.

Action plans should clearly articulate the development partner support that is required to achieve them. The development and updating of the action plan provides an excellent opportunity for countries to ensure that support is coordinated and to identify financing gaps or overlaps. Development partners should ensure that once plans are agreed, their support is consistent with the plan's priorities, amending existing project plans if necessary.

Development partners should not require or undertake separate monitoring. The annual progress reports that a good PFM reform plan should generate, when combined with NSDSs, annual budgets, IMF Article IV assessments and Cairns Compact peer reviews should be more than adequate to enable donors to make judgements on the appropriateness of budget support. These reports could be presented and discussed amongst peers at the FEMM and annual meetings of PIFMA.

Table 1: A Summary of PEFA Assessments in Forum Island Countries

Note: PEFA markings are not reliable for cross country comparisons. This table reflects the baseline and, where relevant, progress in FIC countries. It should not be used to make direct comparisons between countries.

PEFA performance indicator		**Vanuatu 2007**	**Vanuatu 2010**	**Kiribati 2009**	**Samoa 2006**	**Samoa 2010 1/**	**Solomon Islands 2008**	**Tonga 2007**	**Tonga 2010 1/**	**Tuvalu 2007**	**Fiji 2005 1/**	**PNG 2005**	[illegible]
Overview of the indicator set A. PFM-OUT-TURNS: Credibility of the budget													
PI-1	Aggregate expenditure out-turn compared to original approved budget	A	B	A	A	A	C	B	A	B	A	C	[illegible]
PI-2	Composition of expenditure out-turn compared to original approved budget	A	A	B	C	C	B	C	C	D	C	C	[illegible]
PI-3	Aggregate revenue out-turn compared to original approved budget	A	A	D	A	B	A	A	A	C	A	A	[illegible]
PI-4	Stock and monitoring of expenditure payment arrears	A	A	NA	C	NA	C+	B+	B+	D+	D	B	[illegible]
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency													
PI-5	Classification of the budget	B	B	D	B	B	C	C	C	C	C	B	[illegible]
PI-6	Comprehensiveness of information included in budget documentation	A	B	C	A	B	B	A	A	C	B	B	[illegible]
PI-7	Extent of unreported government operations	D+	C+	D+	A	D+	C	D+	A	D+	D+	C+	[illegible]
PI-8	Transparency of inter-governmental fiscal relations	B	B	B	NA	N/A	D	NA	NA	B	D+	D+	[illegible]
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	D+	D	D	A	B	D	C	C	D	C	D+	[illegible]
PI-10	Public access to key fiscal information	C	C	C	C	C	C	C	C	C	B	C	[illegible]
C. BUDGET CYCLE													
C(i) Policy-Based Budgeting													
PI-11	Orderliness and participation in the annual budget process	B+	B	B	A	B+	D+	B	A	B	B	B	[illegible]
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	D+	C+	D+	C	C	C	D+	C	D	D+	D+	[illegible]
C(ii) Predictability and Control in Budget Execution													
PI-13	Transparency of taxpayer obligations and liabilities	C+	B	C+	B	C+	D	D+	A	NA	C+	B+	[illegible]
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	B	B	C	B	C	D+	C+	A	NA	C+	C	[illegible]
PI-15	Effectiveness in collection of tax payments	D+	D+	D+	D	D+	D+	D+	NA	NA	D	A	[illegible]

PI-17	Recording and management of cash balances, debt and guarantees	C+	C+	D+	B	C	C	B	A	D+	C	C+	C
PI-18	Effectiveness of payroll controls	C+	C+	D+	B	D+	D+	B	NA	D+	D	D+	C
PI-19	Competition, value for money and controls in procurement	D+	D+	D+	B+	C+	D+	C+	B+	NA	D+	D+	E
PI-20	Effectiveness of internal controls for non-salary expenditure	C+	C+	D+	C	D+	D+	C+	B+	D+	D	D+	D
PI-21	Effectiveness of internal audit	D+	C	D+	C	D+	D	D+	D	D	D	D	D
C(iii) Accounting, Recording and Reporting													
PI-22	Timeliness and regularity of accounts reconciliation	B	B	D	D	C	C	D	B	D	C	D	D
PI-23	Availability of information on resources received by service delivery units	C	C	D	B	D	D	D	D	D	D	D	D
PI-24	Quality and timeliness of in-year budget reports	B+	B+	D+	A	C+	C+	C+	C+	D+	C	D+	C
PI-25	Quality and timeliness of annual financial statements	B+	A	D+	D	D+	D+	D+	D+	D+	D	D+	D
C(iv) External Scrutiny and Audit													
PI-26	Scope, nature and follow-up of external audit	D	D	C+	D	D+	C+	D+	D+	D+	D	D	C
PI-27	Legislative scrutiny of the annual budget law	C+	C+	D+	D	D+	D+	C+	D+	C+	C	D+	D
PI-28	Legislative scrutiny of external audit reports	D	D	B	B	D+	C+	D	D	D+	C	C	C
D. Donor Practic													
D-1	Predictability of Direct Budget Support	D	C+	NA	NA	NA	N/A	NA	NA	NA	C	NA	N
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	D	D+	D	NA	C	D+	D	D	NA	C	C+	D
D-3	Proportion of aid that is managed by use of national procedures	D	D	D	NA	D	D	D	NA	NA	C	C	D

1/ Draft reports; findings are not necessarily accepted by the authorities.

Annex A: Background to the PFM Roadmap

The Forum Leaders at their 40th meeting in Cairns, Australia, on 6th August 2009 adopted the Cairns Compact to foster new and invigorated commitment to lift the economic and development performance of the region. The key objective of the Compact is to drive more effective coordination of available development resources from both Forum Island Countries (FICs) and Development Partners in order to achieve real progress against national development goals and the globally agreed millennium development goals (MDGs).

At the 2009 Forum Economic Ministers' Meeting, Ministers endorsed the need to urgently develop a Roadmap, aimed at progressive strengthening of Forum Island Countries public finance management. The Roadmap is expected to cover expenditure management, revenue, procurement, accountability and monitoring systems, in order to raise the effectiveness of these mechanisms to enhance the delivery of development resources. Ministers directed the Secretariat to work with relevant development partners, particularly the Pacific Financial Technical Assistance Centre, to develop the roadmap in consultation with Forum Island Countries and development partners. A regional workshop on the Cairns Compact on Strengthening Development Coordination in the Pacific, held in November 2009, provided guidance on the scope of key deliverables to be captured in the Roadmap.

The Roadmap builds on the Forum Accountability Principles adopted by FEMM in 1997. The Principles aimed to promote the adoption, at a whole of Government level, of good practice for public accountability, based on concepts of openness with Government information and public scrutiny of the performance of Governments and public officials, tailored to the circumstances of individual countries. The Accountability Principles identified specific areas for strengthening public finance management systems, including budgetary processes, and public sector procurement.

Annex B: A Brief Overview of Pacific PFM systems

Most countries in the Region, where a PEFA assessment has been undertaken in the recent past, show strengths in the areas of:

1. Aggregate revenue and expenditure outturns compared to original approved budgets

2. Comprehensiveness of information in budget documents, for example documents often include a budget circular and economic survey indicating the macro-fiscal outlook, all underpinned by a comprehensive budget law and detailed Financial Instructions.; and in

3. Orderliness and participation in the annual budget process – with budget calendars clearly laid out and normally adhered to with clear and comprehensive budget ceilings approved by the Legislature.

This may primarily be a reflection of the legislative imperatives of the annual budget process.

However, significant weaknesses are observed in the areas of:

1. **Weak legislative inputs** at the budget formulation stage resulting from inadequate legislative scrutiny**.**

2. **Inadequate resourcing of the budget**- with weak effectiveness in collection of taxes.

3. **Budget formulation**- with little multi year budgeting.

4. **Accounting and control** – for instance in the monitoring and control of arrears, in the lack of payroll controls, internal controls, predictability of funding, quality annual financial statements and the lack of timely reconciliation of accounts.

5. **Lack of transparency** of fiscal relations and management of fiscal risk, including in relation to off-budget expenditures and the operations of State Owned Enterprises.

6. **Weak procurement** procedures, stemming from weak capacity and thin private sectors.

7. **Weak Audit** mechanisms - both external and internal audit.

Donor practices, where they have been assessed, generally perform poorly against measures of predictability and usage of government systems.

Annex C: Examples of successful reforms

The following examples of successful reform in the Pacific can inform other countries' efforts. Although each country's political and institutional environment is quite different, there are lessons from their experience that can help other FICs in constructing their reform plans. Some notable successes have been:

- Modern **budget laws and financial instructions** have been put in place in a number of countries: e.g. Vanuatu's Public Finance and Economic Management Act, Palau's Financial Instructions, Treasury Instructions in the Cook Islands and Papua New Guinea's Fiscal Responsibility Act.

- **Medium-term budgeting** has become embedded in the Samoan budget process. Introduced in 2007-8, the Forward Estimates project relied for success on a country driven project, with sustained partner assistance over two budget cycles, focusing initially on central agencies and then on spending agencies.

- Vanuatu has a successful, sustainable, capable and mature **Integrated Financial Management Information System (IFMIS)** that forms a foundation for future PFM reform. In addition to good IT infrastructure and environment, the system has benefited from considerable effort in training system users and ensuring adaptability to new user requirements.

- Fiji has recently completed an exercise to develop IPSAS based cash **accounting standards**. These will help improve budget execution and reporting and also help an ultimate transition to accrual accounting.

- **Comprehensiveness and transparency**. Samoa's budget is quite comprehensive with good in-year budget reporting. The overall credibility of the budget is good and there is effective recording of expenditure arrears. Vanuatu has similarly good budget comprehensiveness, as do the Solomon Islands.

- **External and Internal Audit-** much progress has been made in the area of external audit in the last few years. Solomon Islands, Tuvalu, Fiji and Cook Islands have considerably improved in this area and further progress is expected under the Pacific Regional Audit Initiative (PRAI). In Internal Audit, following a regional study a number of countries are either establishing the an internal audit function for the first time (Cook Islands, Tonga) or improving existing systems (Samoa, Fiji).

Annex D: Elements of a well functioning PFM System

This annex sets out a sequences of actions that FICs could aim to take in the key areas of the PFM system. Table D1 presents the same information in a tabular format.

A) **Budget presentation, preparation and formulation**: achieving a credible and predictable budget:

- A **budget classification** that facilitates decision making and monitoring- this would initially include economic, object, line item and administrative classifications which enable good input controls and moving towards functional and GFS classifications, and program budgeting, in the medium term{corresponding to P-5 of the PEFA indicators}

- An orderly **budget process-** this would include a clear legal framework (budget law and updated financial instructions). Provisions should include clear responsibilities and accountabilities within the executive, the role for the legislature and an appropriate calendar{corresponding to P-11 of the PEFA indicators}.

- Comprehensive and transparent **budget documentation** including details of financial assets and debt stock, details of borrowings, relations with SoEs. Over time documentation should include quasi-fiscal activities and tax expenditures.

- For those countries with **trust funds**, clear rules on the transfer of resources to the budget and comprehensive reporting on investment strategies and positions.

- **Reliable economic analysis** that provides robust forecasts of annual resource envelopes and expenditure requirements. Once reliable annual forecasts have been established systems can move towards multi-year fiscal frameworks and forward estimates of spending agency expenditure envelopes.

B) **Budget Execution and cash management**: ensuring consistency between expenditure and appropriations and predictability in the availability of funds,

- Reliable and sustainable **information management system**. This would imply to prioritise the computerisation of all information flows, and the implementation of interfaces between existing information systems, as well as the development of local capacities to operate the systems, before moving to an integrated financial management information system.

- Effective **expenditure control**. This would include cleaning up the payroll and effective measures to control "ghosts", ensuring expenditures conform to budgetary allocations, and regular reconciliation of data {corresponding to P-18 of the PEFA indicators}

- **Commitment control** to manage the initial incurrence of obligations, rather than subsequent cash payments, in order to enforce expenditure ceilings and avoid expenditure arrears through the imposition of limits on commitments.

- A **Treasury Single Account** that pools all available cash resources under a single account allowing for comprehensive collation of all Government revenues and expenditures

- **Cash planning** to smooth over the mismatch between the timings of payments and availability of cash so that payments are made when due, minimise borrowing, maximise returns from investment of idle cash and so minimise risk.

- **Donor funding**: predictability of donor funding, especially for countries which receive large direct support or project funding, is essential for good budgeting and planning. Good donor management in such countries is therefore imperative for good budgeting.

C) Fiscal reporting: ensuring funds are appropriately tracked

- Good quality and timely in-year cash based **budget reports** as a first step- this would include regular reconciliation and feedback to, and monitoring of, line ministries' budget outcomes before moving towards measures like output budgeting, reporting on quasi fiscal expenditures, identification of fiscal risks and tax expenditures, etc. {corresponding to P-24 of the PEFA indicators}.

- Timely, and reliable **annual financial statements**. Full and quality information on revenues, expenditures and arrears are important to enable an analysis of Government operations in the first stage, moving towards details of liabilities and assets etc. at a later stage. Coupled with timeliness, this contributes directly to good budget preparation in the subsequent years and is critical to transparency of the PFM system. The **accounting basis** should be clear and achievable. In much of the Pacific this means improving cash accounting first, before introducing elements of accrual accounting. {corresponding to P-25 of the PEFA indicators}.

- Comprehensive **general government finance statistics,** established according international standards. Fiscal reporting shall go beyond budgetary central government. Good quality general government finance statistics should be a priority, before trying to produce consolidated financial statements of the public sector (whole-of-government accounts).

D) Accountability and audit mechanisms: ensuring that management and the public can hold public servants accountable.

- **Procurement systems** that ensure funds are used appropriately with appropriate fiduciary insurances**.** Systems need to take into account country specific requirements, including the limited private sector in many FICs without diluting the underlying principles {corresponding to P-19 of the PEFA indicators}.

- **Internal Audit** to monitor and advise management {corresponding to P-21 of the PEFA indicators} on timely corrective action to ensure effective financial systems. Move towards advanced concepts like performance audits, only after this is effectively achieved.

- Good **external audit** relies on the presence of annual financial statements from the executive. Once these have been established, supreme audit bodies in FICS should target timely delivery of audit reports to the legislature and follow up on the implementation of audit recommendations. Only when effective and timely audit has been established, and proper performance measures are in place, should the move towards performance audit and environmental audit be made.{corresponding to P-26 of the PEFA indicators}.

Table D1: Elements of a well-functioning PFM system

PRIMARY AREAS	SECONDARY AREAS	STEPS
• Budget Framework and Formulation	• A. Budget Classification {corresponding to P-5 of PEFA}	• A1. Economic, object, line item and administrative classification • A2. COFOG classification • A3. GFS classification • A4. Performance Budgeting
	• B. Orderliness and participation in the budget process {corresponding to P-11 of PEFA}	• B1. Legal framework. Clear role of Legislature. • B3. Financial Instructions and budget calendar. . Responsibility and accountability within the executive
	• C. Comprehensiveness of documentation	• C1. Good annual budget documentation • C2. Details of assets, SoEs etc. (gross first, then net)
	• D. Reliable analysis	• D1. Robust resource envelopes and expenditure requirements • D2. MT Fiscal frameworks • D3. Detailed Forward Estimates for Spending agencies • D4. Lomg-term sustainability analyzes
• Budget Execution	• A. Cash management	• B1. Effective TSA • B2. Cash Planning for internal resources • B3. Effective donor coordination to ensure predictability of donor

		inflows & good budgeting
	• B. Information Systems	• B1. Interfacing of applications. Computerization and of all information flows. • B2. Integrated financial management information system.
	• C. Controls {corresponding to P-18 of PEFA}	• C1. Expenditure Control • C2. Commitment Control •
• Fiscal Reporting	• A. Budget reports {corresponding to P-24 of PEFA}	• B1. Quality cash based reporting • B2. Feedback to LMs on budget outcomes • B3. Reporting on quasi fiscal expenditures, identification of fiscal risks & tax expenditures
	• B. Comprehensive statistics	• B1. Central government statistics consistent with international standards • B2. General government statistics consistent with international standards
	• C. Timely accounts {corresponding to P-25 of PEFA}	• E1. Quality Annual Financial Statements reporting on revenues, expenditures & arrears • E2. Timely Annual Financial Statements • E3. Reports on details of assets and liabilities etc.
• Audit Mechanisms	• A Internal Audit	• A1. Set up IA units • A2. Effective use of IA reports by

		management
	• B. External Audit	• B1. Timely and quality external audit reports • B2. Implementation of Audit recommendations • B3. Performance audit etc.
	• C. Procurement {corresponding to P-19 of PEFA}	• C1. Effective procurement systems

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