



Using PEFA to Support Public Financial Management Improvement

PEFA Handbook
Volume IV

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Preface

About the PEFA Handbook

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The Public Expenditure and Financial Accountability (PEFA) program provides a framework for assessing and reporting on the strengths and weaknesses of public financial management (PFM).

A PEFA assessment incorporates a PFM performance report that includes an evidence-based measurement of performance against 31 indicators as well as an analysis of the findings and their impact on desirable budgetary and fiscal outcomes.

The PEFA methodology draws on international PFM standards and good practices and provides a foundation for planning reform, conducting multistakeholder dialogue on strategy and priorities, and monitoring progress. The PEFA program also provides support, monitoring, and analysis of PEFA assessments. A key task of the PEFA Secretariat is to ensure the quality of PEFA reports, which is done by an in-depth review of draft reports and PEFA Check quality assurance. For more information about the program and the PEFA Check requirements, visit www.PEFA.org.

To support users, the purpose of the PEFA Secretariat has developed a comprehensive four volume PEFA handbook. The purpose of the PEFA handbook is to provide users, including government officials (in both central and subnational governments), assessors, development partners, and other interested stakeholders, with guidance on planning, implementing, reporting, and using the PEFA Framework for Assessing Public Financial Management.

The four volumes of the PEFA handbook are as follows:

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Volume I

The PEFA Assessment Process: Planning, Managing, and Using PEFA provides guidance for PEFA users and other stakeholders on the key phases and steps in the PEFA assessment process.

Volume II

PEFA Assessment Field Guide provides detailed technical guidance on scoring the 31 performance indicators and 94 dimensions of PEFA 2016, including data requirements and sources, calculations, and definitions. The field guide also includes a glossary of terms.

Volume III

Preparing the PEFA Report contains advice on writing the report, a template and instructions for each section, and an annex with a standard PEFA report.

Volume IV

Using PEFA to Support PFM Improvement provides guidance on how to use PEFA assessments as part of a stakeholder dialogue to develop and sequence PFM reform initiatives.

Each volume of the handbook is intended to be a dynamic document that will be updated in response to common issues, good practices, suggestions, and frequently asked questions from PEFA users. Periodic updates to the handbook volumes are announced and published on the PEFA website: www.PEFA.org.

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Volume IV is a product of knowledge sharing and collaboration among numerous experts.

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Abbreviations

DeMPA	Debt Management Performance Assessment	5
FMIS	financial management information system	
IPSAS	International Public Sector Accounting Standards	
MAPS	Methodology for Assessing Procurement Systems	
MTFF	medium-term fiscal framework	
ODI	Overseas Development Institute	
PDIA	Problem Driven Iterative Adaptation	
PEFA	public expenditure and financial accountability	
PFM	public financial management	
PI	performance indicators	
PIMA	Public Investment Management Assessment	
SWOT	Strengths, Weaknesses, Opportunities, and Threats	
TADAT	Tax Administration Diagnostic Assessment Tool	

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Introduction

About Volume IV

A successful public expenditure and financial accountability (PEFA) assessment requires the commitment of all major stakeholders involved in public financial management (PFM) in a country.

Nevertheless, the government should be the driving force for the assessment and “own” both the process and results of the assessment; it also should lead the efforts to build on the strengths and address any weaknesses identified in the PEFA report.

In this context, governments have been increasingly seeking the advice of the PEFA Secretariat for information on how to use PEFA reports more effectively to improve PFM performance. Volume IV of the PEFA handbook has been developed in response. However, while the strategic and operational importance of PFM reform is generally recognized, this guidance makes clear that there is no one-size-fits-all solution to supporting and implementing PFM reform. It is important to use PEFA assessment findings in the country context.

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PEFA and the PFM reform process

PEFA reports, when done well, provide a technically sound basis for developing and undertaking PFM reforms. The PEFA framework provides a 360-degree overview of PFM, with evidence-based assessments and scoring methodology as well as a peer-review process that counters the risks of potential optimism bias in the assessment process. The framework facilitates comparison over time and between countries and regions and is internationally agreed on and supported through strong collaboration between key development partners.

Volume IV focuses on the use of PEFA reports for supporting dialogue, planning, design, and implementation of PFM improvement. However, it is important to note the strengths and limitations of PEFA assessments when using PEFA reports as the basis for dialogue on and design of PFM reform. Assessments do not capture all aspects of PFM at a deep level of detail and, as discussed in this guidance, additional analyses may sometimes be needed to understand the underlying technical and nontechnical causes of performance levels.

If not used correctly or appropriately, PEFA assessments can sometimes lead to standardized approaches to reform that do not take the local context into account. While the PEFA scoring methodology embeds good international practices, applied incorrectly, the A to D rating can lead to a focus on improving all low scores without paying appropriate attention to capacity and other constraints, political priorities, sequencing and importance, and other local circumstances. It is important to interpret PEFA assessment findings and use them in a way that reflects the circumstances and priorities of the country in which they are applied.

PFM reform will not succeed without a solid technical foundation. However, by the same token, technically sound reform initiatives will not succeed without adhering to the following principles:

- Understanding the important role of nontechnical factors (political economy, institutional structure, technology, and capacity) in the design of PFM reform
- Understanding the need to involve broader stakeholder groups before and during the design, implementation, and evaluation of reform
- Recognizing the importance of ongoing monitoring, learning, feedback, and adjustment during implementation of reform as key to countering unforeseen events and constraints or leveraging opportunities.

Purpose and objectives of Volume IV

Good PFM performance is determined by the ability of PFM systems to support the effective and efficient achievement of policy objectives while maintaining macro-fiscal control, as measured by the three main fiscal and budgetary outcomes: aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery.¹

Volume IV provides a practical guide to support the design of PFM reform initiatives and action plans informed by a PEFA assessment. Its objective is to support the development and implementation of PFM reform initiatives that:

- Have the commitment and ownership of government
- Are based on clearly stated desired PFM outcomes
- Consider and address potential constraints
- Reflect government priorities and capacities
- Are sequenced in accordance with the desired policy outcomes, government priorities, and potential constraints (including nontechnical constraints) to reform.

¹Aggregate fiscal discipline requires effective control of the total budget and management of fiscal risks. Strategic resource allocation involves budget planning and execution in line with government priorities aimed at achieving policy objectives. Efficient service delivery requires using budgeted revenues to achieve the best levels of public services with the available resources

Volume IV is not intended to be prescriptive in setting recommendations on reform priorities or sequencing.

Rather, it is intended to provide a guide for countries on the issues that need to be considered in developing effective reform initiatives, strategies, or action plans that are designed to address each country's unique situation. In this context, it is important to take stock of relevant analytical work, the country's development strategies, and other relevant documents. This stocktaking is essential for fully understanding the country context, including the technical and nontechnical constraints on and opportunities for reform. It is also essential for understanding the capacity constraints and the need to leverage the institutional links between finance ministries and other stakeholders involved in PFM reform.

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The guidance calls for building on existing PFM reform and improvement strategies. It also suggests building on those reform elements that have been successful and addressing those that have been less successful (and drawing lessons from both).

While the PEFA Secretariat is available to provide more guidance on using PEFA assessments to support PFM improvement, such as training workshops to facilitate reform dialogue and action planning, it does not provide direct technical support for implementing PFM action plans or specific reform initiatives.

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PEFA and PFM improvement

A practical guide

Seven stages of preparing and implementing PFM improvement

This guide aims to assist practitioners in developing and implementing PFM reform initiatives following completion of a PEFA assessment. It sets out seven key stages over two phases for preparing and implementing PFM reform. These stages are based on the practical experiences of governments and advisers that have successfully implemented reform initiatives (table 2.1). While it is expected that each of the seven stages will involve extensive dialogue among various stakeholders, the guide has been developed on the premise that the government is responsible and accountable for prioritizing and implementing PFM reform.

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Table 2.1 Overview of the seven stages of the PFM reform dialogue

Planning and preparation	Stage 1 Identify PFM strengths and weaknesses	<ul style="list-style-type: none"> Present a list of strengths and weaknesses identified in the PEFA report
	Stage 2 Determine underlying causes of strengths and weaknesses	<ul style="list-style-type: none"> Agree if analysis is to be undertaken to identify the technical and nontechnical causes of or factors contributing to the strengths and weaknesses
	Stage 3 Agree on desired PFM reform outcomes	<ul style="list-style-type: none"> Agree on the desired PFM outcomes to come from addressing the problems and weaknesses
	Stage 4 Develop and prioritize PFM reform options	<ul style="list-style-type: none"> Develop a set of reform initiatives that address the weaknesses identified and support the achievement of the desired PFM outcomes Agree on the order of priority of the reforms Review the priorities based on constraints identified in stage 5
	Stage 5 Identify potential constraints to reform	<ul style="list-style-type: none"> Identify constraints to implement reform successfully and possible actions to mitigate those constraints
Implementation	Stage 6 Implement reforms and reform action plans	<ul style="list-style-type: none"> Implement specific actions and identify responsibilities, timelines, and capacity development needs This stage could entail individual initiatives or form part of a reform strategy or action plan
	Stage 7 Monitoring, evaluation, and adjustment	<ul style="list-style-type: none"> Monitor the implementation of reforms and individual actions Review and modify reform initiatives or plans

A flowchart, based on the seven stages, is presented in figure 2.1, and a sample flowchart that using an example for reform design is presented in Annex A.

The flowchart presents a series of key questions to guide PFM reform practitioners through each of the key stages. It also suggests actions based on the responses to key questions. The seven stages and corresponding flowchart are provided as a heuristic tool only. They are not intended to be prescriptive, and application of the guidance provided in this volume may not always be linear.

Several iterations may be required for any or each of the questions set out in the flowchart.

Figure 2.1 A practical guide to PEFA and PFM reform dialogue

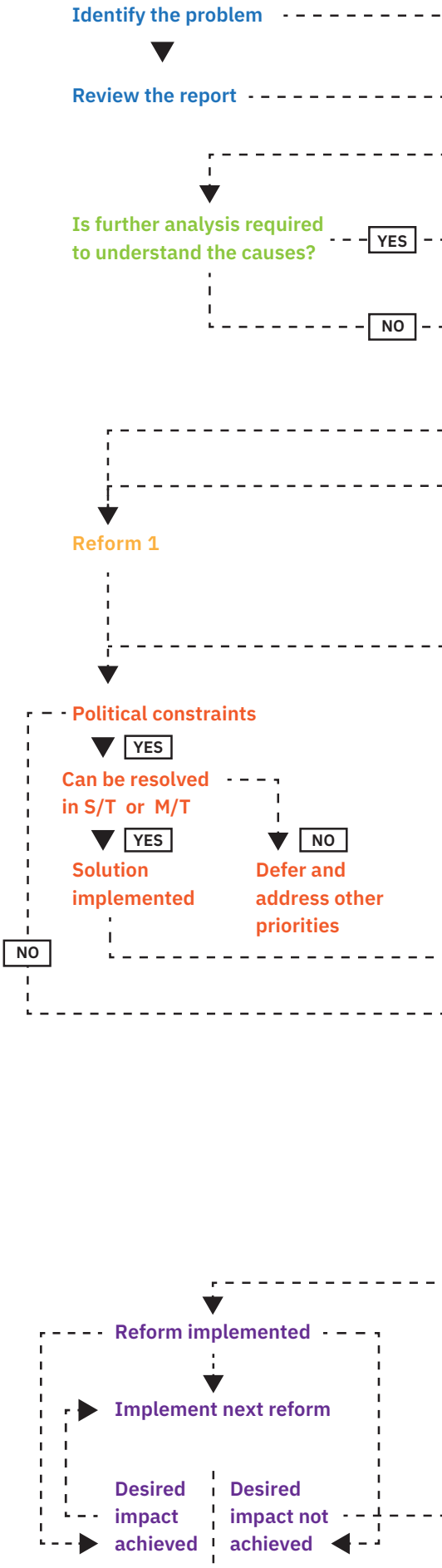
STAGES

STAGE 1 Identify PFM strengths and weaknesses
STAGE 2 Determine underlying causes of strengths and weaknesses
STAGE 3 Agree on desired PFM reform outcomes
STAGE 4 Develop and prioritize PFM reform options
STAGE 5 Identify potential constraints to reform
STAGE 6 Implement reform
STAGE 7 Monitor and evaluate reform

KEY QUESTIONS

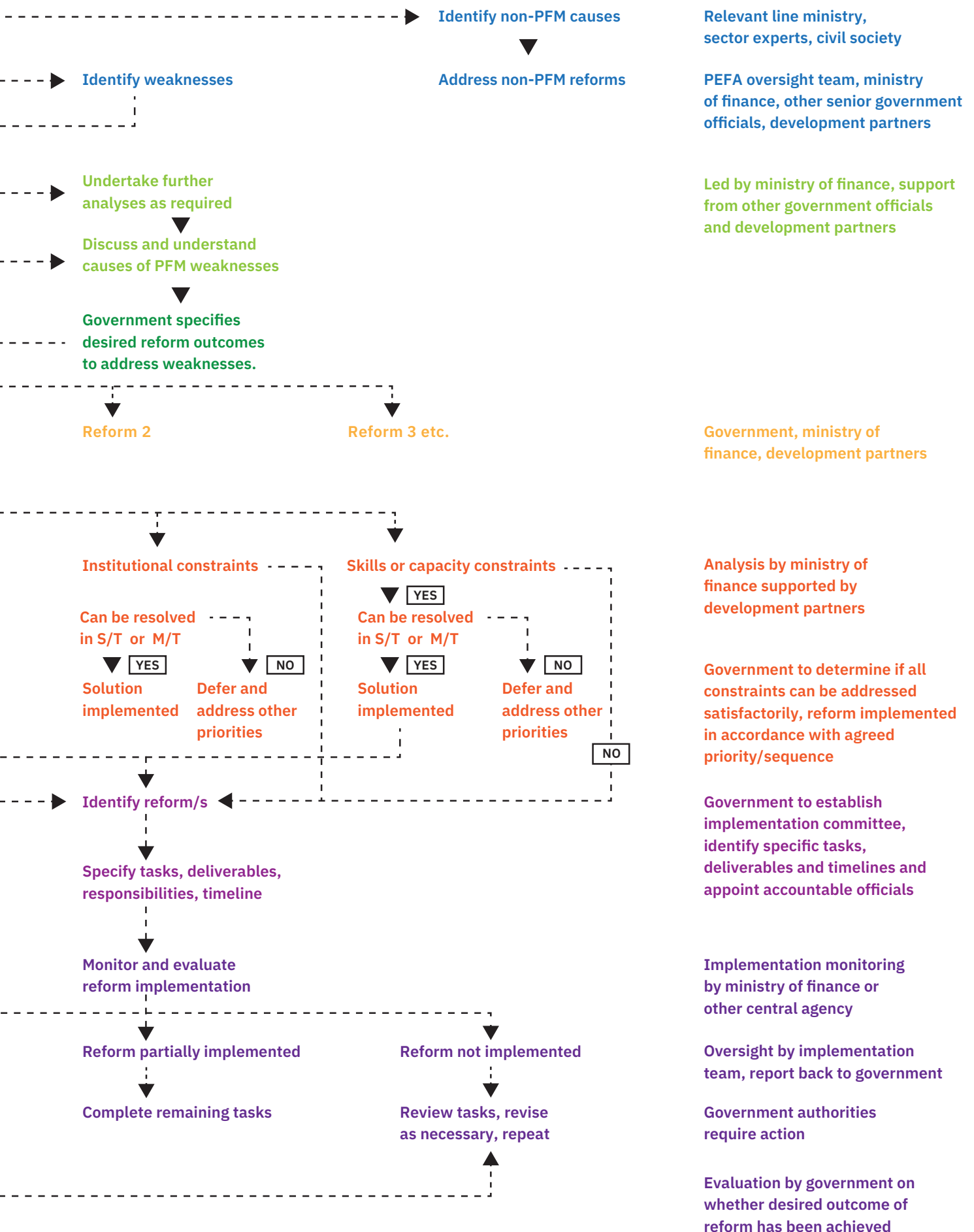
What is the problem?
What are the findings of the PEFA assessment?
What are the causes of the PEFA weaknesses?
What is or are the government's desired outcomes from PFM reform?
What are the most important reforms and sequence for achieving the government's priorities?
Are there constraints to reform?
Can the constraint be resolved or mitigated?
What is the reform to be implemented?
What are the actions, deliverables, responsibilities, timelines, and costs of reform?
Has reform been implemented?
What are the next steps for reform?
Has reform had the desired impact on the identified problem?

PFM REFORM ACTIONS



NON-PFM ACTIONS

STAKEHOLDERS



PHASE 1 Planning and preparing PFM reform



Stage 1

Identify PFM strengths and weaknesses

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What is the problem?

The driver of PFM reform may not always be a PEFA assessment. Sometimes it can be the government's desire to improve overall economic performance, service delivery, or another aspect of public administration. The first question—What is the problem?—provides an opportunity to identify broader policy issues that may have a PFM-related element. It also recognizes that the problem may need to be addressed through actions and solutions other than public financial management.

If the process starts with identification of the problem, the next question is to determine what the PEFA report can tell us about the systemic PFM weaknesses, identified in the assessment, that may be contributing to the problem. In this context, it will be important to take stock of relevant analytical work, the country's development strategies, and other relevant documents in order to understand the country's context, reform priorities, and technical and nontechnical constraints on or opportunities for reform.

For example, a country may identify poor education outcomes—specifically, low levels of academic achievement—as the broader policy problem. The causes of the poor performance may be due to matters not related to public financial management, such as poor teacher training, outdated curriculum, and lack of facilities. At the same time, the PEFA report could, for example, identify a range of issues (ie PFM-related issues) that could potentially undermine the government's ability to achieve its desired education outcomes, including unpredictable budget allocations, lack of control over commitments, inadequate or nonexistent cash-flow forecasting, failure of the planned resources to reach the end users, or a lack of information on performance.

What are the findings of the PEFA assessment?

For some countries, the PEFA report itself, not the identification of a problem envisaged in question 1, will be the main driver of reform. For other countries, the driver of reform may be a combination of problem-driven reform and the results of the PEFA assessment as well as other diagnostic assessments, evaluations, or government decisions.

At this stage, it might useful to create a PFM reform matrix with a list of strengths and weaknesses identified by the PEFA report that provides the basis for further discussion of reform (see table 2.2). The guide expands the matrix example to reflect each of the stages, providing example data for illustrative purposes.

Table 2.2 Example of a PFM reform matrix: Strengths and weaknesses identified by PEFA assessment

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Performance indicator or dimension	PEFA score	Underlying strengths and weaknesses
PI-1	D	Aggregate expenditure outturns exceed original budget by more than 20% in each of the last three years.
PI-1	D	Variance in expenditure composition by functional classification was greater than 15% in each of the last three years. Such variations undermine the predictability and availability of budget allocations to key service delivery agencies.

As an important note of caution, it may not be realistic or desirable for all countries to aspire to an A score on all performance indicators or for a C or D score to indicate a need for a specific reform (as, for example, with Norway's 2008 self-assessment)². It is sometimes necessary to look beyond the low scores to see the country context and impact of the performance of specific indicators on overall PFM performance.

The weaknesses identified should be presented from the highest to the lowest priority, with key stakeholders, such as government agencies, decision makers, development partners, and civil society, participating in this initial prioritization process. Sometimes, a low score may not be a priority for reform, and sometimes an A score may hide significant problems. For example, an A in PI-1, Aggregate budget outturn, may be the result of cash rationing rather than good budget planning.

This stage reflects only an initial prioritization. Sequencing of reform initiatives will need to consider other factors, including resources, capacities, institutional constraints, political commitment, and others (discussed later). These factors will determine the feasibility of implementing a particular reform and its priority relative to other possible reforms.

²Norway's self-assessment in 2008 gave the government several C and D scores, with particular weaknesses identified in internal audit and procurement. The Norwegian response was to acknowledge that procurement systems needed improving, but that internal audit reforms were not necessary because strong internal controls were already in place



Stage 2

Determine the underlying causes of strengths and weaknesses

What are the causes of strong and poor PFM performance identified by the PEFA assessment?

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Once the PFM strengths and weaknesses are identified and weaknesses are initially prioritized, further analysis may be required to establish or understand better their underlying technical and nontechnical causes or contributing factors. While a PEFA report provides extensive evidence for scoring an indicator or dimension, it does not always identify all of the technical and nontechnical causes of good or poor performance. PFM reforms seldom start from a clean slate. Analysis of what has worked or not and the lessons learned is particularly important to understand the underlying causes of PFM performance, to guide reform initiatives, and to identify constraints in later stages.

Further analysis may take different forms. Some problems may require more formal technical analysis, while others may be addressed by more informal, quick inquiry. Countries also should consider other analyses and assessments of underlying issues, such as those undertaken internally by government and externally by think tanks, fiscal councils, supreme audit institutions, nongovernmental organizations, and others.

A review of existing assessments, audits, and other reports is recommended. Reports may include internal and external audit reports, procurement audits, service delivery assessments, surveys, and sector reviews, among others.

Findings and recommendations of other broad PFM diagnostic tools (for example, the International Monetary Fund's Fiscal Transparency Evaluation) or technical assistance reports may also be used. This information could include the application of other PFM diagnostic tools that focus on individual elements of PFM, such as the Tax Administration Diagnostic Assessment Tool (TADAT), Debt Management Performance Assessment (DeMPA), and Methodology for Assessing Procurement Systems (MAPS).

Some of these diagnostic tools may have been applied prior to the PEFA assessment, and relevant data and analysis may be included as evidence in the PEFA report. At other times, governments may see a need to apply one or more of these diagnostic tools after a PEFA assessment, although countries need to be mindful of the resources and time required for these analyses. Specific reform initiatives may be developed as part of a comprehensive and integrated strategy and reform program or based more loosely on individual, prioritized, problem-driven initiatives. Whether to have a formalized and structured reform action plan or strategy or to take a more ad hoc approach will depend on the country's technical capacity and institutional environment as well as on the extent to which problems, solutions, and commitments are adequately understood and agreed on at the outset.

A study by the PEFA Secretariat identifies 46 diagnostic tools for PFM systems that were in use as of December 2016 (PEFA Secretariat 2018a).

In other cases, governments may apply tools such as a Strengths, Weaknesses, Opportunities, and Threats (SWOT) analysis or the Problem Driven Iterative Adaptation (PDIA) approach (for example, the PDIA toolkit from the Center for International Development at Harvard University). The companion document, A Guide to PFM Diagnostic Tools, highlights the coverage of each tool but does not provide recommendations on which tools to use (PEFA Secretariat 2018b).

It is important to identify such factors because they may also act as constraints on or enablers of developing and implementing reform (discussed in stage 5). Analysis may identify reforms that are technically feasible but politically unacceptable. Sequencing and prioritization should take place following a more comprehensive deep dive into the nontechnical factors.

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Building on the matrix example of weaknesses and strengths identified in stage 1, table 2.3 adds the underlying causes of strong and poor performance.

Table 2.3 PFM reform matrix example: Underlying causes of strengths and weaknesses

Performance indicator or dimension	PEFA score	Main strengths and weaknesses	Underlying causes
PI-1	D	Aggregate expenditure outturns exceed original budget by more than 20% in each of the last three years.	Overly optimistic economic and fiscal projections Unavailable economic and fiscal forecasting models
PI-2.1	D	Variance in expenditure composition by functional classification was greater than 15% in each of the last three years. Such variations undermine the predictability and availability of budget allocations to key service delivery agencies.	Lack of capacity in economic and fiscal forecasting Political involvement in setting fiscal projections



Stage 3

Agree on desired PFM reform outcomes

What are the government's desired outcomes of PFM reform?

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Once the underlying causes of the weaknesses are understood, the government should decide the outcomes it wishes to achieve through PFM reforms (see table 2.4). Identifying the desired outcomes of reform helps to guide how the government prioritizes and sequences its reform efforts. By doing this, the government is better able to focus on and prioritize initiatives that will help to achieve the desired outcomes.

Table 2.4 PFM reform matrix example: Desired PFM outcomes

Performance indicator or dimension	PEFA score	Main strengths and weaknesses	Underlying causes	Desired outcomes
PI-1	D	Aggregate expenditure outturns exceed original budget by more than 20% in the last three years	Overly optimistic economic and fiscal projections Unavailable economic and fiscal forecasting models	Stronger fiscal discipline through greater adherence to fiscal targets Improved predictability of budget allocations to service delivery ministries
PI-2.2	D	Significant variation in budget composition by function undermines the predictability and availability of budget allocations to key service delivery agencies.	Lack of capacity in economic and fiscal forecasting Political involvement in setting fiscal projections	

In identifying the desired outcomes of PFM reform, it may be useful to draw on any policy objectives contained in national development strategies or plans and or relevant sector strategies and objectives. This comparison makes it possible to align the reforms with national objectives. Similarly, a comparison of the problem analysis with the national development goals and objectives will also help to identify or clarify the desired PFM outcomes. This process will strengthen the case for reform and its relevance to the government concerned.

Returning to the matrix example, the government's priority outcome may be, at this stage, to strengthen fiscal discipline. The government may consider this the key for improving budget reliability and ensuring that resources are allocated to spending agencies in a predictable manner that supports service delivery and the achievement of its policy goals.



Stage 4

Develop and prioritize PFM reform initiatives

Which initiatives can bring about the desired outcomes?

Stage 4 involves the design specific reform initiatives aimed at achieving the desired outcomes. Each reform initiative or action should include a brief description of the intended result of that action, the intended impact on (or progress toward) the desired outcome, an initial time frame for completing the action (and any milestones to be reached over the short, medium, and longer term, depending on the nature of the reform), and the allocation of responsibility within the government for implementation.

Continuing with the handbook's matrix example, a first priority may be to develop reforms aimed at improving the reliability of budget estimates by reducing the gap between budget allocations and actual expenditures. This step may require better macroeconomic modeling and fiscal forecasting, stronger rules on limiting spending decisions made after the budget has been approved, or implementation of commitment control to reduce arrears. In turn, strengthening macrofiscal forecasting may require improvements in the national accounts, development of new economic models, or the elimination of political interference in forecasting.

It is important to note that alternative desired outcomes may lead to different reform priorities and initiatives. For example, the government may identify improving service delivery outcomes as its main priority. This priority may require improvements in the reliability of budget allocations and other initiatives that affect fiscal discipline, but it also may require improvements in the capture of performance information or better understanding of the availability of resources to service delivery units.

What are the most important reforms, and how do we sequence them?

When a PEFA report highlights a significant and wide range of PFM weaknesses, the challenges may seem overwhelming. Worse, countries and development partners may try to adopt all-encompassing, comprehensive reform plans that are beyond both the implementation capacity of the country and the resources of development partners.

Despite some attempts to agree on sequencing in planning PFM reforms, a consensus among PFM experts has not emerged. Nevertheless, as a starting point, consideration should be given to the feasibility and desirability of adopting a basics-first approach. Such an approach stresses the importance of "getting the basics right" when undertaking reform.

Its aim is to avoid overly ambitious attempts to establish PFM international best practices in countries that lack the capacity to operate basic processes. An example is ensuring that the legal environment exists and that sufficient capacity is built before embarking on capital-intensive automated systems.

Lessons from experience and academic research lead to the conclusion that appropriate design and optimum sequencing of the reform program, including what constitutes the basics as well as the capacity development needs and priorities, are specific to a country based on its unique political, institutional, and capacity characteristics.

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Cost also needs to be considered in setting reform priorities. Reform plans need to take account of available financial resources. For example, the government may consider the implementation of a new financial management information system (FMIS) to be a high priority, but the cost of development, implementation, and capacity development may be prohibitive for the time being. Some of the gains from a new FMIS could be achieved through the adoption of less expensive improvements in processes, regulations, and classification. Similarly, particularly where the level of government commitment and ownership is less than desirable, government officials may wish to consider less complex reforms that could provide quick wins on PFM reform and help to build momentum for further reform. Box 2.1 offers an example of how PEFA findings on budget credibility and fiscal discipline are used to prioritize and sequence PFM reform. Costs are further discussed in stage 6, as reform initiatives and plans are further developed.

Box 2.1

Budget credibility and fiscal discipline as an example of using PEFA for prioritizing and sequencing PFM reform

Budget credibility and fiscal discipline are often the first and foremost concern in many developing countries. In the following example, we take the case of a country that exhibits poor budget credibility and poor fiscal discipline. The government has decided that addressing poor performance in these areas is the first priority of the country's PFM reform strategy.

The PEFA report confirms the government's concerns. The PEFA performance indicators (PIs) most relevant for measuring budget credibility in a country might be PI-1, Aggregate expenditure outturn; PI-2, Expenditure composition outturn; PI-16, Medium-term perspective in expenditure budgeting; and PI-17, Budget preparation process. For fiscal discipline, the relevant performance indicators are PI-14, Macroeconomic and fiscal forecasting, and PI-15, Fiscal strategy.

The next step is to define the causes that lead to poor scores on these indicators and to analyze each of these factors, drawing on PEFA assessments and other diagnostic reports. These causes could be legal, administrative, technical, or institutional (for example, political economy). In some cases, there might be insufficient information to draw any firm conclusions about the causes of inferior performance. Further analysis by the relevant government agencies may be needed, or additional diagnostic work might be commissioned.

Common causes of poor budget credibility include unreliable or unrealistic macroeconomic forecasts that underpin fiscal forecasts. Such forecasts may be the result of institutional factors (for example, underlying national accounts data are untimely and inaccurate); technical weaknesses (for example, internal capacity and expertise to prepare macroeconomic forecasts are lacking); or political economy factors (for example, government manipulates the projections to provide a more positive bias).

The question is then whether these data can be improved and whether these institutional, political, and technical impediments can be overturned. For example, can the national statistics office improve the timeliness of the production of its national accounts data; can the ministry of finance strengthen the skills of the macroeconomic unit and improve the robustness of its macroeconomic modeling and fiscal forecasts; can political interference in economic forecasting be addressed through greater independence and greater transparency of macroeconomic and fiscal forecasting?

The next step is to assess how possible it would be in the short run and in the longer run to make improvements in the regulations identified. Political, technical, and institutional causes should be addressed in turn. The government (with the support of its development partners) would assign a low, medium, or high probability of success to each of these factors. This process may result in the identification of some dead ends from which no prospect of success can be gleaned.

Dialogue among stakeholders at the political level is therefore critical for the approach to work well. Political input is required at two levels: (a) how to prioritize the various reform measures that emerge from the analysis and (b) how to analyze the severity of the institutional constraints that might have an impact on the implementation of each potential reform option.

It is also important to be aware that some priorities are both causally and sequentially linked.

For example, improvement in revenue arrears (PI-19) may lead to improved revenue outcomes (as measured by PI-3) but still require better information on revenue collections and more timely reconciliation (PI-20). Table 2.5 offers more examples of proposed reforms and priorities.

Table 2.5 PFM reform matrix example: Proposed reform and priority

Performance indicator or dimension	PEFA score	Main weaknesses identified	Underlying causes	Desired outcomes	Proposed reform activity (and priority)
PI-1	D	Aggregate expenditure outturns exceed original budget by the last three years	Overly optimistic economic and fiscal projections	Stronger fiscal discipline through greater adherence to fiscal targets	Strengthen macrofiscal forecasting (high)
			Unavailable economic and fiscal forecasting models	Improved predictability of budget allocations to service delivery ministries	Implement cash-flow forecasting (medium)
PI-2.2	D	Significant variation in budget composition by function undermines the predictability and availability of budget allocations to key service delivery agencies.	Lack of capacity in economic and fiscal forecasting		Update budget processes and procedures (high)
			Political involvement in setting fiscal projections		

In the handbook's matrix example, the country identified three reform priorities based on its desired outcome of improving fiscal discipline (see table 2.6).

Table 2.6 Three reform priorities for improving fiscal discipline

Reform priorities	Why?
1 Strengthening macrofiscal forecasting	Strengthening macrofiscal forecasting is identified as the most important reform because of the consistent, significant variations in budget outturns and composition. These variations have led to continuous reallocations across expenditure items, cash rationing, and the inability of ministries to plan their expenditures with any certainty.
2 Implementing cash-flow forecasting	The second priority follows from the first, insofar as ministries need to plan for their cash allocations, based on realistic budgets, in accordance with their program needs.
3 Updating budget processes and procedures	The third priority, updating budget processes and procedures, is recognized as an essential reform initiative to support decision making in prioritizing budget allocations and strengthening adherence to both aggregate and ministerial budget allocations.

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Stage 5

Identify potential constraints to reform

What are the constraints to reform?

Based on the prioritized list of reform initiatives identified in stage 4, the government, in consultation with other stakeholders (including technical experts and decision makers at both the executive and political level), should next identify potential impediments to successfully implementing reform and possible measures to mitigate the impact of those impediments. A checklist of risks arising from the various sources can be formulated to guide the design of reform. In some cases, the constraints of a particular initiative may be so great that they cannot be resolved in the short or medium term, in which case it may be advisable for the government not to engage in a specific reform at that point in time.

It is generally recognized that nontechnical factors play an important role in PFM performance. Such factors can vary significantly between countries and over time. Addressing these factors as part of PFM reform requires political and bureaucratic commitment, learning new skills, and accepting organizational change. As with sequencing and prioritization, the approach to identifying technical and nontechnical constraints will vary depending on the context.

Table 2.7 describes common constraints to implementing reforms, including nontechnical factors, and suggests ways to mitigate them.

Table 2.7 Potential constraints to PFM reform

Constraint	Manifestation	Potential impact	Risk (high, medium, low, or variable)	Mitigation strategy
Political environment	Senior politicians or senior bureaucrats are not willing to support reform implementation.	<p>Critical: Ability to implement effectively or to embed reform is lacking.</p> <p>Critical: Key stakeholders either do not cooperate or resist reform.</p> <p>Moderate: Adherence to new processes and procedures</p>	<p>High: Few reforms will be successful without the commitment of senior levels of government.</p>	<p>Seek the endorsement of political leadership</p> <p>Raise awareness of the benefits of reform</p> <p>If endorsement is not achieved, consider deferring reform and pursuing other priorities that are endorsed and supported by government</p>
Government and development partner engagement	Reform design is not internally driven.	<p>Critical: Reform design is undertaken by development partners and reflects their priorities rather than those of the government.</p>	<p>Variable: The risk depends on the extent of commitment and engagement of the government: the less engagement, the higher the risk that development partners will engage in technical assistance that does not reflect the government's priorities.</p>	Tailor reform initiatives to the specific administrative and political circumstances of a country
Technical capacity	Staff lack specific competencies to develop or support implementation.	<p>Significant: Lack of capacity has both short- and longer-term impact on the ability to implement reform.</p>	<p>High: An understanding of the reform and its application is essential.</p>	Undertake capacity development
Institutional environment	Institutions or organizational structures are not sufficient or appropriate for supporting reform implementation.	<p>Significant: Supervision and workflow management and monitoring are inadequate.</p>	<p>Moderate: It may be possible to establish alternative management and workflow arrangements.</p>	Undertake organizational restructuring to support the reform initiative
Capacity of information and communication technology systems	The administration lacks system hardware and software to support the reform initiative.	<p>Moderate: Some reforms require more advanced systems and software (for example, financial management information systems).</p>	<p>Moderate: Manual processes and procedures can be used pending the acquisition of software and systems.</p>	Seek development partner support and technical assistance

How are the constraints addressed?

This question relates to how the constraints can be resolved or mitigated; that is, what needs to be done to create the right conditions to successfully implement the reform? In the flowchart example in annex A, it is determined that there are no political constraints, but there are both institutional and technical constraints.

In the handbook’s matrix example, it is possible to resolve technical constraints through the creation of a dedicated macroeconomic and fiscal unit and the development of technical skills and capacity in economic modeling and fiscal forecasting for the staff of the macroeconomic and fiscal unit.

For many countries, capacity constraints—staff resources and technical skills—present the greatest impediment to reform. The need to address this constraint has to be considered closely in the design of any reform. Working in partnership with development partners—who may be able to provide technical assistance and other support—can be extremely effective.

If it is not possible to resolve or mitigate a constraint—for example, there is no political will or engagement for reform—then governments and stakeholders should not proceed with implementation until circumstances are more favourable or while acceptance and support for the reforms are being built through advocacy and other means. In cases where constraints can be mitigated in the short or medium term—for example, capacity development—governments should consider acting to do so. However, the cost, priority, and sequencing of these actions should also be considered as part of any PFM reform program.

Table 2.8 includes an additional column on constraints to proposed reform. The completed matrix can help to guide users in establishing a prioritized list of reforms that are achievable within known technical and nontechnical constraints.

Table 2.8 PFM reform matrix: Constraints to reform

Performance indicator or dimension	PEFA score	Main weaknesses identified	Underlying causes	
PI-1	D	Aggregate expenditure outturns exceed original budget by more than 20% in the last three years.	<p>Overly optimistic economic and fiscal projections</p> <p>Unavailable economic and fiscal forecasting models</p> <p>Lack of capacity in economic and fiscal forecasting</p> <p>Political involvement in setting fiscal projections</p>	
PI-2.2	D	Significant variation in budget composition by function undermines the predictability and availability of budget allocations to key service delivery agencies.		

	Desired outcomes	Proposed reform activity and priority	Constraints to proposed reform	Addressing constraints
	Stronger fiscal discipline through: Greater adherence to fiscal targets Improved predictability of budget allocations to service delivery ministries	Strengthen macrofiscal forecasting (high)	Lack of capacity in economic modeling and analysis Political interference in setting macrofiscal projections Unwillingness of line ministries to adhere to budget processes and procedures	Recruit and train macroeconomists Strengthen the legal framework that underpins budget planning and preparation
		Implement cash-flow forecasting (medium)		
		Update budget processes and procedures (high)		

PHASE 2 Implementing PFM reform



Stage 6

Implement reforms or reform action plans

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What are the actions, deliverables, responsibilities, and timelines?

The next stage focuses on confirming the reform initiatives and developing an action plan or strategy for implementation. Table 2.9 provides a template for developing a PFM reform plan that can be adapted for iterative approaches to reform or more sophisticated and comprehensive reform strategies. The template is not intended to be either prescriptive or exhaustive. It simply indicates the key elements to be addressed in designing a reform plan, whether as an individual reform initiative or as part of a more detailed comprehensive strategy.

Table 2.9 Key elements of a PFM reform action plan

Desired outcome	PFM reform	Key tasks and actions	Responsibility	Time frame	Key milestones and outputs	Capacity development needs	Cost and funding source
State the government's intended outcomes from the PFM reform	Specify the reform priorities or initiatives	Set out the individual tasks required to implement the reform	Identify institutional and individual responsibility for completion of each task	Set out the deadline for each task	Identify milestones	Set out required capacity development needs	Estimated cost and funding source

Table 2.10 includes a simplified example of the template in table 2.9, applying the example used from stage 1 to stage 5 to address specific reform priorities centered on the need to improve fiscal discipline. The example aims to demonstrate the logic for developing and implementing priorities resulting from the PFM reform dialogue, highlighting the specific outcome that the reform is intended to achieve (or contribute to) and the specific tasks required to achieve that outcome. It also assigns responsibility and identifies a time frame, specific milestones, and capacity development needs.

In designing reforms, the cost implications should be considered. Such costs should reflect both the capital and recurrent costs of implementing the reform itself as well as any short-term costs, such as technical support for capacity development. Any potential savings from, for example, improvements in efficiency and effectiveness should also be highlighted. Recurrent costs are almost always funded by the government themselves, whereas costs of capital and technical support are sometimes funded by development partners. It is essential the full costs of the reform initiative or plan are calculated and funding sources identified and confirmed before approval and implementation.

Table 2.10
Illustration of key elements of a PFM reform action plan using the handbook's example

Desired outcome	PFM reform	Key tasks and actions	Responsibility	Time frame	Key milestones and outputs	Capacity development needs	Cost and funding source
Strengthen fiscal discipline through greater adherence to fiscal targets	Strengthen macrofiscal forecasting	Establish a macroeconomic and fiscal forecasting unit	Human resources director, ministry of finance	December 2019	Recruit staff for macroeconomic and fiscal forecasting unit by July 2019	Technical support and training staff of macroeconomic and fiscal forecasting unit	Cost of two new staff (Budget) = \$80,000 Technical support (DP cost) = \$40,000
Improve the predictability of budget allocations to service delivery ministries	Implement cash-flow forecasting	Design a medium-term fiscal framework (MTFF)	Budget director, ministry of finance	August 2020	Develop macroeconomic model used for budget preparation by July 2020	Technical support and training staff of macroeconomic and fiscal forecasting unit	Technical support (DP cost) = \$35,000
					Prepare medium-term macrofiscal forecasts based on new model by August 2020		
					Prepare and publish the MTFF by August 2020		
		Develop and distribute a circular advising ministries to prepare monthly cash-flow forecasts	Accountant general, ministry of finance	December 2019	Distribute the budget call circular by July 1, 2019	Not required	No added cost
		Require ministries to update cash-flow forecasts each month	Accountant general, ministry of finance	January 2020	Update cash-flow forecasts for the 2020 budget year	Not required	No added cost
	Update budget processes and procedures	Revise the budget calendar	Budget director, ministry of finance	March 2019	Obtain cabinet approval of the revised budget calendar	Technical support and training for staff of budget department	Technical support (DP cost) = \$20,000
		Revise the budget instructions	Heads of line ministries Budget director, ministry of finance	June 2019	Revise the budget instructions setting out: (a) Budget timetable (b) Aggregate and ministerial budget ceilings (c) Instructions for preparing detailed estimates	Not required	No added cost
Update financial management legislation or regulations to strengthen the legal requirements for adherence to aggregate and ministerial budget ceilings		Heads of line ministries Budget director, ministry of finance	June 2021	Draft revised financial management legislation and regulations by June 2020 Obtain parliamentary approval of the revised financial management legislation by June 2021	Technical assistance support for drafting new financial management legislation	Staffing costs (Budget) = \$75,000 Technical support (DP cost) = \$20,000	

In some cases, therefore, a government's approach to reform may be less structured and more piecemeal based on individual (and achievable) reform initiatives. Specific problems may be responded to in a more ad hoc manner or may simply reflect what is considered achievable given a particular set of circumstances (depending on the political environment, the skills capacity available, or the institutional framework). Such circumstances may not lend themselves to a formal work plan. It is nevertheless important to be clear regarding what the objective of a reform may be, what actions are required, who is responsible for working on the reform, and when the reform is expected to be completed.

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Capacity development takes time and is often nonlinear. Content and approach to capacity building will have to be adjusted over time, reflecting impact and unintended consequences. Special attention should be given to the effectiveness of one-off training compared with a country's institutional strengthening and capacity building.

Work on developing the action plan and identifying the specific reform initiatives and tasks should commence as soon as possible after the PEFA report has been completed. The organizational setup for this work should reflect the circumstances of the country. For example, the work could be anchored by a high-level meeting of senior government officials, with a PEFA oversight team set up for the assessment and all the main stakeholders participating in the workshop disseminating the PEFA report.



Stage 7

Monitor and evaluate reform implementation

Are reforms being implemented?

Progress on implementation should be monitored against specific reforms, actions, milestones, and deadlines, as well as for the potential impact on PFM performance as measured by the relevant PEFA performance indicator(s) or dimensions.

Monitoring should be undertaken continuously for learning and for adjusting objectives, actions, and risk mitigation. Whether reforms are implemented through a structured, an iterative, or an unstructured approach, it is important to track the actions undertaken and deliverables achieved and to hold accountable those who are responsible for carrying out the tasks involved.

Full implementation of a PFM reform task may take several steps over several years. As a result, PEFA indicators and dimensions may not always be suited for measuring progress over the short term. There is also a distinction between monitoring implementation of the reform and evaluating the impact of that reform. Evaluation of longer-term periods should also address the efficiency and

effectiveness of the reform and its impact on the three main budgetary and fiscal outcomes: aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery (discussed later).

Successive PEFA assessments and other diagnostic tools can be planned after three or more years to take another cross-sectional snapshot of progress across the entire PFM framework. In this way, PEFA and other diagnostic tools can be integrated into the government's monitoring and evaluation system with respect to its overall reform program. It is also important for those tasked with implementing reforms to provide regular progress reports to those responsible for monitoring progress. In turn, the officer responsible for monitoring and evaluation should prepare regular quarterly or half-yearly updates for the government to ensure that the PFM reform process is ongoing, transparent, and accountable.

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Some PFM reforms are not suited to annual monitoring because they are too complex and costly or because significant change over a relatively short period of time is unlikely to occur. Many PFM reforms can take several years to implement to the extent that they will affect PEFA dimension or indicator scores. Nonetheless, many new governments consider that having a PEFA assessment early in their appointment provides a useful check on the status of PFM and serves as a benchmark for reform initiatives.

What are the next steps for reform?

PFM reform is rarely linear in its application. Reforms can encounter constraints, and progress can be variable. Governments may need to respond to those constraints and continually adjust their reform plans.

The success or failure of a reform initiative will determine the next steps in the reform process. Failure or partial success will require governments to evaluate the factors that have affected success or failure. Other identified impediments to reform should be addressed. A lack of success may be due to poor or inadequate program design. Practitioners may need to try several iterations of design before a reform is successful.

If reforms are implemented successfully, the government and development partner should move on to the next priority and apply the same approach. In the handbook's example, several attempts at developing economic models and fiscal forecasting techniques may produce sufficiently robust fiscal forecasts.

Has reform had the desired impact on the identified problem?

The final question is whether the reform has had the desired impact on the identified problem. While specific tasks and deliverables should be monitored closely, the reforms should be evaluated to determine whether they have had the desired impact on PFM weaknesses and to address any broader policy problems that may have been the initial catalyst for reform. It is important to look beyond just the PFM impact—in terms of not only the form and functioning of the PFM institutions and systems, but also the impact of improved PFM performance on three key budgetary outcomes: aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery.

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— In the matrix example, the government would evaluate how implementation of the three reform priorities has affected the desired outcome: aggregate fiscal discipline. The evaluation may show that implementation has been successful and had an impact, but that additional reforms are required to strengthen fiscal discipline more. Box 2.2 discusses the balance to be struck between establishing the form and implementing the function of PFM reforms.

Box 2.2

Form versus function

PFM reforms have been criticized for producing “administrative systems in developing countries that look like those of modern states but that do not (indeed, cannot) perform like them” (Andrews, Pritchett, and Woolcock 2017). While in some cases there has been too much focus on the PFM’s form (which, at times, has been too complex for the capacity of the country to absorb and implement), it is difficult to reform a function without first putting in place the necessary laws, regulations, and processes to support the reform. It is clear that countries and their development partners need to ensure reform of the “function” as well as the “form” of PFM systems.

In many cases, establishing the form is an essential prerequisite to implementing the function. Focusing on form per se is not bad; rather, it is important to follow up on the implementation of form by adhering to function. This alignment often requires intensive and sustained technical assistance and support for capacity development.

A review of contemporary literature suggests some dissatisfaction with how the reform design process has worked in the past. Once the stakeholders have been identified and their motivations understood, the decision-making process should focus on reaching an agreement between different stakeholders on defining the limits of reform, agreeing with donor partners on the overall strategy for reform, and ensuring that the authorities are fully aware of the implications of, and fully committed to, the reform.

In contrast to this idealized view of how the decision-making process should occur, various complications frequently arise:

- Reform activities are often too broad and overly ambitious in scope. There seems a built-in bias in the PFM area to be overly optimistic about what can be achieved and to underestimate the time required to achieve it. Such excessive optimism also seems to be a common feature of large-scale public projects.
- Donor assistance to PFM remains rather homogeneous despite continuous efforts to tailor reforms to country needs. Despite this effort and the insistence by donors that reforms should be led by the authorities and address their perceived problems, such tailoring is not always put into practice. For instance, Andrews (2007, 2009, 2010 [[AQ: or do you wish to cite Andrews et al. (2015 or both?)]] found a disturbing similarity in reforms being pursued in Africa, regardless of differences in the countries' contexts and stages of PFM system development. Andrews perceived that bureaucratic agencies were being biased toward what has worked in the past or what they are familiar with—using the phrase, “institutional isomorphism.”^a
- Reform packages targeting PFM reforms are rather homogeneous. Fritz, Verhoevn, and Avenia (2017) found that these packages often include medium-term expenditure frameworks and program budgeting to achieve a better policy orientation of budgets; introduction of new budget classifications and accounting standards (including, in many countries, the ambition to shift to International Public Sector Accounting Standards [IPSAS]); establishment and upgrading of information technology systems for managing public expenditures; better cash management, including the introduction of treasury single accounts; stronger internal audit and external audit; and ex post accountability. Reform packages typically focus on a selection of this set of reforms and, in some cases, most or all of these areas. The considerable homogeneity of reform intentions, also reflected in the five case studies (Georgia, Nepal, Niger, the Philippines, and Tanzania) on which this conclusion builds, shows that the tailoring of reforms to a country's context is often inadequate.
- Countries are often biased toward agreeing with donor proposals when political benefits (and resources) come up-front and costs (if any) come much later. Part of the explanation for this bias arises from the way in which local authorities enter into dialogue with donors. Given the usual political cycle, the time horizon of the politician's term of office tends to be shorter than that of the donors. Resources come first, and, given the nature of PFM reforms, results occur only after a considerable time. In contrast, donors want reform programs, and they stress the importance of having local authorities lead and drive the reform. However, how the political commitment is evidenced and sustained deserves more consideration in the design of reform programs.

^aIsomorphism implies that common reforms are presumed to provide a rational means to attain desirable ends, especially organizational legitimacy in external settings (Andrews 2009, 53).

Box 2.2 (continued)

Form versus function

In contrast to this idealized view of how the decision-making process should occur, various complications frequently arise:

- Choosing reform activities on the basis of local demand sometimes entails tradeoffs. Getting the authorities to own and lead reforms is essential, but, if taken too far in some contexts, such leadership could prove risky and may involve PFM tradeoffs. Donors should reexamine more explicitly how far technical PFM considerations should be compromised to fit a country's political economy context.

Others have advocated taking more radical approaches to questioning whether a particular PFM area can be reformed in certain circumstances and whether it is desirable to keep allocating resources if the required enabling factors are not in place. This questioning highlights both the capacity for reform and the ability to ensure that reform initiatives are implemented with the appropriate and optimum sequencing. Andrews, Pritchett, and Woolcock (2017) analyzed experiences with public sector reform, including PFM, based on case studies in eight countries in East Asia. These studies focused on three key areas that affect the success or failure of reform: design quality, political environment, and institutional capacity. This approach provides a useful basis for developing PFM reforms following a PEFA assessment and subsequent PFM reform dialogue.

3

Planning for, and managing PFM improvement

Determining the right approach

Based on the seven-stage approach, the reform dialogue is intended to lead to a set of desired public financial management (PFM) outcomes around which the government's reform priorities can be agreed and initiatives can be developed to address weaknesses identified in the PEFA report, supplemented by further analysis as required. What happens next will depend largely on the country context. Box 3.1 offers two examples of approaches related to country context, while box 3.2 presents similarities in PFM reform projects.

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Box 3.1

Country context shapes the approach to reform

Comprehensive program

In some cases, it will make sense to develop a comprehensive program of reform initiatives that is formalized into a new (or revised) PFM reform strategy or action plan. More comprehensive reform strategies or action plans are most appropriate in circumstances where the government has had previous experience successfully developing and implementing reforms, where existing capacities are good, or where the government has established an agreed-upon PFM capacity development program with development partners.

More open-ended, less structured

In other cases, a more open-ended, less structured and iterative approach to reform focused on specific high-priority problems may be more appropriate. This approach might be appropriate where reform action plans have been developed in the past without any impact, where commitment to reform has been variable over time, and where the causes of unsatisfactory performance and progress are poorly understood. In these cases, smaller, less ambitious iterative reform initiatives with a focus on continuous feedback and learning may be more effective.

Many experienced practitioners tailor reforms to country circumstances or apply a system of trial and error in reform design and implementation, focusing on reforms that address the government's main problems and priorities and that can be implemented. Andrews, Pritchett, and Woolcock (2017) propose a similar approach referred to as Problem Driven Iterative Adaptation (PDIA). However, for many countries, governments and development partners often prefer a comprehensive reform strategy over a more iterative approach. This decision often leaves countries weighed down with multiple reform initiatives that strain their capacity, undermine political commitment, and often result in reform fatigue. Nevertheless, even in settings where an iterative approach is more appropriate, there are benefits to setting out initiatives in a structured, albeit simplified, agenda.

Further guidance on prioritization and sequencing

44 The literature unfortunately provides very little practical guidance on how a government should decide which areas of PFM it should prioritize in preparing its PFM reform strategy. The most concrete advice on getting the basics right focuses more on horizontal sequencing than on vertical sequencing (Schick 1998, 2015). The literature, however, has largely drawn a blank about the issue of selection—what a country should choose to do first, second, and third and what criteria are relevant. Should improving cash management be given priority over establishing a treasury single account, or vice versa? Should eliminating spending arrears be given priority over building capacity in macrofiscal forecasting and analysis? What degree of priority should be given to upgrading the legal framework for public finance and budgeting? These are important questions on which many different answers can be (and often have been) given, most of them based on loose or missing criteria.

This guidance provides general guidelines and criteria that may help to narrow down the possibilities and organize the subsequent dialogue, by bringing together the seven key stages set out in chapter 2. It does not establish a rigorous analytical framework for prioritizing and sequencing reform.

Stage 1

Analyzes the latest PEFA assessment report and identifies the areas of weak performance. While a mechanical approach to selecting areas of weak performance based on a simple ranking of the PEFA scores should be eschewed—for reasons well rehearsed in the literature—useful information can be derived. The assessment should be compared with previous PEFA reports (if available) to establish whether a consistent pattern of relatively weak-performing areas emerges. Comparisons with other frontline diagnostic assessments, such as Tax Administration Diagnostic Assessment Tool (TADAT), Fiscal Transparency Evaluation, and Public Investment Management Assessment (PIMA) reports, as well as relevant technical assistance reports from the International Monetary Fund, the World Bank, and other credible sources should also be made where these are available.

Stage 2

Draws on assessing the causes of poor performance. In many cases, an indicator is underperforming for several reasons (for example, PI-14, Macroeconomic and fiscal forecasting) that could be linked to technical capacity, lack of suitable information technology systems to produce economic modeling, or political override. Existing diagnostic analyses of the country may not provide sufficient information to assess the causes of inferior performance in all cases, and, where this is the case, the guidance recommends further analysis. Having a better understanding of the underlying causes will enable countries and their development partners to identify which of these causes can be addressed and in what time frame. Some of the underlying causes (technical or process oriented) may be resolved quickly. Others, particularly long-standing political constraints, may take significantly longer or, as discussed in chapter 2, may be impossible to overcome in the short or medium term.

Stage 3

Requires an understanding of a government's desired outcomes from PFM reform. For most low- and middle-income countries, two major objectives of fiscal policy will be to strengthen fiscal discipline and to improve the credibility of the annual budget. In relation to the PEFA framework, this understanding narrows down the focus quite substantially. Other areas of PFM could still be featured as priorities, subject to further analysis (discussed later). During this stage, it is important to ask what constitutes a country's overall strategy for fiscal policy and PFM. For example, do any documents published by the government—such as budget speeches, a fiscal strategy statement, or a PFM reform strategy—define policies or strategies? If a country has a program with the International Monetary Fund, its overall policy objectives may also be enshrined in the program documents, which could include specific benchmarks, such as a commitment to produce a new budget law or fiscal rules or to bring spending arrears under control. Such documents may be useful in identifying a country's short- or medium-term PFM reform priorities.

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Stage 4

Focuses on designing specific reform initiatives aimed at achieving the desired outcomes. Each reform initiative or action should include a brief description of the intended result of that action, the impact on (or progress toward) the desired outcome, an initial time frame for completing the action (and any milestone reached over the short, medium, and longer term depending on the nature of the reform), and the allocation of government responsibility for implementation. It is important to note that alternative desired outcomes may lead to different reform priorities and initiatives.

Stage 5

Assesses the possible obstacles (technical, institutional, or political) to achieving improvements in the areas identified. As set out in chapter 2, a template could be prepared, based on this analysis, that identifies the areas of reform that should potentially be allocated high priority, with observations about whether the reform is likely to be relatively easy to achieve, moderately challenging, or extremely challenging. Only areas in the first two categories should be considered further.

Even with the filters applied in the stages of prioritization described above, the process is likely to result in a large menu of high-priority reforms. There is some justification for this outcome since in most low- and middle-income countries, almost by definition, many PFM areas are relatively weak compared with the PEFA benchmarks. However, an approach that includes all areas in a country's PFM reform strategy leads to overly detailed strategies, which are commonplace in low- and middle-income countries. Such an approach leads to both unrealistic expectations of what can be achieved in a particular time frame and, consequently, often unfair perceptions of failure, as reform programs exceed the capacity of countries to implement them.

Many or most of the projects included in these strategies are executed only partially or not at all. Further filtering may be required to bring the list of projects down to a manageable size that aligns well with a country's fiscal and political priorities. This stage is likely to require more input from senior managers and politicians than from technicians.

In practice, history suggests that countries at any level of development are unable to manage successfully more than one or two major reform projects at one time. In practice, however, it has proved difficult to persuade development partners—many of whom are focused on pursuing their own objectives for achieving good development outcomes and disbursing resources through their official development assistance programs—of the virtues of a lean and focused PFM reform strategy.

The last step of prioritization and sequencing (stage 5) should engage in a dialogue with senior government officials and (ideally) political leaders to discuss the analysis and agree on a set of reform priorities based on the analysis. This dialogue can take many forms.

Stage 6

Focuses on confirming the reform initiatives and developing a reform action plan or strategy for implementation. Table 2.9 provides a template for developing a PFM reform plan that can be adapted for iterative approaches to reform or more sophisticated and comprehensive reform strategies. The template does not intend to be either prescriptive or exhaustive.

Stage 7

Focuses on monitoring and evaluating implementation of reform against specific reforms, actions, milestones, and deadlines as well as the potential impact on PFM performance as measured by the relevant indicator(s) or dimensions of PEFA performance. Monitoring should be used continuously for learning and adjusting objectives, actions, and risk mitigation.

Managing change

This section focuses on change management and its importance. Change management refers to the “process of helping people understand the need for change and [motivating] them to take actions, which results in sustained changes in behavior” (Schick 2015, 3). The process is important, as the introduction of new ways of working will only deliver results if they are widely accepted and actively used, rather than resisted or circumvented. While change management ideas have originated in the private sector, they have also been applied to public sector organizations, with most observers noting some specificity (Kuipers et al. 2014; van der Voet 2014). Change management and the political economy of PFM reforms are related, but they cover distinct aspects of authorization, implementation, and effective use of reforms.

Depending on the level and solidity of political commitment to PFM reforms, it is then sensible to design a reform strategy that corresponds to the relative window of opportunity and change management effort. Change management entails deliberate efforts to communicate effectively within affected organizations regarding why a certain change is being made, what to expect in terms of sequencing of reform steps, what training will be needed and offered, and so on. This is particularly relevant for reforms that affect a large number of staff and how things are done—for example, the introduction of a new accounting system or a large-scale information technology application. When rolling out changes to procurement systems, this type of change management may also involve nongovernmental stakeholders—for example, suppliers.

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Change management literature acknowledges five important areas for promoting effective change. A World Bank Policy Research Paper, *Change Management That Works: Making Impacts in Challenging Environments* (Hughes et al. 2017), identifies five areas, acknowledged in the change management literature, as essential for promoting effective change: leadership, project governance, engagement and communication of stakeholders, workforce enablement, and organizational realignment.

All practitioners acknowledge that leadership is essential for implementing PFM reforms. “Leadership of successful change requires vision, strategy, the development of a culture of sustainable shared values that support the vision and strategy for change and empowering, motivating, and inspiring those who are involved and affected” (Gill 2003, 307). However, formal statements of support for a change program are not sufficient. Change must be articulated in a way that is understood by those affected by the change “in terms of normative frames of reference shared between themselves and their subordinates” (Hughes et al. 2017, 8).

Project governance that reflects the local political economy context can help to ease implementation of the change program. This means that decision making for PFM reform needs to be done locally by persons who have the power to mandate action and to hold to account those responsible for implementation. Decision making at the wrong level can result in difficult challenges of coordination or resourcing that affect implementation.

Engagement and communication with stakeholders are about ensuring that those affected know about a change, such as a reform initiative, and are willing to accept it. The first condition being met does not necessarily or automatically lead to the second condition being met. Rather, change has to be seen as beneficial to both the proponents of reform as well as those affected by it. This process requires open and continuous dialogue between parties as well as empathy and flexibility of the proponents of change in responding to the legitimate concerns of those affected by the change, including refinements of the reform initiative.

Organizational alignment today refers to the process by which organizational practices are reoriented to reflect a new way of working. This may involve a change in work practices, organizational structures, and job descriptions as well as to the types of skills and competencies required to implement the reform.

Workforce enablement is essential if PFM reform and improvement are to be adopted and embedded successfully. Workforce enablement, the last element highlighted by Hughes et al. (2017), is generally referred to in the literature as training in the application of new processes and systems or capacity

development. Hughes et al. (2017, 10) noted that the term can also be viewed more broadly as “representing a level of confidence and familiarity with new processes, systematic learning, and an acceptance of new ways of doing things as appropriate and valid means of achieving common goals.”

Progressing through the stages of PFM reform and improvement outlined in volume IV, it is important to be mindful of the need to manage change in the context of these five elements if implementation and PFM improvement are to be successful. Users should consider the usefulness of other guidance materials available to develop and support their approach to change management, including *Managing Change in PFM System Reforms: A Guide for Practitioners* (Schick 2015) and the work by Hughes et al. (2017).

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Organizational arrangements

It is recommended that the government formally appoint a dedicated, full-time, core government team (of, say, two or three officials) responsible for the design and development of PFM reform initiatives and action plan. This PFM reform team would facilitate the process of identifying, prioritizing, and sequencing reform initiatives in consultation with all relevant and interested stakeholders.

This PFM reform team should be headed by a team leader who is accountable for preparing, implementing, and monitoring reform efforts and for reporting progress to senior management.

Creating a full-time team will enable the officials to be focused on the development and implementation of reform without the burden and potential distraction of other day-to-day activities of the government. Core team members should be experienced with PFM issues and familiar with the PEFA methodology, PEFA assessment results, and volume IV guidelines of the PEFA handbook. They should be able to share this knowledge and build the capacities of other government officials.

The team leader should have regular access to senior managers and political authorities to discuss options for PFM reform. The team should allow sufficient time for design, prioritization, and sequencing, enabling all stakeholders to be consulted and reform initiatives and plans to be agreed upon. In this regard, it is important for the team to build “strategic alliances” with the legislature, nongovernmental organizations, media, and general public to generate traction for implementation.

Pilot testing the application of volume IV

The PEFA Secretariat is planning to pilot test the application of the guidance of volume IV in selected volunteer countries. Lessons learned from the pilot testing will be incorporated into the final published version of the guidance.

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Annex A

Example of a flowchart for reform design

KEY QUESTIONS

PFM REFORM ACTIONS

STAGE 1

What is the problem?
What are the PEFA findings?

Poor education outcomes

Review the PEFA report for PFM issues that impact on education

STAGE 2

What are the causes of the weaknesses identified by PEFA?

Is further analysis required to understand the causes? **YES**

STAGE 3

What needs to be done to address these weaknesses?

Government states improving service delivery as its main priority and identifies three PFM reform

STAGE 4

What are the most important PFM reforms and sequence for achieving the government's priorities?

1. Strengthening macro-fiscal forecasting

2. Implement cash flow forecasting

STAGE 5

Are there constraints to reform?
Can the constraints be resolved or mitigated?

Political constraints

Institutional constraints

NO

YES

Can be resolved in S/T or M/T

YES

Solution implemented

STAGE 6

What are the reforms to be implemented?
What are the actions, deliverables, responsibilities and timelines?

Create macro-fiscal unit

Task: Develop MTFF
Responsibility: Budget Director
Deliverable: MTFF;
Timeline: 2020 Budget Cycle

STAGE 7

Has the reform been implemented?
What are the next steps for reform?
Has the reform had the desired impact on the identified problem?

MTFF implemented

MoF monitors MTFF preparation reassess impact for relevant (eg 1-3, 15)

Implement next reform

Improved budget outturns for education



	NON-PFM ACTIONS	COMMENT/GUIDANCE
<p>Weakness identified include poor budget predictability; no cash flow forecasting; no performance information</p> <p>Further analysis undertaken of the causes of poor performance</p> <p>Analysis identifies: weak fiscal forecasts, cash rationing of budget allocations; absence of performance reporting</p> <p>3. Strengthen budget processes & procedures</p> <p>Skills/ capacity constraints</p> <p><input checked="" type="checkbox"/> YES</p> <p>Can be resolved in S/T or M/T</p> <p><input checked="" type="checkbox"/> YES</p> <p>Solution implemented</p> <p>TA support and training MFU staff</p>	<p>Poorly qualified teachers; outdated curriculum</p> <p>Implement teacher retraining program; update curriculum</p>	<p>Issues identified outside the PEFA context</p> <p>Relevant PFM issues identified through PEFA</p> <p>See Stage 2. What are the causes of strong and poor PFM performance identified by the PEFA assessment?</p> <p>See stage 4 on developing and sequencing reform</p> <p>Repeat the review of constraints for each reform</p> <p>Consider whether constraint is solvable. See table 2.7. Defer reform if constraints are not resolvable</p> <p>If all constraints can be address satisfactorily, implement reform in accordance with agreed priority sequence</p> <p>Consider developing a PFM reform plan or strategy. See table 2.9</p> <p>Continuously monitor progress with implementation of reform and task</p> <p>For specific problem-driven reform evaluate wheather reform has had the desired impact</p>

Notes