Good Governance for Economic Resilience

High-Level Seminar: Building Robust Governance Frameworks

Strengthening Governance Throughout the Public Financial Management Cycle

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Strengthening Governance Throughout the PFM Cycle

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Overview

I. Introduction to Fiscal Governance

II. PFM Legal Framework

III. MTBF and Budget Formulation

IV. Budget Execution

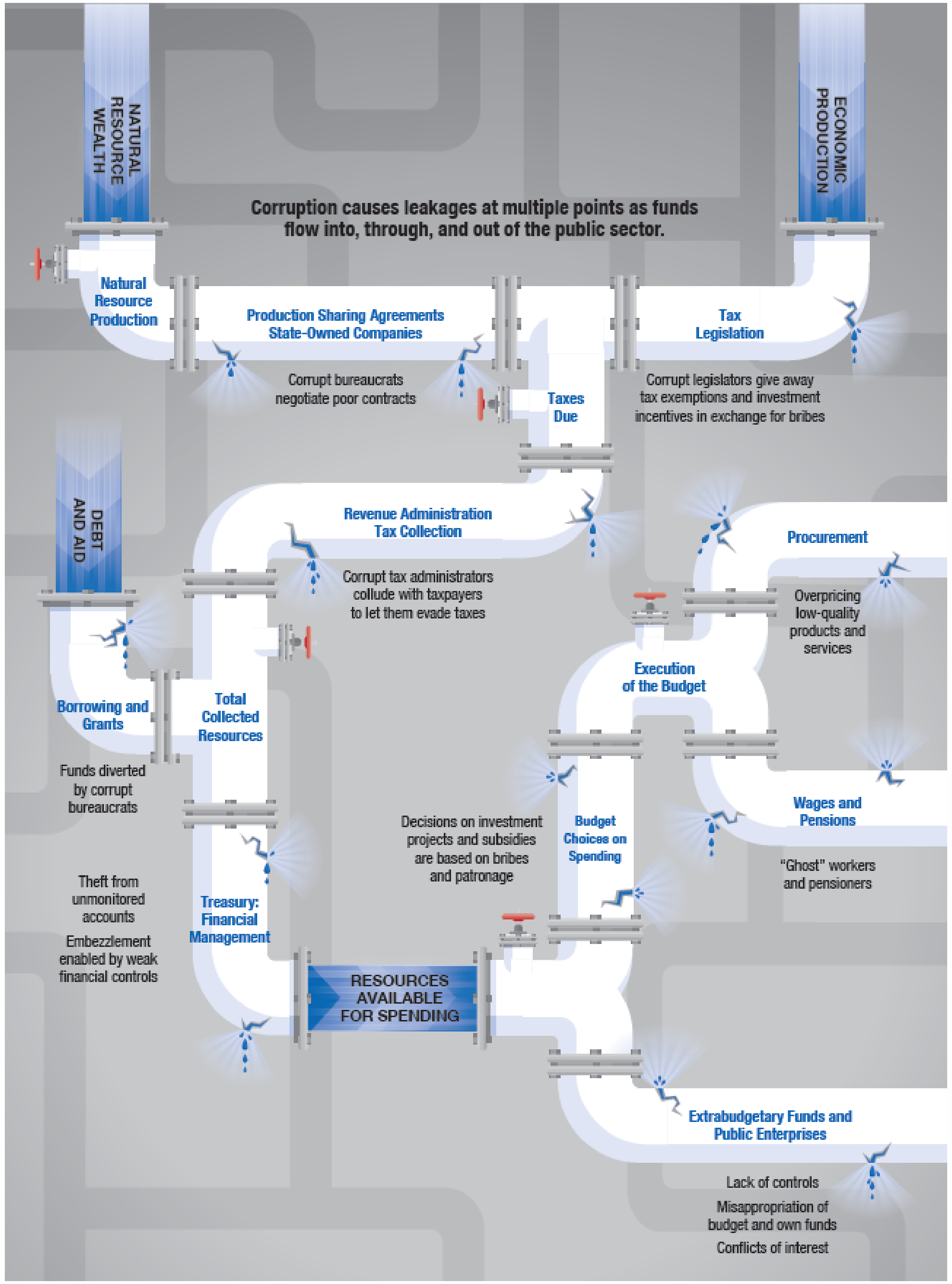
V. Accounting and Financial Reporting

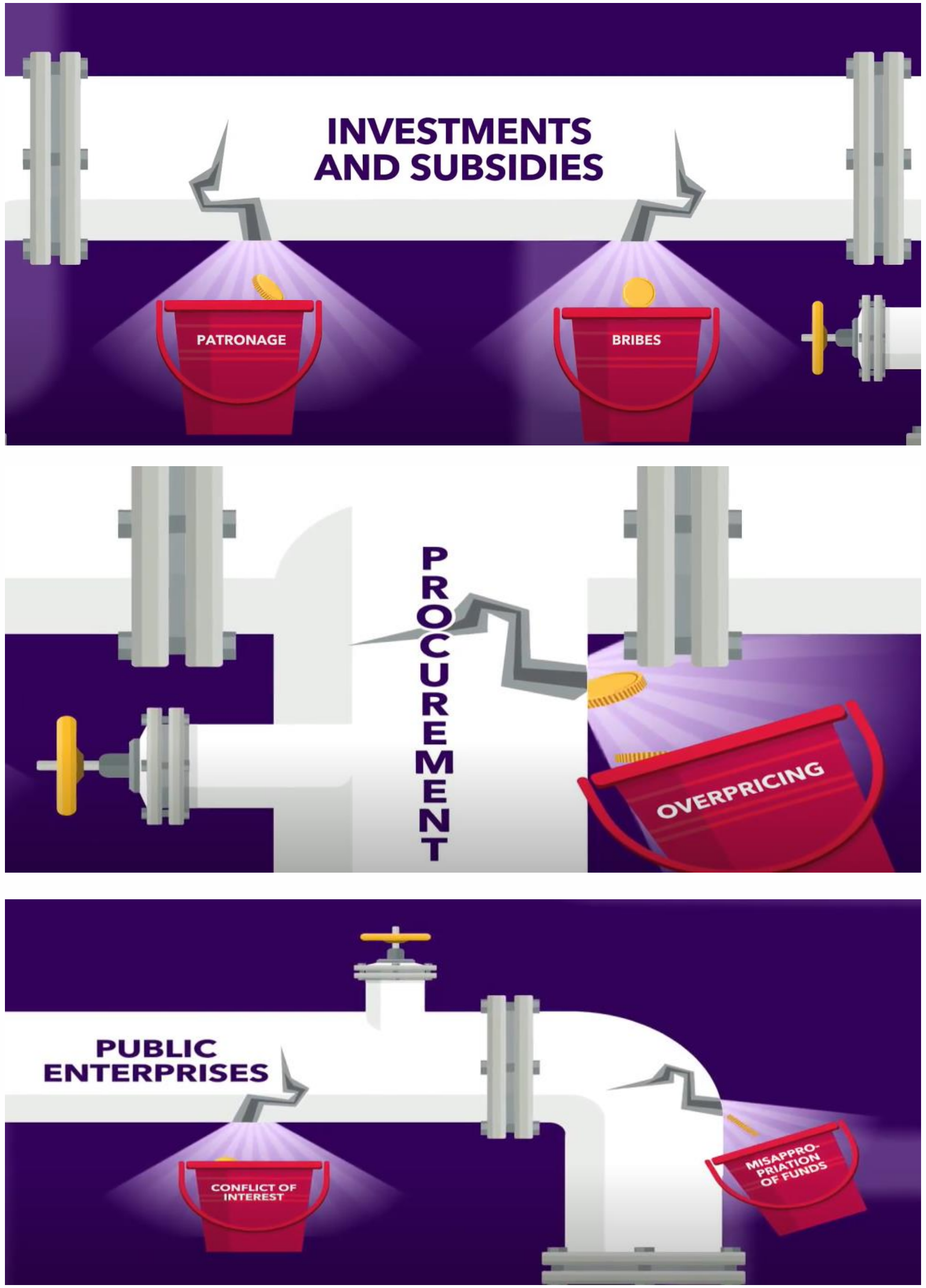
VI. Control and Audit

VII. Reforms

I

Fiscal Governance





Source: Fiscal Monitor-April 2019

Fiscal Governance: Identifying and Addressing Weaknesses

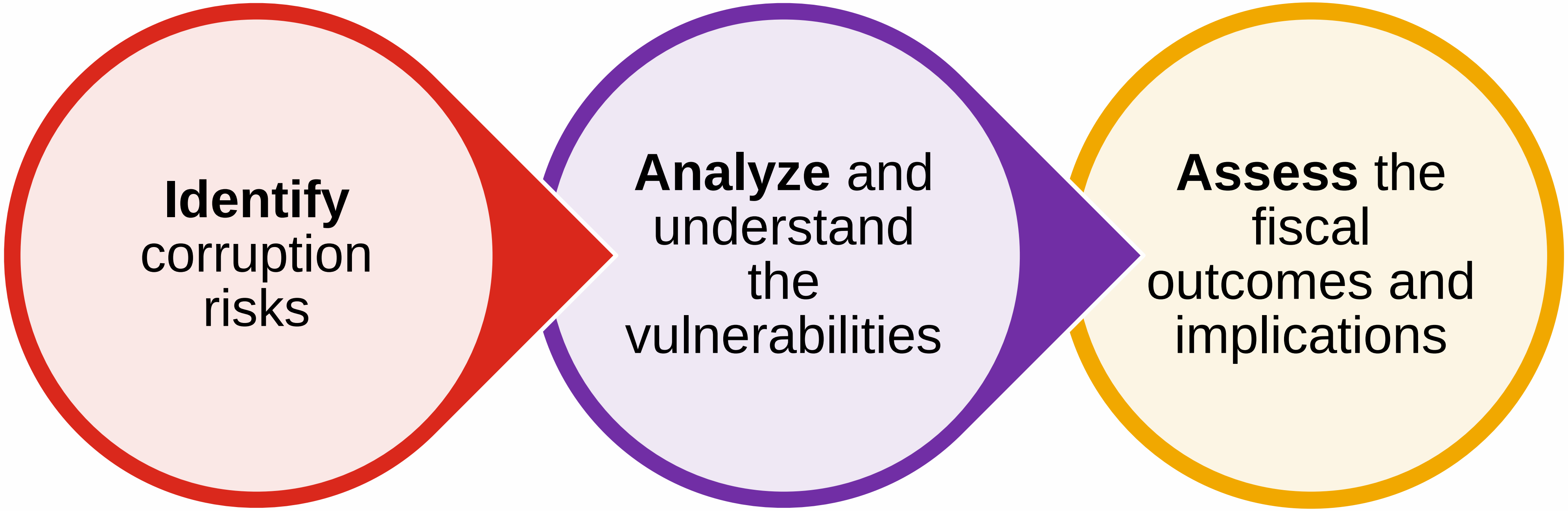
Fiscal Governance—Weaknesses in fiscal governance—the institutional frameworks and practices of the public sector (central government, subnational governments, and public corporations)—can have harmful effects in three areas:

- First, weak practices in **revenue administration**, including those arising from corruption, can weaken a state's ability to collect revenues, with adverse consequences for deficits, debt accumulation, and the ability to provide public services.

- Second, on the expenditure side, weaknesses in **public financial management** (including procurement) can generate inefficiencies and inflate costs. Moreover, corruption can distort expenditure choices away from those beneficial for inclusive growth and toward wasteful subsidies or hard-to-price projects that generate greater kickbacks.

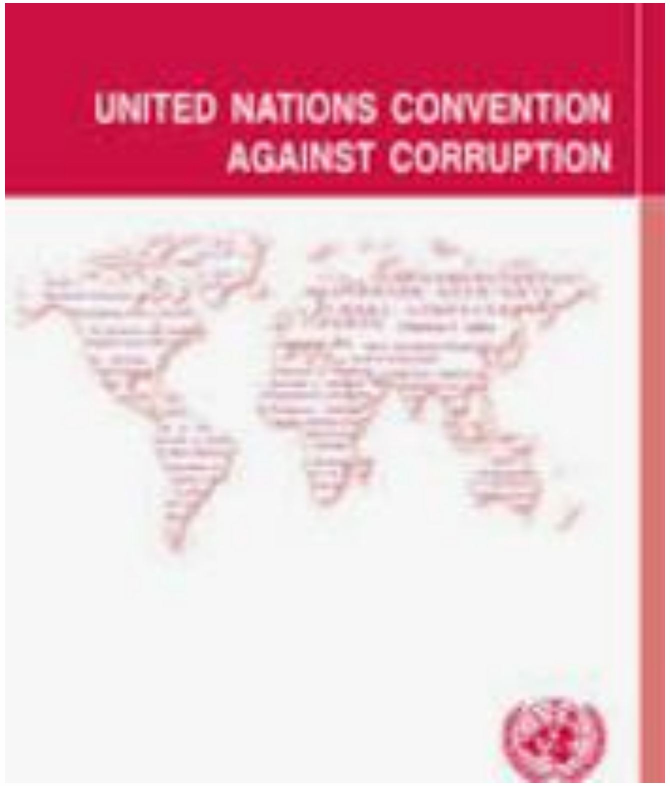
- Third, insufficient **fiscal transparency** can undermine accountability and provide opportunities for misappropriation of public funds.

How do we identify weaknesses and potential corruption risks to address them effectively?



Step 1: Identifying Corrupt Acts

The first step is to identify corrupt acts and understand the environment in which they occur. The United Nations Convention Against Corruption (UNCAC) defines corrupt acts in detail, particularly in Chapter III.



Two common forms, especially relevant to the PFM cycle:

1. **Bribery**: This includes rewards, loans, gifts, donations, special treatment, or services provided to influence decisions.

2. **Embezzlement and Misappropriation**: This occurs when officials steal from the state budget, extra-budgetary funds, or siphon off project resources.

Let me tell you a personal story ….

Step 2: Identifying Vulnerabilities

Vulnerabilities refer to weaknesses in systems, mechanisms, or processes that can be exploited to support or facilitate corruption.

Examining these vulnerabilities involves assessing factors like gaps in the PFM framework, weak controls, or specific features of a country's systems.

Red flags: Deviations from standard practices often indicate that PFM systems or processes are vulnerable to abuse.

Examples:

- Procurement process
- Collusion of contractors, authorities, auditors, SAI/General Prosecutor

Step 3: Identifying Corrupt Acts

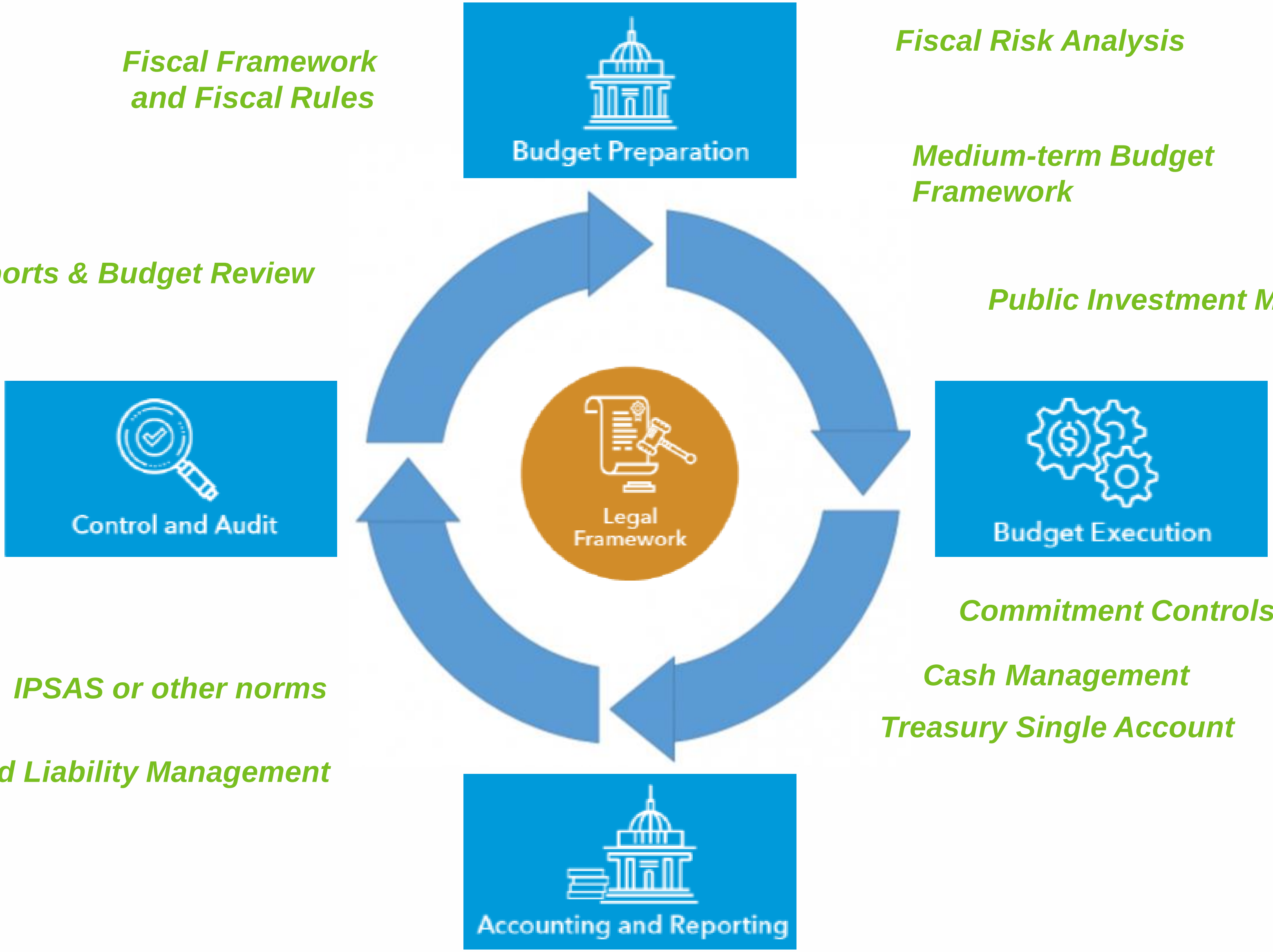
The final step involves evaluating the fiscal outcomes of corruption, which are the impacts or harm caused by corrupt acts and vulnerabilities within the PFM system.

Procurement: a corrupt act such as accepting bribes could lead to:

- Inflated costs of infrastructure projects, as bribe payers seek to recover their payments by overpricing bids.
- Use of low-quality materials, deficient assets and further increasing costs over time.
- Significant loss of public money

These actions ultimately cause significant resources lost; population needs unmet, fiscal outcomes significantly deviate from planned fiscal targets.

The Public Financial Management Cycle



Fiscal Framework and Fiscal Rules

Fiscal Risk Analysis

Medium-term Budget Framework

Public Investment Management

Commitment Controls

Cash Management

Treasury Single Account

Fiscal Reports & Budget Review

IPSAS or other norms

Asset and Liability Management

II

Governance and the PFM Legislative Framework

PFM Legal and Regulatory Framework

Legal Framework

- Constitution
  - PFM Act
    - Appropriation /Funding Acts
    - Revenue, Debt, Financing Acts
    - Other Entity Acts (Decentralized PFM)
    - Other related Acts (i.e. Procurement)

Examples of Red Flags that Create Governance Vulnerabilities in PFM Legal and Regulatory Framework

Governance Vulnerabilities: PFM Legal and Regulatory Framework

- Outdated (Legislation, Regulations & Instructions)
- Incomplete (Asset, Liabilities, Entities)
- Process rather than principle based
- Inconsistency between Acts (Roles, Responsibilities, Reporting)
- Weak enforcement
- Inadequate dissemination

III

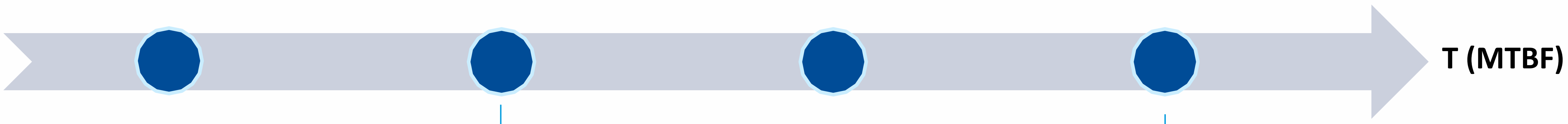
MTBF and Budget Formulation

Key Stages of Budget Preparation Process (Budget Calendar)

Budget Preparation

Develop and regularly update **macro-fiscal forecasts as a basis** to prepare an aggregate envelope for Public Sector Entities

Developing detailed **budget proposals** are **consistent with** available aggregate resources, sustainable implementation, equity, operational efficiency and mitigating fiscal risks



Strategic Budget Framework
Agreeing in a participative manner **the allocation of resources** to specific sectoral and program policy objectives, targeted outcomes and central/decentralized entities (t-3/4)

Preparing a transparent and accountable **medium term framework and annual budget proposal** for approval by the legislature

Potential Governance Vulnerabilities in Budget Preparation

Vulnerabilities	Macro-fiscal forecasts	Strategic Budget Framework Paper	Detailed budget costing and Budget Challenge	Budget Proposals for Legislature
Credibility of MTBF forecasts and link to budget				
Adequacy medium-term strategic planning framework				
Limited MoF oversight of the budget process & Calendar				
Inadequate Budget Methodology				
Weak Budget Challenge function				
Inadequate focus on performance & outcomes				
Lack of engagement and participation				

Examples of Red Flags that Create Governance Vulnerabilities in Budget Preparation

Governance Vulnerabilities: Budget Preparation

- Absence of a statutory budget calendar. Inadequate budget calendar
- Non-compliance with the legal framework (Content, Process, timeliness, coverage etc)
- Political manipulation of macro-fiscal forecasts Including chronic overestimation/underestimation of revenue, expenditure & financing
- Excessive unspecified expenditure in the budget
- Partisanship in budget allocations and expenditure classifications
- Undue pressure on government officials during budget preparation and discussion in parliament

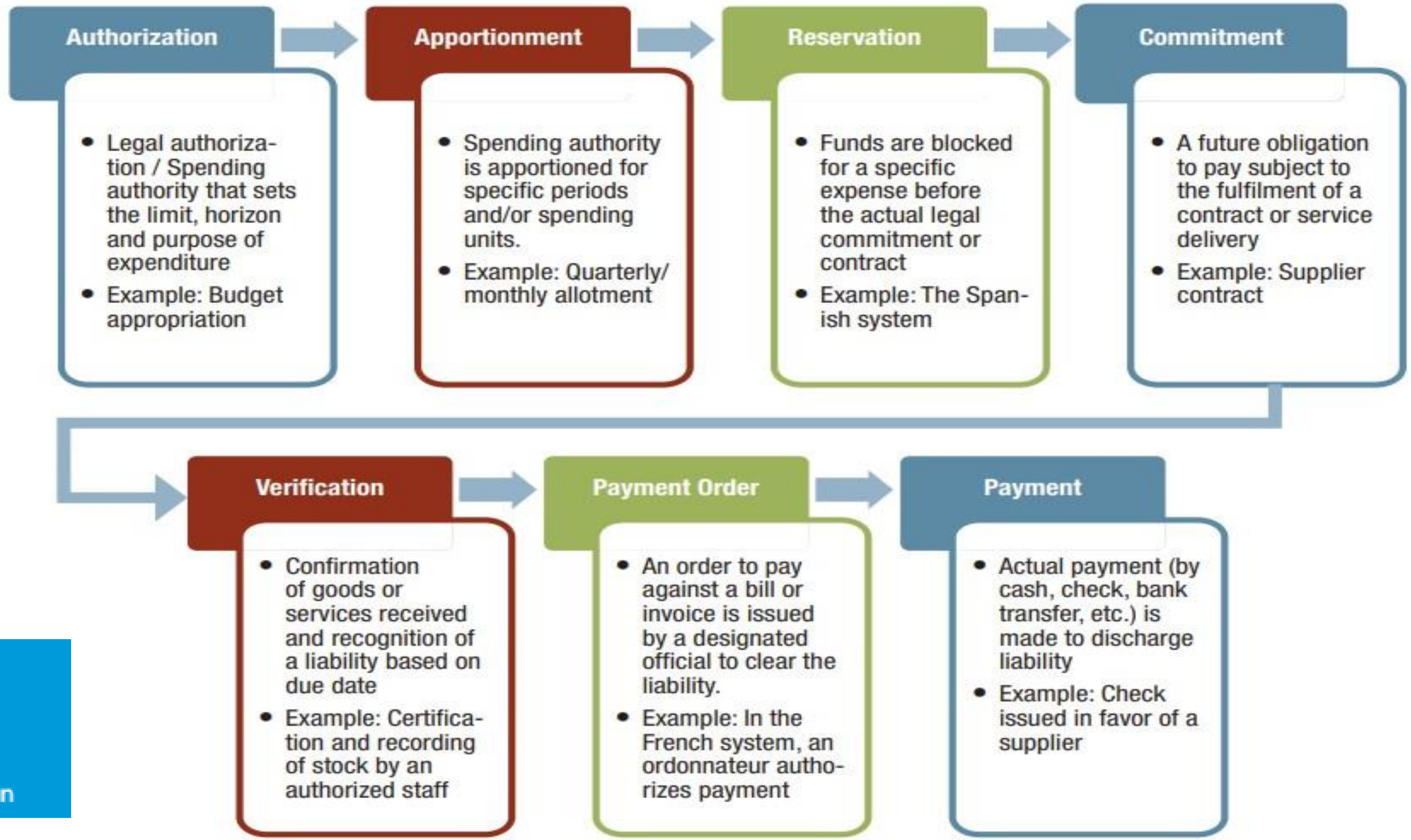
Implications of Budget Preparation vulnerabilities

- Significant deviations between planned budget and outturns
- Inflated costs in budget lines
- Creation of new budget lines that are not justified
- Higher than planned fiscal deficit and debt
- Increasing arrears

IV

Budget Execution

Stages of Budget Execution – Expenditure Cycle



Budget Execution

Source - S. Pattanayak, "Expenditure Control: Key Features, Stages, and Actions". IMF Technical Notes and Manuals (March 2016).

Potential Governance Vulnerabilities in Budget

Vulnerabilities	Authorization Cash flow Forecasting & Release	Procurement & Commitment Control	Verification and Recognition	Cash Management & Payment
Inadequate Action plans				
Inadequate/absent Procurement Plans				
Inadequate /absent funds release, commitment and cash flow forecasts				
Funds release shortfalls and delays, cash rationing and creation of arrears				
Inadequate or absent internal controls including commitment control, capital project expenditure and control of transfers				
Inadequate ICT based systems (Cash Flow Forecasting, Revenue Mobilization, IFMIS, Salaries, Procurement, Debt etc.)				
Inadequate staff structures , numbers and skills				
Inadequate treatment and management of Asset/Liabilities (Capital/Recurrent, Creditors/Debtors, Investments etc.)				

Examples of Red Flags that Create Governance Vulnerabilities in Budget Execution

Governance Vulnerabilities: Budget Execution

- Large discrepancies between the approved budget and Outturns
- Breaches in authorization, commitment or verification of spending, arrears buildup
- Procurement contracts bypassing the required stages and checks
- Unauthorized transfer of funds
- Overpricing of contracts between the private sector and the government
- Lack of required safety procedures and cybersecurity in IFMIS
- Lack of clear legal provisions in-year budget changes—virements, carry-overs or supplementary budgets

Implications of Budget Execution Vulnerabilities

- Inefficient and non-transparent use of resources
- Mis-procurement
- Over commitment, excess reservation and misallocation of resources
- Funding of non-prioritized expenditure
- Leakage of resources (taxes, payroll, contractors, beneficiaries)
- Creation of substantial arrears and other unfunded liabilities
- Inefficient asset and liability management including use of cash

V

Accounting & Financial Reporting

Key stages of Financial Reporting

Accounting and Reporting

1. Accounting Classification (GFSM 2024)
2. Recognition, Measurement & Valuation Standards
3. Accounting Systems (Rev, Exp, Assets & Liabilities)
4. Reconciliation Budget, Position Performance & Cash Flow
5. In- year Entity Reporting
6. Year End Entity Financial Statements
7. Year End Segment and Consolidated Financial Statements

Potential Financial Reporting vulnerabilities

Vulnerabilities	Chart of Accounts & Standards	Financial Systems	In year Reporting	Year-end Financial Statements
Nonstandard or uniform Chart of Accounts with partial entity coverage				
Undefined or incorrect accounting treatment (IPSAS) for flows stock and other economic transactions				
Non integration of source systems with general ledger (e.g. Debt, Revenue)				
Missing or inadequate source systems (Asset and Liability Management)				
Missing transactions and flows (Aid, Assets)				
Existence of material unreconciled balances or inter entity transactions				
Irregular and delayed production of in-year and year end financial reports and statements				
Incomplete consolidated accounts (Transactions, stocks or entities)				
Material audit qualification				

Examples of Red Flags that Create Governance Vulnerabilities in Financial Reporting

Governance Vulnerabilities: Financial Reporting

- Irregular or delayed production of in-year and year end Financial Reports
- Non-standard Chart of Accounts
- Incomplete financial statements (entities, stocks or transactions) and lack of comparative figures
- Unreconciled balances and suspense accounts (b/f, in-year, c/f) and inter entity transactions
- Aggregation rather than consolidation. Inconsistency between Financial Statements
- Lack of demand for financial reports. Non-publication of financial reports and statements

VI

Control and Audit

Types of financial oversight mechanisms

Audit bodies in the executive branch	Supreme Audit Institutions	Parliament and citizens
• Internal audit units provide assurance on an organization’s operations, in particular through independent evaluations of the effectiveness of internal control, risk management and governance processes.	• External audit - independent from the executive • SAIs hold governments accountable for how they use public resources on an ex-post basis.	• Parliamentary oversight is a core role of parliamentarians • Citizens and civil society organizations exercise public scrutiny.

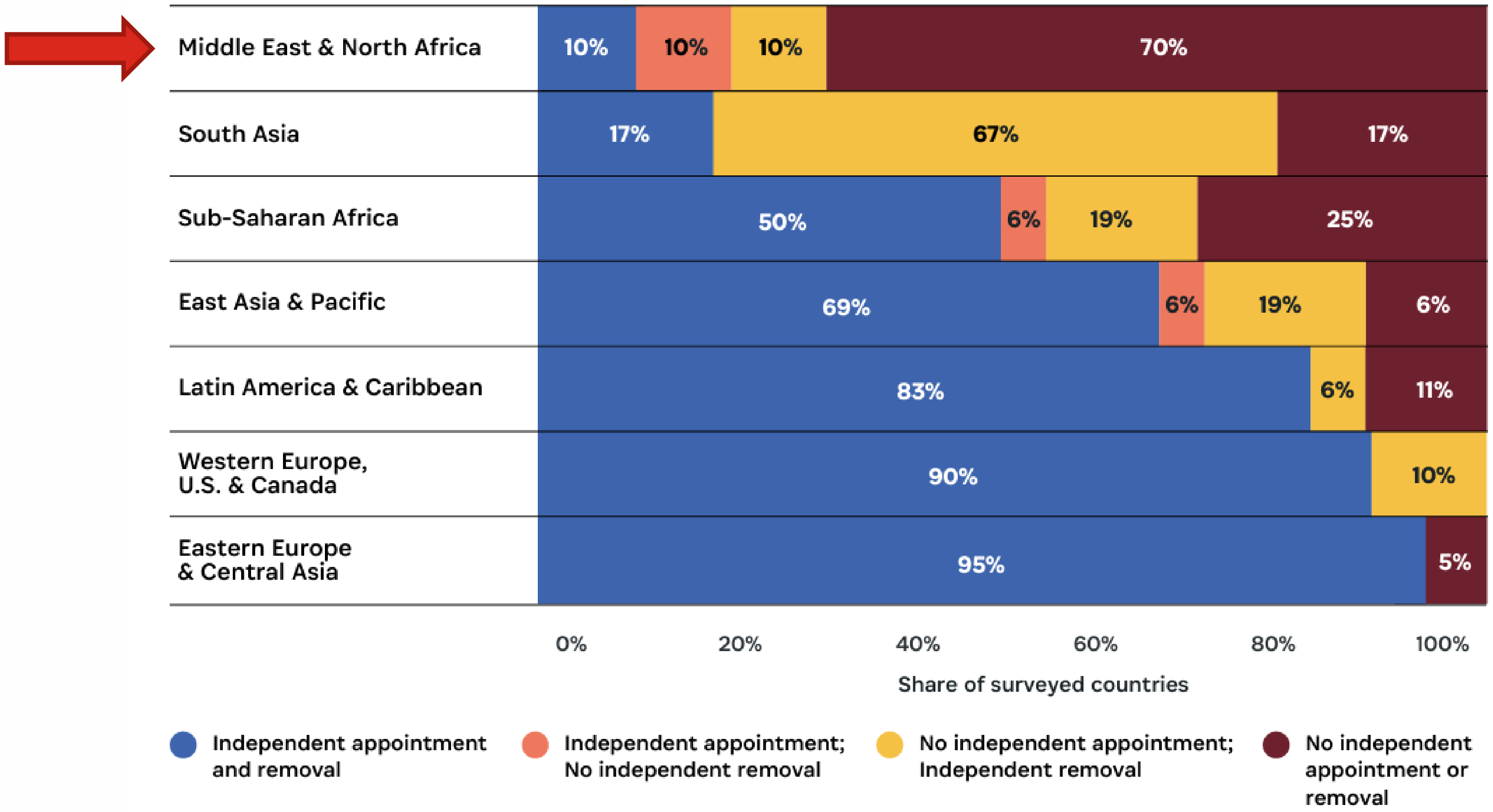
Vulnerabilities & Red flags

Governance Vulnerabilities: Financial oversight

- Lack of independence
- Weak capacity
- Lack of/deficient monitoring and reporting

- Provisions in the law do not guarantee independence of SAI Heads and staff
- Limited legal mandate to audit, limited discretion to select audit topics and decide on timing, limited access to information on budget execution
- Executive interference in the approval of SAIs budget
- Internal Audit units not independent from spending units
- No procedures to solve discrepancies between the audit unit and management
- Lack of financial and human resources
- No publication of SAI reports
- No submission of alleged corruption cases to judicial authorities
- No reporting from the internal audit unit
- No coordination mechanisms between internal and external audit
- SAI are politized, collude with bad actors.

Legal Independence of the SAI Head



Source: Supreme Audit Institutions Independence Index: 2021 Global Synthesis Report

Fiscal implications

- Financial mismanagement leading to waste of public resources
- Irregularities in budget execution (*irregular expenditures*)
  - No deterrent effect to prevent the mismanagement of funds
  - Irregularities and corruption not detected
  - Irregularities and corruption not sanctioned

VII

Reforms

Mitigating Governance Vulnerabilities and Supporting Anti-corruption Efforts

Institutional Framework (including anti-corruption)	Amendment to PFM related laws, adoption of new standards	Strengthened PFM practices: MTBF, PIM, procurement, commitment controls
Improved Control/Audit Frameworks	External Oversight	Public Disclosure of Fiscal Information
Civil Service Code of Ethics / Effective Sanctions	Safeguards on Extra Budgetary Funds	Digital Technology

Conclusion

- Addressing PFM governance vulnerabilities requires strengthening institutions, promoting transparency, and ensuring accountability.
- Benefits include higher revenue collection, reduced waste, better policies, and sustainable growth.
- Lasting success depends on investing in strong fiscal institutions and fostering a culture of good governance.