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PEFA FRAMEWORK ENHANCEMENT FOR BETTER MEASUREMENT OF COUNTRY PFM SYSTEMS

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Analytical Note 1: Environmental Changes to the PEFA Framework

Prepared by Frans Erik RONSHOLT

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LIST OF ABBREVIATIONS

DG	Directorate General
DSA	Debt Sustainability Analysis
ECFIN	DG for Economic and Financial Affairs
EITI	Extractive Industries Transparency Initiative
EU	European Union
GDP	Gross Domestic Product
IBP	The International Budget Partnership
IMF	International Monetary Fund
LIC	Low income country
MTEF	Medium Term Expenditure Framework
OBI	Open Budget Index
OECD	Organisation for Economic Cooperation and Development
PBB	Performance Based Budgeting
PEFA	Public Expenditure and Financial Accountability
PETS	Public Expenditure Tracking Survey
PEWG	Public Expenditure Working Group
PFM	Public Financial Management
PI	Performance Indicator
PIM	Public Investment Management
ROSC	Report on Standards and Codes
SC	Steering Committee
SIGMA	Support for Improvement in Governance and Management
WB	World Bank

1. BACKGROUND TO THE PEFA FRAMEWORK REVISION

The PEFA Programme's Phase IV 2012-2017 includes a comprehensive review and related revision of the PEFA Framework as one of its main activities. Review of issues with the PEFA Framework's design and application has already taken place on the basis of the extensive data material compiled from assessment in more than 140 countries. The review[1] has highlighted a number of basic issues to be dealt with during the revision:

- *Clarity* of the performance indicators, both in terms of incorporating as many as possible of the 220 official clarification issued by the PEFA Secretariat and addressing a few more clarity issues identified by the review;
- *Calibration* of the scoring requirements, both in terms of setting appropriate benchmarks and in ensuring a suitable progression from 'poor' towards 'good' practice[2];
- *Sub-dimensions,* where multiple scoring criteria in an indicator dimension leads to overload of requirements or inconsistencies in calibration;
- *Data availability* for some indicators, leading to high frequency of 'not rated' due to lack of data;
- *Obscurity* where the indicator does not measure what it is supposed to measure or has other serious shortcomings in content;
- *Performance Report structure*, as practice has shown issues with report length, overlaps between sections and inconsistent content of analysis in the reports.

In addition to these issues and following an external pre-consultation during the first half of 2012, eight 'environmental changes' (ref. Annex A) were defined by the initial stakeholder workshop on revision of the PEFA Framework, held in Washington DC on 25 September 2012. The implications for the Framework and how environmental changes could be reflected in the revision is the subject of this analytical note. Each of the environmental changes is discussed in chapter 2 below including options and chapter 3 makes recommendations for dealing with each of the 'changes' in the revision of the PEFA Framework.

The present analytical note does not address the above-mentioned basic issues, which will be addressed by the Framework revision, except where options for addressing an environmental change interacts with one or more of the basic issues. Consequently, this note does not attempt to consider all of the current PEFA performance indicators (PI) as several papers, notes, memos and commentaries circulated among the PEFA partners have already done so.

[1] Described initially in the paper "Revising the Performance Measurement Framework, Report to the Steering Committee", PEFA Secretariat September 2011

[2] The issue has been raised of whether the criteria for deciding the original calibration requirements across indicators corresponds to the core PFM functionality benchmarks established in Daniel Tommasi's Background Paper 2 to the "Good Practice Note on Sequencing PFM Reforms". For some considerations of this issue, please refer to Annex D below.

2. ENVIRONMENTAL CHANGES TO PEFA ASSESSMENTS

The first five of the environmental changes concern ways in which new or enhanced content may be added to the PFM Performance Report of a PEFA assessment. It may therefore be useful to first **explore the general scope and options for adding content to a Performance Report**.

PFM systems cover a wide range of subjects and sub-systems which ideally should all be assessed in detail when an overall PFM assessment is conducted. To do so would require a very comprehensive assessment tool with hundreds - if not thousands - of indicators. The PEFA Framework has been designed to be a manageable tool in terms of both the readability of the assessment report and the resource requirements for its application. On that basis the decision from the onset was to have a strict limit on the number of indicators, set an indicative limitation on the number of pages of the assessment report and focus on a broad overview of the most important aspects of PFM systems, even if this meant loss of details for individual sub-systems.

There are several ways in which a PFM sub-system or topic may be reflected in a PEFA assessment, including in order of visibility in the Framework:

- Coverage by indicators focused on the sub-system;
- Coverage by indicator dimensions (or sub-indicators) focused on the sub-system[3];
- Coverage by the narrative of standard Sections 1, 2, 3.8 and 4 of the performance report;
- Coverage in the analytical summary – The Summary Assessment section.

As there appears to be no appetite for any significant expansion of the Framework's *indicators*, the scope for adding content is rather limited in this way. Presumably one or two indicators may be added, but the justification of each one would need to be very strong as additional indicators affect the ability of the Performance Reports to provide users with a clear overview. It is also an approach that is likely to have immediate resource implications. There may also be an exceptional opportunity to replace an existing indicator, considered to have limited usefulness – some comments suggest that PI-23 may considered in that respect.

The indicator structure presently allows for up to 4 *dimensions* to be scored separately for each indicator, and then to be aggregated to reach a score for the entire indicator using aggregation method M1 or M2. This would theoretically allow for 31 x 4 = 124 dimensions compared to the current 76 indicator dimensions in the Framework. However, adding any new content through new dimensions is possible only for topics for which the relevant indicators have dimensional space i.e. where the current number of dimensions is less than four. Only four indicators currently have four dimensions (PI-12, 18, 19 and 27), so there is quite some scope for taking this approach. Adding content in this way would still have implications for the overview of assessment results and resource requirements, but less so than adding entirely new indicators. This approach was taken for two of the three indicators revised and re-issued in January 2011.

Sub-dimensions appear in two forms, (i) either as multiple and equally important requirements in an indicator dimension subject to combined or parallel calibration in the scoring criteria, or (ii) as lists of criteria, the fulfilled number of which will determine the indicator dimension score. In the case of lists, all criteria in the list may be treated equally and the score is determined by the number of criteria met

[3] Including coverage by sub-dimensions (sub-sub-indicators) through multiple requirements to be considered in scoring the indicator dimension – though this is usually not a desirable approach;

irrespective of which ones are met, or – alternatively - selected criteria may be considered mandatory for reaching certain score levels with additional criteria to be met among any of the remaining ones. Multiple, equally important sub-dimensions are used frequently across the performance indicators (e.g. PI-26i), whereas lists are relatively rare (only appearing in PI-6, PI-10 and PI-19). As the only one, dimension PI-19iv applies a list with a mixture of mandatory and non-mandatory criteria for scoring. There is in principle substantial – in theory, unlimited - scope for adding content through sub-dimensions, but this comes with a number of disadvantages: (i) differences in fulfillment of individual sub-dimensional requirements do not show up in scoring overviews, (ii) the different dimensions of an indicator may be unequally loaded with system coverage and related scoring requirements, which could result in the overall indicator score not appropriately reflecting the overall performance of the system, (iii) difficulties in easily showing performance changes over time e.g. when scores remain unchanged despite improvement in some sub-dimensions, and (iv) a proliferation of detailed scoring criteria with added length of the performance report and additional resource implications for assessment implementation. Ideally, sub-dimensions should be avoided – and eliminated to the extent possible, where they already exist.

When adding content to the Framework, it is important to consider the implications for tracking performance change over time. Addition of new indicators has no implications for tracking progress on existing indicators. Adding an indicator dimension with a new topic to an existing indicator will affect tracking at indicator score level, but the score for each dimension may be tracked separately. Change of standards may be introduced in a way that uses the same information as previously, but treats this information differently in reaching a score. Tracking over time will still be possible but the indicator scores are no longer directly compatible (this was the approach to changing PI-3 in January 2011). Where these approaches are not possible, tracking over time of the relevant PFM system performance will be lost, and this should only be the case where the current content of the indicator is seriously flawed (the approach taken to PI-2i and PI-19i & ii in the January 2011 reissue).

Adding content through the narrative chapters is only an option to a very limited extent. None of narrative chapters allow for measuring and scoring performance indicators, which is arguably the most powerful aspect of the Framework.

Section 1 provides background data to help define the assessment's coverage of the public sector and thereby the relative importance of some of the indicators. Sections 2.1 and 2.2 provide economic and fiscal context to the assessment, whereas section 2.3 offers the opportunity to explain in broad terms a range of factors that form part of the underlying causes for systems performance – though without going into details and being exhaustive - e.g. the extent to which certain requirements are laid down in legislation (constitution, laws, regulations) as well as the institutional and organizational framework for the PFM systems. Section 4 is focused on reform content, organization and implementation and is not suited to adding any content to the performance assessment.

Section 3.8 offers an opportunity to focus on a specific issue that is considered important in the country being assessed, e.g. by bringing together findings on indicators that relate to the issue and adding important information on the issue which is not called for by the standard indicators. The PEFA Framework lists three frequently occurring subjects[4], but no guidance has been issued on how to reflect any of those – or other - subjects in section 3.8. However, this section is rarely used in performance reports. The reasons could be (i) it is not a standard requirement so is skipped due to the assessment team's resource constraints, (ii) the TOR may not have demanded any specific issues to be covered in section 3.8, so it is not clear to the assessors what specific subject would be useful to present in more

[4] The three subjects are: "Sub-national governments", "Public Enterprises" and "Management of revenues in natural resource rich countries".

detail, (iii) the section lacks the power of an indicator to draw attention to its findings, (iv) the authors may have chosen to include the analysis in the 'Summary Assessment' section of the report where it is likely to get more attention, instead of section 3.8. There is substantial scope for enhancing the use of section 3.8, mainly by assessment planners/managers indicating in the TOR the country specific issues to be covered in the section, but also by providing guidance on how to conduct such an analysis on a number of frequently occurring issues and combining this qualitative analysis with the indicator findings in the overall summary assessment.

The 'Summary Assessment' section is supposed to be limited to 3-5 pages and serves two purposes: (i) to provide analysis that brings together the findings from the performance assessment in section 3 and explains the implications for the ability to achieve the three main budgetary outcomes, and (ii) to provide a short summary of the assessment findings, similar to an executive summary. These two purposes are to some extent conflicting. An executive summary should be very short and not include any information or analysis which is not already presented in the main body of the report. An analytical section that brings together the various findings from other sections to provide a holistic overview and indication of relative importance of issues will tend to be longer and include new analysis. Consequently, many performance reports include Summary Assessment sections of 10 or more pages in order to add explanation of the analysis of findings. This conflict could be resolved by separating an 'executive summary' (of say 2-3 pages) from a new, mandatory 'analytical overview' (of say up to 10 pages) – in combination with abolishing the optional section 3.8. The new analytical overview may be inserted as a new mandatory section between the current sections 3 and 4. Irrespective of which approach is chosen, there appears to be need for much better guidance on how to prepare and present the cross-cutting analysis and the summary.

In summary, addition of content to the PFM Performance Report could realistically take the following forms:

- Addition of a few, strongly justified performance indicators – or replacement of any indicator considered of limited value;
- Additional indicator dimensions on important topics where relevant indicators will have dimensional space – after any restructuring as a result of addressing the basic revision issues;
- Addition of criteria to sub-dimensional lists, where such lists already exist or where a currently complex indicator dimension may benefit from conversion to a list of criteria;
- Addition of qualitative assessment in the narrative parts of the report, either in section 3.8 or by separating an 'executive summary' from an 'analytical overview'.

2.1. Issues insufficiently covered in the PEFA Framework

Environmental Change identified: "Governance; transparency; accountability; longer term implications of[5] *the budget; asset and liability management; oversight (not only of financial statements); tax expenditures; non-tax revenues; internal control; internal audit: are insufficiently covered in the Framework, and need emphasis, either through improved language (which may have to be more sensitive to different heritages), or new dimensions".*

Since many different PFM subjects have been raised under this heading, this section discusses the justification and options for adding essential but missing content to the PEFA Framework.

[5] Based on the deliberations of the September 2012 workshop, this should probably have been listed as '… implications ***for*** the budget'.

Since its launch in 2005 numerous complaints have been received by the PEFA program from various sides as to the lacking coverage of individual sub-systems, with demand for more indicators to cover particular subjects. Such demands originate mainly from PFM practitioners and institutions that only or predominantly work on limited parts of the overall PFM systems. E.g. a typical demand has come from the procurement community suggesting that the coverage of procurement in the PEFA indicator is disproportionally low compared to other subjects due to 30-70% of budget expenditures being managed through procurement systems. Taking this approach into a wider context, an attempt is made to link all government financial flows to parts of the PFM systems and in turn to the coverage of those systems by the PEFA Framework, as illustrated in Annex B. A major problem is, however, that the relative importance of the individual types of flow varies considerably from one country to another and that balance sheet items also need to be considered. A rough indication of relative importance is included in the table, based on data from selected PEFA assessment reports. With these caveats in mind, Annex B nevertheless suggests that management of non-tax revenue and physical assets are areas that are relatively neglected in the Framework. Non-tax revenue is partially covered by PI-3 (if it is in the budget) and PI-7i (if it is not in the budget), whereas physical assets management is covered only by indicators that apply across all categories of revenue, expenditure and balance sheet items – ref. the three columns to the far right of the table – particularly by the very general internal control assessment in PI-20ii & iii. The systems for procurement, payroll and interface with the financial sector also have relatively low coverage, but do have dedicated indicators.

A different but also broad approach to identifying gaps in coverage of systems is taken by Daniel Tommasi[6] who identified the following gaps in the PEFA Framework:

a) Provisions in the legal framework: (i) whether the legal framework includes 14 specific provisions (Listed in Annex C); and (ii) whether these provisions are enforced.
b) Payroll system - For expenditure control, IT systems are theoretically desirable, but results are uneven. They require adequate capacity for supervising their development and maintaining them. At least computerizing the payroll will be cost-effective.
c) Existence of dual controls of payroll - Where the payroll is established centrally by the MoF, the payroll should be communicated to line managers to enable them to verify whether only their staffs are paid under their budgets;
d) Regularity of reconciliation of treasury and line ministries accounts - In Francophone systems, Treasury and authorizing officer accounts may differ significantly for the payment orders. Such a weakness should be addressed. Similar weaknesses may also concern some other countries;
e) Transparent and very limited uses of suspense account and special payment procedures - Extensive use of suspense accounts, or in francophone systems, payment before payment order procedure, reflects often poor budgetary controls. PEFA PI-22 deals with reconciliation, but in addition the volume of such transactions should be closely monitored;
f) Capacity to fully cost expenditures - PEFA PI-12(iii) mentions the recurrent costs of investment, but costing includes also capacity to forecast inflation, estimate the “true” cost of mandatory expenditures (e.g. student allowances), etc. It should be assessed whether such information feeds into the budget preparation process;
g) Capacity to prepare reliable revenue forecasts - PEFA PI-3 compares forecasted revenue to actual data. However, the realism of forecasted revenue depends on both technical capacity and political or human factors. Politicians often over-estimate planned revenues to show a low planned deficit;

[6] Ref. EU/IMF/PEFA: “The Core PFM Functions and PEFA Performance Indicators” by Daniel Tommasi, January 2013

h) Assets registers maintained and controlled - Expensive fixed assets potentially subject to waste and embezzlements should be registered. Fixed assets registers should be controlled by a person independent from the assets keeper. PEFA PI-20 (ii) deals with other administrative controls but for expenditures, assets are not mentioned;
i) Cash handling - Rules and systems should be in place to minimize cash handling in revenue collection and payments. New forms of electronic payment systems and spread of internet access and (more so) mobile phones make this more and more accessible to LICs;
j) Effective system of sanctions for non-compliance.

Of the gaps identified by Tommasi,

- Gap (a) touches the fundamental approach of the PEFA indicators, and individual PEWG task teams should consider if any of these features need explicit incorporation into existing indicators.
- Gaps (b) and (c) relate to details of payroll management which would be difficult to address in the Framework unless these aspects replace less important features currently included in PI-18 – due to lack of dimensional space. A consideration is that any other expansion of payroll management coverage could strengthen the case for a similar expansion of procurement coverage – doubling the pressure on limits to the number of indicators. Tommasi's proposal to include "computerization" is tricky to address in the Framework as this is an underlying capacity issue (ref. section 2.5 below), which would require definition of appropriate levels of computer use and software capability for each score level.
- Gaps (d) and (e) suggest additions to PI-22 which is a feasible suggestion.
- Gaps (f) and (g) relate to underlying causes for good or poor performance of certain PFM functions, which are not the focus of the PEFA Framework, ref. section 2.5 below.
- Gap (h) is a clear deficiency also highlighted by the analysis in Annex B to this note and needs to be addressed.
- Gap (i) also merits consideration as an addition, but to be complete it would need to cover the entire progression from cash payment, through cheque payment to electronic bank transfers.
- Finally, gap (j) may be considered as already covered by the existing PI-21iii, PI-26iii and PI-28iii, which are focused on the impact of the sanctions systems rather than existence and operation of the sanctions systems. Adding more details to the Framework in this area does not appear justified.

Going from these broader views of coverage to the specific items listed in the description of the first 'environmental change' and considering them one by one, the following points may be made:

a) *Governance*[7] is a very wide concept, going far beyond handling of financial resources. Whilst 'governance' includes government mobilization and use of financial resources, the concept typically covers broad subjects such as Voice and Accountability, Political Stability and Absence of Violence, Government Effectiveness, Regulatory Quality, Rule of Law and Control of Corruption[8]. Covering this wide range of subjects in the PEFA Framework would neither be practically possible, nor desirable. Selected issues may be added to PEFA where the implications for public financial resources are strong, but would then need narrowing down to the exact aspects of governance that would be relevant in assessing PFM systems. It would appear that

[7] According to the World Bank: Governance consists of the traditions and institutions by which authority in a country is exercised. This includes the process by which governments are selected, monitored and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern economic and social interactions among them.
[8] E.g. ref. World Bank's Worldwide Governance Indicators http://info.worldbank.org/governance/wgi/index.asp

those specific aspects are already covered by the Framework or included in the further issues of deficiency discussed right below.

b) *Transparency, accountability and oversight* may be considered together due to the close linkages between them. This is an area of particular importance to EU budget support operations. These issues are already relatively well covered by the Framework, including in PI-6, PI-10, PI-26, PI-27 and PI-28, and this coverage as concerns 'oversight' includes not only the financial statements. Nevertheless, there is scope both for expansion of coverage – particularly of publication of important documents in PI-10[9] – and for ascertaining that PEFA coverage and standards are well coordinated with other assessment tools in these areas (ref. section 2.6 below). One suggestion from the PEFA pre-consultation phase is to make use of the draft High-Level Principles on Fiscal Transparency, Participation and Accountability[10] which have been the focus of extensive preliminary consultations, and could provide a useful basis for the review and alignment of the PEFA framework to recent development in international standards.

c) *Longer term implications for the budget* – beyond the typical 3-5 year coverage of MTEFs - are currently covered only by debt sustainability analysis (PI-12ii), but this could be expanded to include analysis of longer term trends and forecasts related to e.g. demographically influenced entitlement schemes, developments in natural resource revenue or implications of major national investments. This is an area of more advanced reform and emerging good practice (further discussed in section 2.6 below).

d) *Asset and liability management* appears to be an area which is clearly underrepresented in the Framework and needs to be addressed by the revision – especially as regards assets as emphasized above.

e) *Tax expenditures* may currently to be covered by PI-7 in terms of whether they are presented in the budget or netted off (as unreported expenditures). It may be sufficient to improve the guidance in the Framework for this indicator to ensure that this item is always included in a PEFA assessment. More comprehensive coverage of how tax expenditures are managed would be difficult to incorporate without expansion of the number of PIs.

f) *Non-tax revenues* appear to constitute an area which is underrepresented in the Framework, as mentioned above. This is a particularly important issue in countries with high dependency on natural resource revenue where participation in joint extraction ventures, royalties and production sharing arrangements are common sources of revenue. It may therefore be sufficient to address this issue in countries where natural resource extraction is a major part of economic activity, ref. further under section 2.4 below. As domestic revenue mobilization is given emphasis in the EU Budget Support Guidelines, this may be an area for the EU to follow up during the Framework revision.

g) *Internal control* is covered by the PEFA Framework but is one of the indicators categorized as suffering from 'obscurity'. A thorough revision of PI-20 is therefore expected as part of the basic revision process and nothing further seems justified until a new version of PI-20 emerges from the task team work.

[9] PI-10 constitutes a list of criteria as discussed under "sub-dimensions" in the introduction to chapter 2 of this note. Any number of documents (criteria) could in principle be added to this list, but for the sake of consistency across the Framework, any additional criteria should concern either documents/reports already covered in other indicators for internal government or legislature's use (e.g. a budget strategy paper), or documents/reports produced specifically for the benefit of the public (such as a "citizens' budget" document).

[10] Ref.http://fiscaltransparency.net/

h) *Internal audit* is also covered by the existing Framework and is likely to be revised by the relevant task team. There is scope for adding content through a fourth dimension to the indicator, but further addition to the Framework beyond PI-21 does not appear justified. Both internal control and internal audit are areas in which the EU has expressed a strong interest of PEFA Framework enhancement.

2.2. Corruption coverage

Environmental Change identified: "Corruption: it does not seem appropriate to attempt to define an indicator (as the Framework is evidence-based), but this could merit a specific subsection in the Performance Report (supported by complementary guidance on which indicators may indicate the potential for corrupt practices)"

Corruption is a common feature in risk assessment frameworks for donors' provision of financial resources to partner governments through country systems – in particular in relation to budget support operations. However, PFM performance assessment or diagnostic instruments such as the PEFA Framework are not risk assessment tools, though their findings are routinely used as an input to risk assessments[11].

The description of the issue above already highlights that the development of a performance indicator for the PEFA Framework may not be appropriate. Three arguments support this view: (i) the PEFA Framework is evidence-based and collecting evidence on corruption (rather than perceptions) is inherently difficult and probably possible only through major surveys that would go far beyond resource allocations for PEFA assessments; (ii) only some aspects of corruption relate to PFM systems, as many corrupt practices do not have any direct impact on public resources (e.g. obtaining priority or speeding up services in many areas of service delivery, and other general governance issues); (iii) a PEFA assessment should represent a common understanding between many stakeholders on the performance of PFM systems as a basis for decisions on what weaknesses to address in reform programmes (typically the government and its development partners); introducing a controversial subject such as corruption in the assessment will complicate achievement of a commonly agreed Performance Report.

Due to the last mentioned argument, it may indeed not be desirable at all to include a specific sub-section on this issue. A better approach may be to address corruption in a separate report which could either be commissioned at the same time and to the same assessment team as the standard PEFA assessment, or be integrated into the work of a subsequent risk assessment.

Nevertheless, it would be useful in any of those cases to have guidelines that (i) specify what aspects of corruption interact with PFM systems and what aspects of corruption fall outside this scope, and (ii) highlight how relevant information from PEFA Performance Reports may be extracted and used for a corruption assessment.

A draft table addressing the second part of such guidelines was prepared by the World Bank and further edited by the PEFA Secretariat between 2006 and 2008 but was never finalized and issued. As the PEFA Framework has become widely used, it may now be an opportune moment to finalise such guidance. The guidance could be issued as an internal guidance note by one or several of the PEFA partners (e.g. the EU) without becoming an official PEFA document, as an official PEFA guidance on corruption assessment may negatively affect the PEFA Framework's standing among partner governments.

[11] Ref. further discussion in the 'Stocktaking of PFM Diagnostic Instruments' paragraph 7.9

2.3. Extractive Industries

Environmental Change identified: "Extractive industries; the sale of state resources; and 'effective institutions' are not covered by PIs, but may be captured in either the 'Summary Assessment' or in a (new) specific subsection in the Performance Report".

More than 50 countries derive more than a quarter of fiscal revenues directly from the natural resource extractive sector[12], with a number of others anticipating significant increases in the short-term. While current and prospective resource rich settings potentially enjoy significant "fiscal space" to finance public services and investments, there are on-going concerns about the effectiveness in collection of revenue and efficiency in allocation and use of the resources. Because revenues from extractive natural resources are non-renewable, capital scarce developing countries should be particularly concerned with the future economic prospects of creating productive domestic physical and human capital from the revenue of natural resource extraction as well as – with appropriate trade-off - the accumulation and maintenance of financial assets for spending at a time when the natural resources have been exhausted.

There are particular features of resource rich settings that create additional challenges for improving the quantity and quality of public finance management. Changes in actual resource extraction and international price levels can often put significant related pressures on the overall process of managing government resources. Additionally, resource rich countries often face challenges of absorptive capacity at the macro and micro level when seeking to scale-up public expenditure. Moreover, fiscal adjustments in the context of adverse shocks and poor natural resource revenue management can conversely compromise how the existing capital stock is maintained and the current project portfolio completed.

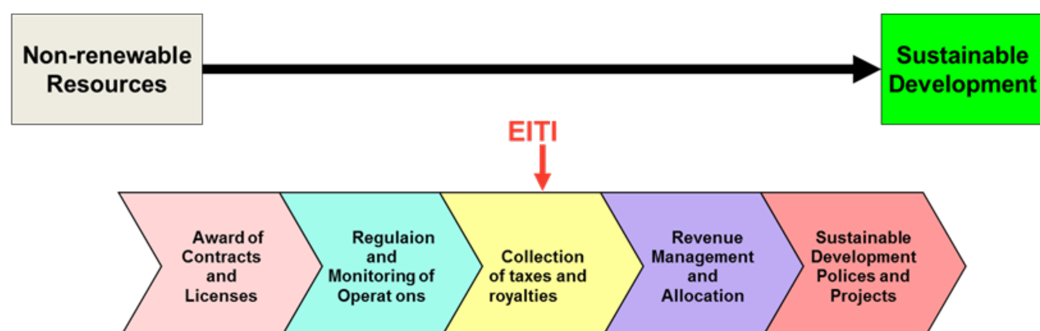
Resource rich countries appear to face a specific set of challenges. Resource rents accumulate mainly to the state (whether central, regional or local government), raising concerns of how these resources can be best allocated to present and future generations. Thus, the non-renewability and volatility of natural resource revenues poses a number of challenges for medium-term expenditure management. Spending volatility in particular can compromise effective public investment. The magnitude of these transactions and their technical complexity[13] provide a high exposure to risks of malpractice. In developing countries, this situation is often combined with a lack of technical capacity and political failure to address risks adequately. An extensive literature has developed on whether natural resource dependence/endowments are associated with disappointing development outcomes. While this conjecture continues to be debated, there is a growing consensus that the quality of institutions and the prevailing political-economy of both resource rent extraction and use is critical to determining the ultimate performance of individual governments.

Resource-rich settings can draw on a range of guidance to improve public financial management. The IMF's *Guide on Resource Revenue Transparency*[14] provides a comprehensive framework for assessing transparency and accountability across the whole value chain. The international Extractive Industries Transparency Initiative (EITI) has been focused on promoting greater transparency around the fiscal payments resource companies claim to make to governments, and those that governments actually receive. The World Bank has been strengthening its engagement in resource-rich countries to help meet

[12] Usually defined to cover hydro-carbon and minerals extraction
[13] E.g. in relation to defining taxable profits, transfer pricing, production sharing contracts, investment in public-private joint ventures.
[14] IMF 2007

their growth and poverty reduction objectives by adopting a comprehensive value chain approach (also called “EITI++”) in seeking to assist countries dependent on natural resources (see Figure 1).

Figure 1. Value Chain Approach to World Bank EITI ++ (Source: World Bank)



The need for additional background information and possibly performance indicators related to the specific circumstances in natural resource-rich countries has already been recognized in the original issue of the PEFA Framework – one of the main reasons for including a section 3.8 on ’country specific issues’ in the PFM Performance Report format. The PEFA assessment for Norway provided this special section on petroleum revenue management, whereas reports on e.g. Kazakhstan, Kuwait and Timor Leste have dealt with the issue by incorporating relevant elements in the background section and under individual indicators, but not in a uniform way. Providing guidance - and additional indicators, if justified – to ensure a more systematic and comprehensive coverage of the relevant aspects of natural resource revenue management would be very useful for PFM assessments in natural resource rich countries.

Issues that would need to be dealt with in a PEFA assessment in this respect include:

- Description of the public institutions involved in natural resource revenue management, their roles and responsibilities;
- The existence and operations of natural resource revenue funds, particularly the interface with the annual government budget;
- Transparency of fiscal policy, revenue collection and financial flows related to natural resource extraction;
- The provision for quasi-fiscal operations in extraction contracts or through related public sector institutions (such as providing public infrastructure or consumer subsidies as extra-budgetary operations, sometimes in-kind);
- Assurances of integrity in terms of data quality, internal controls and independent audit.

Whilst most of these aspects may already be covered to some extent in a PEFA assessment through the specified Performance Report sections and performance indicators, experience shows that there is need – at the minimum - for very specific guidance on how to deal with natural resource revenue in each part of a PEFA assessment, and – possibly needed for comprehensive coverage - the addition of one or two indicators to assess important aspects of natural resource revenue management which is not or only very indirectly addressed by the PEFA Framework today (particularly the non-tax revenue aspects). Any new indicators need to meet the same standards for specificity and evidence-basis as the PEFA indicators at large.

Such guidance and additional indicators would draw *inter alia* on the guidance and standards developed by EITI, IMF, and the World Bank as referred to above.

The special provision in a performance report and the additional indicators may be applicable only in countries where natural resource extraction constitutes a specified minimum share of GDP and/or government revenue. Such a feature would not be new since e.g. the PEFA donor indicators only apply in countries with significant donor operations, and the indicators related to sub-national governments similarly apply only where such governments exist.

2.4. Public Investment Management

Environmental Change identified: "Public Investment Management: as this is a sub-system within PFM and has a 'drill-down' tool, there could be a need for a new dimension in PI-11".

Public Investment Management (PIM) is a critical link in fiscal policy design. Traditionally, much of public spending goes to wages, current operations and debt service with limited growth impact. Poverty reduction and eradication is the ultimate goal of the EU's (and most other traditional donors') aid operations, and growth is a key to creating jobs and fiscal space for social welfare transfers. Therefore, public investment may be considered a key to achieving poverty reduction, but only if good decisions on investment choices are made, and assets are efficiently created, operated and maintained.

However, there is substantial evidence of inefficiency in public investment management regardless of country income level in terms of:

- Poor project selection (wasteful "white elephants") that do not transform into productive assets
- Unrealistic time schedules in ex-ante appraisal and consequent delays in completion
- Chronic under-execution of capital projects
- Cost over-runs
- Neglect to operate and maintain created assets

These weaknesses relate to a range of areas of concern in PIM systems including:

- Unduly political interference and corruption in PIM process
- Lack of objective criteria for project selection
- Unclear lines of responsibility and accountability
- Shortage of project appraisal, procurement and management skills
- Lack of coordination between different levels of government, across jurisdictions

Improvement of PIM systems needs to be seen as a distinct part of budget reform with specific processes and institutional arrangements. The World Bank has developed a PIM diagnostic approach[15] to address this issue. The PIM tool is based on eight 'must-have' features of efficient PIM systems – from project identification to post-completion evaluation. However, this approach has not yet been transformed into a PEFA-like drill-down tool with indicator scoring levels and requirements. A related development is the PIM Index developed by the IMF in 2011[16], which uses a four-component approach (closely aligned with the World Bank's eight 'must-have's') and draws information from a range of existing data sources, including PEFA assessments for the purpose of country comparison.

[15] World Bank 2010
[16] IMF 2011

At present the PEFA Framework only has one indicator dimension (PI-12iv) that specifically focuses on budgeting for capital investment – namely on the link between project selection and sector strategies combined with links between investment decisions and forward estimates of recurrent expenditure. Some other aspects are covered by PFM sub-systems that apply to public investments without being specifically focused on public investment, e.g. public investment management is influenced by the effectiveness of strategic planning at sector level (PI-12iii), debt contracting procedures (PI-17iii), procurement systems (PI-19), procurement planning and commitment control (PI-16ii and PI-20i), donor project interface (D-2) as well as general systems for budget management, treasury management and control/oversight systems[17]. And public investment implementation in turn impacts budget outturn (PI-1). Finally, the proposed inclusion of assets management in the PEFA Framework (ref. 2.1 above) may address some PIM inefficiency concerns.

However, the crucial PIM element of existence and application of comprehensive and transparent criteria for project selection and inclusion in the annual budgets is not well covered in the PEFA Framework. This important aspect of PIM would potentially fit into indicator PI-11 as an additional dimension either in its own right or as part of a new dimension covering the content of budget preparation guidelines. It could also be a replacement of the current PI-12iv. Jointly with the other PEFA elements listed above this would provide quite a comprehensive coverage of PIM issues.

The relevant aspect of PIM for PI-11 should link with the World Bank's PIM assessment approach. However, that tool does not have a scoring system such as the PEFA Framework. Whilst the subject of the proposed additional PEFA indicator dimension may be suggested by and linked to the PIM assessment approach, the scoring requirements would need to be developed from scratch.

2.5. Underlying capacity issues

Environmental Change identified: "Underlying capacity issues could be captured in a specific subsection in the Performance Report to avoid misunderstandings that might arise: for example, in PI-12 – where an 'A' rating is allocated even if the DSA is undertaken by an external stakeholder".

PEFA assessments measure if certain PFM functions are effectively performed to specified levels. Assessment of the capacity to undertake each of the PFM function would generally provide the reasons for better or poorer performance – depending on how 'capacity' is defined[18]. To include consistent explanation of underlying capacity issues in a PEFA assessment would require a much deeper diagnostic exercise than is currently the intension and practice, and should in principle cover all PFM functions that do not score an 'A'. Such a comprehensive diagnostic would require that the assessment team studies all issues related to capacity in the widest sense, identifies deficiencies and reasons for lack of success/progress in the related area, covering (i) the institutional rules of the game – both formal such as legislation, and informal such as the incentives for political action and civil servants job performance, i.e. include a political economy analysis; (ii) the institutional and organizational arrangements in place – such as reporting structures, working facilities and tools including physical infrastructure, vehicles, IT systems, manuals and related operational funding; and (iii) human resources in terms of numbers, skills, experience, etc. Such a detailed analysis would most likely double - if not triple - the resources needed to

[17] These are among the data extracted from PEFA assessment for IMF's PIM Index.

[18] Some authors refer to capacity as a human resource issue exclusively, measured in terms of staff numbers and their skills; others separate 'capability' from 'capacity' the former being the transformation into action of the latter; others – e.g. UNDP - consider capacity to be the all-inclusive "process by which individuals, organizations, and societies develop abilities to perform functions, solve problems, and set and achieve goals premised on ownership, choice, and self-esteem".

undertake an assessment, significantly extend the calendar time required to complete the work and correspondingly expand the size of an assessment report.

However, these underlying causes or capacity factors should be investigated at a later stage of the PFM reform cycle, namely during the design or review of the reform programme. The *Good Practice Note on PFM Reform Sequencing*[19] highlights many of the capacity factors (essentially covered by the scope of 'external factors' listed in the Good Practice Note, partly covered by details in its Annexes I and II). The advantage of dealing with underlying causes and capacity factors at this subsequent stage in the reform cycle is that the number of PFM functions for which the analysis may be needed will already have been narrowed down by the prior steps of identifying gaps in core functionality and other technical considerations leading to agreement on a sub-set of reform options for further analysis (ref. *Good Practice Note* para. 56).

The example of a capacity gap given in the explanation of this 'environmental change' refers only to one particular case and explanation, namely the common situation that the IMF and/or the WB are the driving forces in conducting DSAs in countries that have a current IMF programme. However, the PEFA Framework considers whether such analysis is conducted for and used by the government, not whom actually performs the technical work. Usually some government staff participate with the IMF/WB in conducting DSAs. Alternatively the government could have decided to contract the DSA assignment to a consultant or research institution (e.g. MEFMI in Zambia, Debt Relief International in the UK) which would lead to the same PEFA assessment results. There is no reason why a government should be penalized for having outsourced a piece of technical work, and Performance Reports often indicate where this has happened (PETS being another example).

There could be cases where a general comment on the government staff capacity and its relationship to the PEFA assessment results would be relevant. This could be the case in a fragile country where a large portion of the middle management and technical expertise in government is provided by long term technical advisers and short term consultants, whether local or foreign. In that case an explanation in the PEFA Performance Report may focus on the apparent contradiction between the general level of PEFA scores and the general stage of development in the country, highlighting the challenge for the government to simply maintain the overall level of performance during an anticipated transition process from reliance on foreign expertise to local consultants and finally to developing a local civil service[20].

In section 2.1 above it was mentioned that two of the gaps in the PEFA Framework identified by Daniel Tommasi, relate to underlying causes for good or poor performance of certain PFM functions, specifically gaps (f) and (g). These gaps focus on the capacity to forecast revenues and estimate the expenditure of service provision and other activities. The PEFA Framework could potentially include indicators on how the revenue forecasts and expenditure estimates are done - if there is agreement on what is good practice in this respect - which equates to having the capacity to undertake those functions in the widest sense of capacity.

In conclusion, assessing underlying causes for good or poor performance of individual PFM functions does not as a general rule belong in the PEFA Framework, neither in indicators nor in the narrative, unless the issue is of a very general nature affecting PFM functions across the board. Any further guidance on this subject should be addressed in connection with enhancing the *Good Practice Note on Sequencing PFM Reform* when some experience with the current version of the note has been gained.

[19] EU/IMF/PEFA and Jack Diamond, January 2013

[20] An example is Afghanistan where the PEFA scores in 2005 were relatively high across functions, due to the massive use of foreign personnel to run the government systems; an issue well noted by the responsible Afghan managers. Kosovo and Sierra Leone constitute similar cases.

2.6. Trends in defining ‘Good PFM Practices’

Environmental Change identified: “Whether (and to what degree) other PFM trends can be incorporated in the Framework, as some will develop and become accepted as ‘good practices’, while others will not”.

PFM practices are continually experimented with; some of those experiments are successful and the practices become widely adopted. Some of these practices eventually become codified and issued as international standards by international organisations following public consultations. In other cases certain PFM practices become accepted through extensive documentation and support by professional literature or in PFM-related tools widely used. This is typically the way internationally accepted ‘good’ practices develop. The PEFA Framework already draws on many such standards, but some of them develop over time and the related codification becomes updated[21]. To remain relevant to the majority of countries, the PEFA Framework needs to evolve accordingly or the Framework will run the risk of becoming irrelevant to an increasing number of countries. Countries will wish to see how they can make further improvements as their PFM performance scores reach ‘A’ and ‘B’ ratings in many areas, a particular issue for countries in the upper middle income group. At the same time, countries with less sophisticated PFM systems will be discouraged from using the PEFA Framework if they see that countries at a level of development they aspire to do not use the tool because they find it irrelevant. A comprehensive review and revision of the PEFA Framework - as the one currently underway – is the opportunity to introduce such new practices and benchmarks.

There are several ways in which recently established “good practices in PFM” may be reflected in the PEFA Framework:

- A radical approach would be to introduce more advanced practices or higher benchmarks of functions already in the Framework by adding a score level higher than ‘A’ – e.g. an ‘AA’ rating. Though this would represent a significant change to the structure of the scoring system, it would maintain the ability to track performance change over time as an additional higher scoring level leaves the remainder of the indicator intact. However, such an approach would only be useful if such a higher level could be defined for all (or at least, most) indicators. It is not clear that this would be possible at present and it would in any case require substantial resources and time, which may not be practical within the timeframe agreed for the current revision.
- A more realistic approach may be to reflect new “good practices” in existing indicators by adjusting scoring requirements, e.g. lifting the benchmarks for ‘A’ ratings. This approach would be feasible on any selection of indicators, but would affect comparability over time as e.g. countries that have achieved ‘A’ ratings in the past may no longer merit such a rating under the new criteria despite no change in performance. However, it may still be possible to assess if performance has changed.
- A third approach is to add a new indicator or an indicator dimension. Given the PEFA partnerships agreement on strict limitations on the number of indicators in the Framework, adding entirely new indicators is hardly desirable unless they replace an existing less relevant indicators.

During the review process a number of ‘new’ good practices have been raised as additional to the current Framework coverage, the most prominent being: performance-based budgeting (PBB), accrual accounting and impact for the budget of longer term developments (Ref. 2.1 above).

[21] Two examples of this nature are the IMF’s *Fiscal Transparency: Report of Standards and Codes (ROSC)* and the continually developing IPSAS accounting standards.

- Performance-based budgeting (sometimes less ambitiously referred to as Performance Informed Budgeting) is gaining widespread attention across countries of all levels of development, including in low income and lower middle income countries. Most OECD countries apply some aspects of PBB. It is also featuring significantly in the *Good Practice Note on Sequencing PFM Reforms* as one of the most important advanced reforms. The opportunity to incorporate this element of PFM in the PEFA Framework during the current revision should not be missed, unless it proves impossible to find indicator space and to reach agreement on what constitutes relevant indicator/dimensions and benchmarks.
- PBB is concerned with results and the linkages between outputs/outcomes in service delivery with the budget management process. The two indicators/dimensions that at present get closest to those aspects are PI-12iii (which is focused on sector strategies and their costing) and PI-23 (which is focused on ensuring that financial resources reach service delivery units). There is also a link to performance audit in PI-26i, but not as a feature that necessarily defines the rating of the indicator dimension, and PI-5 includes reference to programme classification which is often an element of PBB. The option with most potential for introducing results-oriented or performance-based budgeting in the Framework might be to restructure PI-23, which has been criticized for being flawed[22] or obscure[23] and therefore might be the subject of revision. The links to PI-5, PI-12iii and PI-26i should be strengthened in that process through guidance rather than changes to indicator structure and scoring criteria and requirements.
- Accrual accounting is likewise a subject of widespread application, but since this constitutes an accounting standard under IPSAS, it may be considered in a revision of the scoring requirements for PI-25ii or in the related guidance that in any case would benefit from being more specific on what constitutes 'IPSAS or corresponding national standards are applied' due to the numerous and evolving IPSAS standards of which some are cash-based and others accrual-based.
- Conducting analysis of the impact for the budget of longer term developments and disclosing such information is becoming a standard feature of PFM in most OECD countries, although the horizon of such analysis varies significant (from 25 to 90 years)[24]. As a result IPSAS is in the process of formulating a standard on this issue. Debt sustainability is one aspect of such analysis and as such the PEFA Framework already includes an element of this nature in PI-12ii. There are two ways in which long-term fiscal analysis could be enhanced in the Framework without adding a new indicator or dimension: (a) change PI-12ii to focus on the impact on the budget of additional long term trends and developments, rather than debt only – demographical changes, contingent liabililties and forecasts for natural resource extraction may be the most relevant aspects to add if specificity is required; (b) if IPSAS issues a final standard in this area, it could be incorporated in PI-25iii as one element in the criteria for an 'A' rating.

2.7. Synergies with existing assessment instruments

Environmental Change identified: "Synergies should be sought with existing instruments, for example, fiscal risks and the ROSC: Transparency with the OBI".

It is important that PFM assessment instruments apply the same standards in areas where they overlap, as different tools may otherwise result in conflicting messages about performance of PFM systems in a

[22] PEFA Secretariat, November 6 2012
[23] SECO/IBR/Fiscus memo of September 2012
[24] Ref. OECD 2009

country. The PEFA Framework was originally developed by drawing on a series of widely accepted tools and standards. As the PEFA Framework and other tools develop, such coordination of standards needs to continue (ref. sections 2.1 and 2.6 above).

A study undertaken for the PEFA Secretariat as a contribution to work of the PFM Task Force of the Working Group for Aid Effectiveness[25] focused on the existence, hierarchy, complementarity and overlap of PFM diagnostic Instruments[26]. The study in particular noted several tools with a substantial degree of overlap with the PEFA Framework, including the IMF's Fiscal Transparency ROSC, the Commonwealth Secretariat's PFM Self-Assessment Toolkit, the International Budget Partnership's Open Budget Index and the OECD's Budget Practices and Procedures Database[27]. With the exception of the Commonwealth Secretariat's toolkit, which is apparently no longer in use, the other instruments are being updated periodically. As there is significant overlap in both country application and subject matter, it is important that standards and good practices in these instruments are aligned. Otherwise, the standards and practices that are internationally accepted would be undermined.

Whilst there is a particularly high degree of overlap between the PEFA Framework and the Fiscal Transparency ROSC, there are several other instruments that likewise cover the areas of transparency, oversight and accountability[28]. Those areas would therefore be particularly important to focus on in terms of alignment of standards. These are also areas of particular interest for the EU as they relate to the budget support eligibility criteria.

Each instrument has been developed for its own purposes and institutional use and implementation modalities differ substantially for some of the instruments. This limits the potential for merging overlapping instruments. Nevertheless, there is potential for harmonizing the application of these instruments in order to reduce the related transactions costs, particularly for the national governments being subject to assessment. Synergies between assessment tools that significantly overlap with the PEFA Framework should be explored, therefore, by coordinating the assessments in terms of joint data collection and joint teams or well-timed sequence of assessment, so that one assessment draws on the data and findings of the preceding one.

2.8. Boundary between the Government Sub-sector and the entire Public Sector

Environmental Change identified: "The boundary between the Government sector and the Public Sector may need to be redefined for the purpose of an assessment".

The PEFA Framework is quite flexible on how the boundary of 'the government' is set for the assessment – but the decision needs to be clearly explained in the Performance Report. It may focus on central government only – the most common approach, or on sub-national government at a certain level, on sub-national government at all levels combined, on one specific sub-national government, or - the most comprehensive approach – the entire general government sector.

[25] Managed by the OECD's Development Assistance Committee
[26] 'Stocktaking Study of PFM Diagnostic Instruments', OECD/PEFA 2011.
[27] The EU's PFM Assessments undertaken by SIGMA and DG ECFIN's Operational PFM Assessments are also mentioned but are not indicator based assessments.
[28] This includes Performance Assessment Framework for Supreme Audit Institutions, being developed by INTOSAI and currently in an advanced draft version.

Irrespective of the option adopted for an assessment, the government sector is supposed to be defined according to the principles established in the GFS 2001 Manual[29]. Other parts of the Public Sector – i.e. outside the government sub-sector – comprise financial and non-financial public corporations which are established under different legislative provisions from government units, operate mainly on commercial principles and depend mainly on revenue obtained from selling their goods and services (even if government subsidies are also provided).

The implications of public corporations on government finances stem mainly from (i) dividends being due to the government from corporate profits, (ii) subsidies made to the corporations by the government, (iii) quasi-fiscal operations undertaken by the corporations on government demand, (iv) on-lending and guarantees issued for loans to public corporations. In addition to regular transfers of dividends and subsidies, these relations between public corporations and the government sector may give rise to contingent liabilities and potentially a future demand on the government treasury.

The PEFA Framework covers the relationship with public corporations through the requirement to describe the public sector and the boundaries for the assessment of government in chapter 1 of the performance report, by requiring an assessment of non-reported extra-budgetary operations (in PI-7i) which e.g. includes quasi-fiscal operations, and by assessing oversight of the public corporations' financial reporting (in PI-9i).

Whereas the principles of how the boundary is fixed in the PEFA Framework should be quite clear, experience has shown that (i) the PEFA Framework may not adequately cover the PFM systems that should manage these relationships and (ii) some practical problems have been a challenge to many assessors, such as:.

- the often inadequate description in Section 1 which results in lack of understanding of the extent of public corporations in terms of number of entities and economic importance as well as the financial flows between the government and the public corporations;
- lack of readily available data to determine if an entity is a government unit or a public corporation;
- uncertainty on how to treat public-private partnerships;
- the lack of a checklist on what counts as extra-budgetary operations to be covered by indicator PI-7i – resulting in very varying coverage across assessments;
- the rather crude requirements listed for scoring of PI-9i.

There is, therefore, need for improved guidance as well as more specific data and scoring requirements to be inserted in the PEFA Framework, but hardly any need for additional indicators or narrative sections.

[29] IMF, Government Finance Statistics Manual 2001

3. Recommendations

3.1. On integration of the environmental issues in the Framework revision

(i) Issues insufficiently covered in the PEFA Framework

There is a strong case for pursuing improved coverage of 'assets management' and 'management of non-tax revenue', even if this should require an expansion of the PEFA Framework. Non-tax revenue is particularly relevant to countries with important natural resource extraction.

Given the emphasis on 'transparency, accountability and oversight' in the EU Budget Support Policy and the existence of other assessment tools that cover these areas, it would be useful to revisit the PEFA Framework coverage and standards in those areas from a holistic point of view.

Other suggested gaps may be addressed by task teams when reviewing the existing indicators one by one, particularly PI-20 and PI-22, and in this process decide if explicit reference to coverage in the legal framework should be incorporated into the indicator (ref. Tommasi's list in annex C).

(ii) Corruption coverage

Aspects of corruption that are facilitated by weak PFM systems or impact PFM systems may be identified from PEFA assessments and should be the subject of separate analysis outside PEFA performance reports, potentially incorporating other sources of information on corruption. Guidance should be developed for that purpose, but preferably not as guidance issued by the PEFA Programme.

(iii) Extractive Industries

Guidance should be issued on how to incorporate natural resource revenue management into the PEFA Framework, and if necessary one or two performance indicators should be developed and added to the PEFA indicators, but be applicable only in countries where natural resource extraction exceeds a certain percentage of GDP, ref. also recommendation (i) above.

(iv) Public Investment Management

PIM systems compete for coverage in the PEFA Framework with the subjects listed under (i) above. An additional indicator dimension could be incorporated in PI-11 – unless this space is better used for a more important addition – and could focus on the existence and use of criteria for selection of projects to include in the annual budget. Such a change may affect the existing PI-12iv.

(v) Underlying capacity issues

PEFA assessments measure if certain PFM functions are effectively performed to a specified level. Assessment of capacity factors that may provide the reasons for better or poorer performance would significantly expand PEFA assessments and should be avoided. The *Good Practice Note on Sequencing PFM Reform* highlights many of the capacity factors (both political and technical factors) and any additional guidance could be provided through future updates of that guidance material.

(vi) Trends in defining 'Good PFM Practices'

To remain relevant to the majority of countries, the PEFA Framework needs to evolve as new PFM systems standards emerge. In order to enable ability to track performance change over time, more advanced practices of functions already in the Framework may be introduced by adding a score level higher than ‘A’ – though this would represent a significant change to the structure of the scoring system and probably not be appropriate during the current revision process. It would be more practical to redefine the requirements for an ‘A’ rating to incorporate emerging higher standards, where appropriate. Practices that are not already in the Framework may be introduced by adding a new indicator. The subjects that are most relevant to consider are: performance budgeting, accrual accounting and the fiscal impact of longer-term developments.

(vii) Synergies with existing assessment instruments

It is important that PFM assessment instruments apply the same standards in areas where they overlap, as different tools may otherwise result in conflicting messages about performance of PFM systems in a country. The PEFA Framework was originally developed by drawing on a series of widely accepted tools and standards. As the PEFA Framework and other tools develop, such coordination of standards needs to continue. An area of substantial overlap is transparency, oversight and accountability where focus would be on IBP’s OBI, IMF’s Fiscal Transparency ROSC, INTOSAI’s SAI Performance Measurement Framework, OECD’s Budget Practices and Procedures Database and the High-Level Principles on Fiscal Transparency, Participation and Accountability.

Synergies between assessment tools that significantly overlap with the PEFA Framework should be explored by coordinating the assessments in terms of joint data collection and joint teams or well-timed sequence of assessments, so that one assessment draws on the data and findings of the preceding one. This coordination is best performed at the country level, with the country government leading the coordination efforts.

(viii) Boundary between the Government Sub-sector and the entire Public Sector

PEFA performance reports in general need to be more specific on the structure of the public sector and what is covered as the ‘government sector’ by the assessment as well as quantification of the part of the public sector that is not covered by the assessment. Improved guidance and more specific data requirements should be inserted in the PEFA Framework in this respect.

The ***overall, recommended approach*** to dealing with the eight environmental issues may be summarized as follows:

- Strengthening of the indicator set to cover public assets management and management of natural resource revenue should be pursued, even if it requires a (minor) expansion of the number of performance indicators;
- Within the current number of performance indicators, the available space for adding indicator dimensions may be utilized to provide additional important content, e.g. on public access to information (PI-10), public investment management (PI-11/12), payment system and account reconciliation (PI-22) and performance based budgeting (potentially replacing PI-23);
- Update of good practice standards for subjects already covered to a reasonable extent should form part of the work of the task teams, considering updating indicator by indicator.

- The narrative sections of the Performance Report would need strengthening in relation to description of the structure of the public sector and the boundary of 'government' for the assessment, including where relevant public institutions involved in natural resource management.
- Corruption assessment, underlying causes for performance and synergies with other assessment instruments should be addressed through additional technical and process guidance outside the PEFA Framework proper.

3.2. Further technical notes to be prepared

The following technical notes should be considered for the further work on PEFA Framework Enhancement in relation to the eight environmental changes:

a) Detailed options for incorporating assets management in the PEFA Framework;

b) Detailed options for incorporating payment systems and additional aspects of accounts reconciliation in the Framework;

c) Coordination of standards with broad overlapping assessment tools – particularly in the area of transparency, accountability and oversight.

d) Guidance on how to assess PFM related aspects of corruption from a PEFA assessment.

e) Incorporating management of natural resource revenue into PEFA Framework with detailed proposals for guidance and – if needed - for 1-2 additional indicators applicable only to natural resource rich countries.

f) Strengthening coverage of public investment management with detailed proposals for an additional indicator dimension to PI-11 or replacement of PI-12iv.

g) Proposals for strengthening description of the public sector and government sub-sector in Section 1 of the Performance Report.

h) Analysis of the links between PEFA assessment and PFM reform including coverage in the Good Practice Note on Sequencing PFM Reform of capacity factors and underlying causes for performance and recommendations for improvements as required[30].

i) Restructuring the 'Summary Assessment' of a Performance Report with recommendations on where and how analysis should be undertaken of issues and topics covered across multiple indicators, including some of the 'environmental changes'.

Some of the general recommendations for the approach to the 'environmental changes' - and the related recommendations for additional technical notes - relate to specific indicators or indicator clusters, e.g. the recommended technical notes (a), (b) and (f). They therefore fall within the responsibilities of individual PEWG task teams. But for the most part, reflecting the 'environmental changes' in the revised PEFA Framework requires work that cuts across the responsibilities of the task teams as currently assigned. It therefore needs to be decided if any task team – or the core PEWG itself - will be assigned responsibility for review of cross-cutting content, including for review of and changes to the narrative sections of the PFM Performance Report.

[30] This note may also review the setting of score benchmarks for core PFM functionality, ref. Annex D below.

ANNEX A. LIST OF 'ENVIRONMENTAL CHANGES'

LIST OF 'ENVIRONMENTAL CHANGES' IDENTIFIED AT THE INITIAL PEFA STAKEHOLDER WORKSHOP ON 25 SEPTEMBER 2012

(i) Governance; transparency; accountability; longer term implications of the budget; asset and liability management; oversight (not only of financial statements); tax expenditures; non-tax revenues; internal control; internal audit: are insufficiently covered in the Framework, and need emphasis, either through improved language (which may have to be more sensitive to different heritages), or new dimensions;

(ii) Corruption: it does not seem appropriate to attempt to define an indicator (as the Framework is evidence-based), but this could merit a specific subsection in the Performance Report (supported by complementary guidance on which indicators may indicate the potential for corrupt practices);

(iii) Extractive industries; the sale of state resources; and 'effective institutions' are not covered by PIs, but may be captured in either the 'Summary Assessment' or in a (new) specific subsection in the Performance Report;

(iv) Public Investment Management: as this is a sub-system within PFM and has a 'drill-down' tool, there could be a need for a new dimension in PI-11;

(v) Underlying capacity issues could be captured in a specific subsection in the Performance Report to avoid misunderstandings that might arise: for example, in PI-12 – where an 'A' rating is allocated even if the DSA is undertaken by an external stakeholder;

(vi) Whether (and to what degree) other PFM trends can be incorporated in the Framework, as some will develop and become accepted as 'good practices', while others will not;

(vii) Synergies should be sought with existing instruments, for example, fiscal risks and the ROSC: Transparency with the OBI;

(viii) The boundary between the Government sector and the Public Sector may need to be redefined for the purpose of an assessment.

ANNEX B. FINANCIAL ELEMENTS OF CENTRAL GOVERNMENT OPERATIONS

System/Actor Flow classification	Magni-tude, range of total flow	Tax Admin	Central & MDA revenue admin	Payroll manage-ment	Procure-ment systems	Debt Manage-ment	Assets manage-ment	SOEs & SNG oversight	Donor Interface	Financial Sector interface	Budget Management (planning, execution, reporting)	Treasury Manage-ment	Internal control & external oversight incl public
INFLOW	45-50%												
Tax Revenue	25-40%	X									X	X	X
Domestic Non-Tax Revenue	2-20%		X					X			X	X	X
External Grants	0-25%								X		X	X	X
Debt contracting	5-20%					X			X	X	X	X	X
OUTFLOW	50-55%												
Salaries/Wages	10-20%			X							X	X	X
Recurrent goods & services	15-25%				X				X		X	X	X
Capital Investment	5-20%				X		X		X		X	X	X
Grants/subsidies	10-25%							X			X	X	X
(On-) Lending	0-5%					X		X			X	X	X
Debt Service	0-10%					X				X	X	X	X
BALANCE SHEET													
Liabilities	n.a.					X		X		X	X	X	X
Financial assets	n.a.	X					X	X		X	X	X	X
Physical Assets	n.a.						X						X
Current PEFA Coverage		PI-13 PI-14 PI-15	(PI-3)	PI-18	PI-19 (PI-10)	PI-4 PI-12ii PI-17i & iii	(PI-20)	PI-8 PI-9	PI-7i D-1 D-2 D-3	PI-17i & ii	PI-5, PI-7 PI-11, PI-12 PI-1, PI-2 PI-3, PI-4 PI-22, PI-23 Pi-24, PI-25	PI-16 PI-17ii	PI-20 PI-21 PI-6 PI-10 PI-26 PI-27 PI-28

ANNEX C. Core Features of the Legal Framework Not covered by the PEFA Framework

The legal framework should include, among others, the following provisions – according to Daniel Tommasi in Background Paper 2 to the Guidance on PFM Reform Sequencing:

1) Specify the date by which the budget should be adopted by the legislature, and procedures if this is not met.
2) Comprehensiveness of the budget, enhanced data presentation in the budget documents.
3) Appropriation management rule that limit the freedom of the executive to make shifts between appropriations, without parliament's approval, in order to ensure that the policies stated in the budget will be effectively implemented.
4) Authority to contract loans and grant guaranteed. Procedure to submit them to Parliament approval.
5) Prohibition of the initiation of unbudgeted expenditures by the executive branch in the course of budget execution, except through supplementary appropriations.
6) Requirements for financial and fiscal reporting.
7) Timely submission of the end-of-year accounts.
8) Independence of the external auditor.
9) Transparent and rules based systems for intergovernmental financial relationships.
10) Appropriations should be “gross” so that expenditures should not be offset against revenues
11) Specify rules for carry-over of budget authority at end of fiscal year, (usually requiring all to be re-appropriated although there may be some flexibility for investment spending).
12) Contingency and reserve provisions should be limited with clear rules for the use of such funds.
13) Limitations on the legislature’s powers to change the executive draft budget (e.g. prevention of the legislature from revising revenue projections upwards in order to accommodate more expenditure).
14) Specify extent of the minister of finance’s authority to cut appropriations, and the conditions under which this is permitted.

ANNEX D. LINKS BETWEEN PFM REFORM DESIGN AND PEFA ASSESSMENTS

Background: The Good Practice Note on Sequencing PFM Reforms (January 2013) makes extensive use of Core PFM Functions to identify first priorities for reform programmes. This is based on Background Paper 2 to the Good Practice Note – prepared by Daniel Tommasi – which identifies for each PEFA indicator dimension (with a few justified exceptions) the score that corresponds to achieving 'core PFM functionality'.

The original PEFA message was that the PEFA Framework was designed in terms of the scoring calibration so that 'C' would represent a basic but functional PFM system – with 'D' representing a non-functional system and 'A' a well-functioning system using internationally accepted good practice. However, the core functionality scores used in the Good Practice Note vary from 'D' to 'A' and is only set as 'C' for 21 out of the 64 indicator dimensions that are given a core functionality score or benchmark.

'D' is set as the core functionality score for five indicator dimensions that measure support to policy analysis. This means that the remaining 39 core functionality scores/benchmarks are set above the 'C' level (36 as 'B' and 3 at 'A'). The justification for the 'B' is in most cases that "it will take time to reach the score 'B' " or "score 'B' corresponds generally to effective achievements". For the score 'A' the justification is mainly that only a limited percentage of low and middle income countries currently score 'A'.

It would therefore be worthwhile to ask:

- Are these core functionality scores/benchmarks set appropriately and consistently?
- Does the current calibration of the PEFA indicators offer consistency in what represents core functionality?

Rather than using PEFA scores for low and middle income countries to determine if the bar has been set at the right level, it may be useful to study the performance levels of well-developed high income countries particularly OECD countries. The OECD Budget Practices and Procedures database and other tools used for OECD may be an appropriate starting point for defining the appropriate scoring requirements for an 'A' rating, whereas the PEFA assessment scores in low and middle income countries may offer a basis for deciding a suitable progression towards that benchmark.

This issue could be covered in the proposed analytical note on linkages between PEFA assessments and PFM Reform design and monitoring.

ANNEX E. LIST OF REFERENCES

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