



Technical Assistance Consultant's Report

**Project Number: TA 6499 REG: Strengthening Governance and Accountability
in Pacific Island Countries (Phase 2)**

December 2010

Nauru: Public Financial Management Performance Report

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Asian Development Bank

Contents

Abbreviations	ii
Summary Assessment	4
Assessment of Performance	4
I. Introduction.....	10
1.1 Objective of the Public Financial Management – Performance Report (PFM-PR)	10
1.2 Process of preparing the PFM-PR	10
II. Country Background Information.....	12
2.1 Country Economic Situation.....	12
2.2 Description of Budgetary Outcomes	15
2.3 Description of the legal and institutional framework for PFM.....	17
III. Assessment of the PFM Systems, Processes and Institutions	20
3.1 Budget Credibility.....	20
3.2 Transparency and Comprehensiveness.....	24
3.3 Policy Based Budgeting.....	31
3.4 Predictability and Control in Budget Execution.....	33
3.5 Accounting, recording and reporting.....	45
3.6 External scrutiny and audit.....	49
3.7 Donor Practices.....	53
IV. Government reform process	56
4.1 Description of recent and on-going reforms	56
4.2 Institutional factors supporting reform planning and implementation.....	57
Annex 1: Summary Table of PFM Performance Indicator Ratings	58
Annex 2: Sources of Information	63
Annex 3: List of People Met.....	65
Annex 4: Workshop Attendance	66

Abbreviations

AMU	Aid Management Unit
ADB	Asian Development Bank
AGAs	Autonomous government agencies
AusAID	Australian Agency for International Development
COFOG	Classification of Functions of Government
DPPD	Development Planning and Policy Division
EHC	EIGIGU Holdings Corporation
EU	European Union
FBO	Final budget outcome
GFS	Government Finance Statistics
GoN	Government of Nauru
ICT	Information and communications technology
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
ISPPIA	International Standards for the Professional Practice of Internal Auditors
MPs	Members of Parliament
MDAs	Ministries, Departments and Agencies
MYOB	Mind Your Own Business
NSDS	National Sustainable Development Strategy
NAC	Nauru Agency Corporation
NFMRA	Nauru Fisheries & Marine Resources Authority
NPRT	Nauru Phosphate Royalties Trust
NRC	Nauru Rehabilitation Corporation
NPV	Net Present Value
NZAID	New Zealand Agency for International Development
PALCO	Pacific Aircraft Leasing Holding Corporation
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PFM-PR	Public Financial Management Performance Report
PFTAC	Pacific Financial Technical Assistance Centre
PACTAM	Pacific Technical Assistance Mechanism
PFA	Public Finances (Control and Management) Act 1997
PI	Performance indicator
RON	Republic of Nauru

SIDS	Small island developing state
SOPAC	Pacific Islands Applied Geosciences Commission
SPC	South Pacific Commission
SOE	State owned enterprise
SN	Sub-national
TOR	Terms of Reference
UN	United Nations
UNDP	United Nations Development Programme
WHO	World Health Organization
YALCO	Yarren Aircraft Holding Corporation

Currency and indicative exchange rates

Local currency unit = Australian Dollar (A\$)

1 US dollar = A\$ 1.0084 (16 December 2010)

Fiscal Year

01 July -30 June

SUMMARY ASSESSMENT

Assessment of Performance

This Public Financial Management Performance Report (PFM-PR) was prepared at the request of the Government of Nauru (GoN). The purpose of this PFM-PR is to provide a baseline measurement of current PFM performance standards in Nauru using the Public Expenditure and Financial Accountability (PEFA) Performance Measurement Framework developed by the PEFA partners¹ as a tool that can provide reliable information on the performance of PFM systems, processes and institutions over time. The PFM-PR does not assess government policies or capacity levels.

The assessment of current PFM systems against the indicators used in the PEFA framework and the preparation of the PFM-PR was undertaken by a consultant team engaged by the Asian Development Bank (ADB) under ADB's technical assistance for strengthening governance and accountability in Pacific Island Countries (Phase 2).² The supporting analysis for the PFM-PR is based on the Government of Nauru (GoN)'s PFM performance in the three financial years 2008-10. This is the first PEFA assessment completed for the GoN.

i. Integrated assessment of PFM Performance

Overview

Nauru has an underdeveloped PFM system. The country has been gradually moving into a new era of PFM since the election of a reformist government in 2004. Unsatisfactory PFM practices have been put aside and a period of fiscal restraint has been initiated. Supporting measures have included the application of an effective expenditure control system resulting in the achievement of actual (or near) balanced overall budgets in recent financial years. Donors have contributed a high level of technical assistance in several PFM areas over the last three financial years that has substantially provided the foundations for implementing PFM improvements.

Many of the poor indicator scores outlined in this report are attributable to historic weaknesses or gaps in Nauru's PFM system. Action to address some of these weaknesses is already under way. This PFM-PR assessment provides a baseline of current PFM performance levels and a platform from which a robust plan can be prepared to address key areas of identified PFM weaknesses.

The overall results of the assessment of PFM performance are set out in Table 1 below whilst a summary of the rationale for individual indicator assessments is provided in Annex 1.

¹ PEFA partners are the World Bank, EC, IMF, French Ministry of Foreign Affairs, DFID, the Royal Norwegian Ministry of Foreign Affairs and the Swiss State Secretariat for Economic Affairs.

² ADB. 2008. Strengthening Governance and Accountability in Pacific Island Countries (Phase 2). Manila (TA 6499-REG for \$1,900,000, approved on 3 November 2008, cofinanced by the Japan Special Fund and the Government of Australia).

Table 1: Summary of overall results

PFM Performance Indicator		Scoring Method	Dimension Rating				Overall Rating
			i	ii	iii	iv	
A. PFM OUT-TURNS: Credibility of the budget							
PI-1	Aggregate expenditure out-turn compared to original approved budget	M1	N/R				N/R
PI-2	Composition of expenditure out-turn compared to original approved budget	M1	N/R				N/R
PI-3	Aggregate revenue out-turn compared to original approved budget	M1	N/R				N/R
PI-4	Stock and monitoring of expenditure payment arrears	M1	D	B			D+
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency							
PI-5	Classification of the budget	M1	D				D
PI-6	Comprehensiveness of information included in budget documentation	M1	C				C
PI-7	Extent of unreported government operations	M1	N/R	A			N/R
PI-8	Transparency of inter-governmental fiscal relations	M2	N/A				N/A
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	M1	D	N/A			D
PI-10	Public access to key fiscal information	M1	C				C
C. BUDGET CYCLE							
<i>C (i) Policy-Based Budgeting</i>							
PI-11	Orderliness and participation in the annual budget process	M2	B	D	B		C+
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	M2	D	C	D	D	D
<i>C (ii) Predictability and Control in Budget Execution</i>							
PI-13	Transparency of taxpayer obligations and liabilities	M2	D	C	D		D+
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	M2	D	C	D		D
PI-15	Effectiveness in collection of tax payments	M1	C	A	D		D+
PI-16	Predictability in the availability of funds for commitment of expenditures	M1	A	A	A		A
PI-17	Recording and management of cash balances, debt and guarantees	M2	C	B	D		C
PI-18	Effectiveness of payroll controls	M1	C	A	A	D	D+
PI-19	Competition, value for money and controls in procurement	M2	D	D	D		D
PI-20	Effectiveness of internal controls for non-salary expenditure	M1	A	C	C		C+
PI-21	Effectiveness of internal audit	M1	D	D	D		D
<i>C (iii) Accounting, Recording and Reporting</i>							
PI-22	Timeliness and regularity of accounts reconciliation	M2	A	D			C+
PI-23	Availability of information on resources received by service delivery units	M1	D				D
PI-24	Quality and timeliness of in-year budget reports	M1	A	C	C		C+
PI-25	Quality and timeliness of annual financial statements	M1	N/R	N/R	N/R		N/R
<i>C (iv) External Scrutiny and Audit</i>							

PI-26	Scope, nature and follow-up of external audit	M1	N/R	N/R	N/R		N/R
PI-27	Legislative scrutiny of the annual budget law	M1	C	B	D	B	D+
PI-28	Legislative scrutiny of external audit reports	M1	N/R	N/R	N/R		N/R
D. DONOR PRACTICES							
D-1	Predictability of Direct Budget Support	M1	A	A			A
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	M1	D	D			D
D-3	Proportion of aid that is managed by use of national procedures	M1	D				D

Credibility of the Budget

Although the level of budget credibility has been poor recently because of the considerable shortfalls in domestic revenue and expenditure in 2009-10 compared with budget projections, the Government has maintained relatively firm expenditure control in the two latest financial years to 30 June 2010. Government revenues were reduced in 2009-10, partially as a result of the global financial crisis which led to a material reduction in expenditure compared with budget forecasts. Variance in expenditure composition was modest in 2009-10 in spite of the difficult fiscal conditions experienced in this period. A small overall deficit was recorded in the latest financial year following a surplus in 2008-09.

The Government has significant expenditure payment arrears arising from historically poor PFM practices in the period prior to 2004. These are being slowly addressed. Current expenditure payment arrears are minimal.

Comprehensiveness and Transparency

There is limited supporting information currently provided in the budget documentation. The amount of fiscal information available to the public is also modest due to no in-year budget data being released promptly and delays in the preparation and auditing of the financial statements of government and state owned enterprises (SOEs). The poor reporting performance of SOEs has prevented the Department of Finance from undertaking any regular monitoring of SOEs' performances.

Policy Based Budgeting

The annual budget formulation process is satisfactory. Political difficulties have undermined adherence to the budget calendar in some recent budget rounds as well as the timely approval of Budgets by Parliament. The quality of guidance in budget circulars is weakened by the absence of formal budget ceilings in these circulars.

Multi-year budgets are not prepared. Work similar to a debt sustainability analysis was undertaken in 2007-08 and guided the preparation of a debt management strategy. Costed sector strategies have not been prepared for any ministries. Budgeting for investment and recurrent expenditure are separate processes; few recurrent cost estimates arising from donor (investment) projects are provided.

Predictability and Control in Budget Execution

Nauru has one form of taxation, customs duties. The customs regulatory and administration systems are relatively weak. Controls for the collection of customs duty are weak and trends in the collection of customs duty arrears are not monitored.

The Department of Finance maintains a sound cash flow planning system. Cash flow forecasts are prepared, monitored and updated on a weekly basis. Variations to budgeted expenditure levels can be initiated through Supplementary Appropriation Acts.

A comprehensive debt database was prepared in 2006-08 to assist the development of a debt management strategy for the Nauru government and is updated several times each year. The data contained in the debt management database has never been audited. The government's Australian dollar balances are held in bank accounts in Brisbane, Melbourne and Nauru. Consolidation of all the government's Australian dollar cash balances is not possible as there are no formal banking services available on Nauru. The current legal framework in Nauru covering government borrowing and the issuing of guarantees is relatively weak. No formal comprehensive debt management framework is in place to guide government borrowing or the issuing and reporting of guarantees given by the government.

The GoN payroll records have been computerized since 1 July 2010 and the Mind Your Own Business (MYOB) payroll module is now being used. Payroll controls are satisfactory as procedures to support the MYOB software have been implemented. No payroll audit, however, has been undertaken.

New procurement procedures were issued by the Chief Secretary's Department in September 2010 which centralized the majority of government procurement activity from 14 September 2009. The procurement regulatory framework is, however, weak with limited implementation of the new Procurement practices.

The overall standard of internal controls is weak. Although expenditure controls are strong, other internal controls prescribed in the Accounting and Budget Manual, last revised in 1979, are very weak and inconsistent with current practices. There are no supporting financial regulations addressing internal control topics. The Pacific Financial Technical Assistance Center (PFTAC) drafted a revised and more appropriate set of financial instructions, incorporating more effective internal controls, in May 2010. These have not been approved by the Cabinet as of December 2010. The weakness in internal controls exposes the present spreadsheet based accounting system leaving it prone to errors.

The GoN has not formally established an internal audit capability. The office of the Director of Audit has undertaken limited internal audit activity.

Accounting, recording and reporting

At present, the GoN's financial records are maintained on a spreadsheet based accounting system. Over the three year period to 30 June 2010, the GoN's accounting, recording and reporting performance was relatively weak, substantially due to the impact of the poor standard of financial governance prevailing prior to 2004 and the associated weak financial management systems in place during this period.

The Department of Finance has not prepared any annual financial statements since the late 1990's due to previous difficulties in its financial management systems. The recent preparation of updated government cash books and completion of bank reconciliations for all five principal bank accounts for the period since 1 July 2007 has provided the Department of Finance with the data for deriving the annual financial statements for the 2007-10 financial years which are forecast to be completed by 30 June 2011. These will be completed on a cash basis but will not comply with the International Public Sector Accounting Standards (IPSAS) cash accounting standard.

External scrutiny and audit

No audits have been undertaken recently as the Department of Finance has not prepared financial statements for some years. The Director of Audit did, however, present a Special Report to Parliament on 31 December 2008 discussing the working of different government entities in the period 20 May 2008 to 31 December 2008 including comments on the failure of government entities to prepare financial statements and the status of the respective financial statements and audit reports. The absence of audits of financial statements has also resulted in no regular reviews being undertaken of the financial management system and associated controls, compliance with current accounting policies and the quality of financial reporting.

Donor practices

Useful information is available about donor cash and in-kind aid flows. Taiwan provides budget support consistent with budgeted forecasts and on a timely basis. Not all major donors provided project disbursement forecasts in the 2009-10 year used for undertaking donor indicator assessments. Nauru's major donor, Australia, provides timely quarterly reports on its aid flows. Slightly less than 50% of aid flows were managed through national procurement, payment / accounting and reporting procedures.

ii. PFM impacts on budgetary outcomes

The relative performance of PFM systems affects the overall achievement of budgetary outcomes at three levels, namely aggregate fiscal discipline, strategic allocation of resources and efficient service delivery. The present underdeveloped state of the Nauruan PFM system is having a negative impact on strategic resource allocation and service delivery.

Although the budget credibility indicator assessment results are relatively poor, the government has maintained sound fiscal discipline over the last three years by applying strong cash and expenditure management. Revenue constraints have a greater impact on strategic resource allocation and service delivery than expenditure constraints. The government is potentially exposed to some financial risk by the present poor financial reporting performance of four leading SOEs³ whose combined spending substantially exceeds the current value of total government spending. Any unexpected operating losses may impact delivery of core services.

Currently there is limited ability to improve medium-term strategic resource allocation. Few ministries have sector plans, supported by robust financial estimates, to inform their budget submissions. To date no medium-term budgeting activity has been undertaken.

³ Menen Hotel, Nauru Air Corporation, Nauru Rehabilitation Corporation and Ronphos Corporation.

The limited medium-term focus in budgeting, weak internal control systems especially in procurement and internal audit and the mediocre standard of accounting represent major constraints to the delivery of basic services. The absence of government financial statements has prevented stakeholder scrutiny that would normally assist the review of sectoral budgetary allocations and service delivery performance levels.

iii. Prospects for reform planning and implementation

Since its election in 2004, the present Nauru government has gradually laid the foundations for recent PFM improvements. This has been achieved with the help of the Government of Australia who has provided considerable technical assistance on financial management topics since 2004. At present the three senior positions in the Department of Finance are staffed by Australian and Pacific island expatriates funded by the Australian government's Pacific Technical Assistance Mechanism (PACTAM) program. In addition, the Government of India provided an auditor to take up the position of Director of Audit in 2008.

During 2009-10 the government introduced a series of new PFM initiatives including:

- The application of a more robust budget process in the preparation of the 2010-11 Budget.
- The reconciliation of all five principal government bank accounts for the three years ended 30 June 2010; this work provides the foundations for the preparation of outstanding financial statements for the latter period.
- The introduction of new procurement measures including a process designed to reduce the need for the handling of cash in local procurements.
- The computerization of payroll records that came into effect on 1 July 2010 using the MYOB payroll module.

The 2010-11 Budget outlined the following two new major PFM initiatives scheduled for the 2010-11 year:

- The proposed establishment of a new financial accounting system, estimated at \$500,000, to improve the management, control and reporting of all Government financial transactions.
- The proposed establishment of a National Revenue Office (NRO).

It is important to note that Nauru's recent and currently proposed PFM reform measures are being undertaken in the context of prevailing relatively modest overall PFM standards. The abovementioned PFM initiatives demonstrate that the government has the capacity to lead and implement a series of gradual PFM reforms on a timely basis, assisted by its major development partners.

I. INTRODUCTION

1.1 Objective of the Public Financial Management – Performance Report (PFM-PR)

1. This PFM-PR seeks to provide a comprehensive baseline measurement of the current performance of Public Financial Management (PFM) processes and systems in Nauru. The PFM-PR has been prepared using the Public Expenditure and Financial Accountability (PEFA) methodology. The PEFA methodology does not assess the merits of government PFM policies or capacity levels. The costs associated with the preparation of this assessment have been funded by the Asian Development Bank (ADB)⁴.

1.2 Process of preparing the PFM-PR

1.2.1 Methodology

2. The assessment was undertaken as a joint exercise by a GoN official (Javan Tamakin who is also the GoN's Chief Accountant), acting as a GoN focal point, and a technical expert engaged by ADB (John Leonardo). The fieldwork was undertaken during September 2010. A three-hour workshop was held with key stakeholders on September 2 2010 prior to the commencement of the associated fieldwork to outline the PEFA methodology, proposed work timetable and stakeholder consultation plans. A two hour workshop was held on September 28 2010 at the conclusion of the field work to provide key stakeholders with details of the preliminary results and an outline of Nauru's indicative performance compared with two other South Pacific small island developing states (SIDS)⁵.

3. The project team met with Nauru's major donors, Australia and Taiwan, during the fieldwork stage. Both major donors participated in the two workshops and met with the PEFA team. In addition, the technical expert also met representatives of the European Union and three United Nations organizations who visited Nauru during September 2010.

4. The technical expert met extensively with the senior officials of the Department of Finance, particularly the Secretary, Deputy Secretary - Treasury, Deputy Secretary – Economic Development and Monitoring, Chief Accountant and the Chief Statistician. The technical expert also met with the Minister of Finance on 14 September 2010.

5. In addition, the PEFA team met with senior staff from the key ministries of Commerce, Education, Health, Justice (responsible for customs revenue), Chief Secretary's Department and the Office of the Director of Audit. Prominent members of civil society and private sector stakeholder groups were also consulted.

6. The Department of Finance provided a significant proportion of the financial information used in the preparation of the PFM-PR. Ministry officials and stakeholder groups contributed valuable insights on current government PFM processes and systems.

1.2.2 Scope of the assessment as provided by the PFM-PR

7. This PFM-PR addresses the government's PFM processes and systems. Nauru's SOEs, however, play a significant role in the Nauru public sector. As audited consolidated data on the financial performance of SOEs is not available, a conservative assessment of their share

⁴ ADB. 2008. Strengthening Governance and Accountability in Pacific Island Countries (Phase 2). Manila (TA 6499-REG for \$1,900,000, approved on 3 November 2008, cofinanced by the Japan Special Fund and the Government of Australia).

⁵ Kiribati and the Kingdom of Tonga

of estimated 2010-11 public sector expenditure was made using the 2010-2011 budget data of four major SOEs. This assessment demonstrated that the SOEs represent approximately 56.6% of total public sector activity⁶. Details of the shares of estimated 2010-11 public sector expenditure attributable to the government and SOEs is presented in Table 2 below.

Table 2: Government of Nauru's share of estimated 2010-11 public sector expenditure (A\$)

Organization	2010-11 Budget	Estimated % of total public expenditure
Government of Nauru	\$60.9 million	43.4%
Nauru SOEs	\$79.5 million	56.6%
Total	\$140.5 million	100.0%

8. Section 2 provides background information on the economic, fiscal, legal and institutional context for the PFM-PR. Section 3 discusses the scores for the 31 PFM performance indicators. Section 4 describes the government's recent and on-going PFM reforms and the institutional factors supporting PFM reform and planning. A series of annexes provide supplementary reference information, including a summary of the performance indicator ratings (Annex 1), a list of the information sources used in preparing this report (Annex 2), a list of people met (Annex 3), details of attendees at the two workshops held in Nauru (Annex 4) and the TOR for the PFM-PR preparation (Annex 5).

⁶ Budgeted 2010-11 expenditure for SOEs was calculated using the 2010-11 budgeted expenditures of four SOEs: Menen Hotel, Nauru Air Corporation, Nauru Rehabilitation Corporation and Ronphos Corporation. An exhaustive list of all 2010-11 budgeted expenditure for SOEs was not available. Inter-company transactions have not been eliminated when calculating the reported 2010-11 expenditure data.

II. COUNTRY BACKGROUND INFORMATION

2.1 Country Economic Situation

2.1.1 Country context

9. The Republic of Nauru, a phosphate rock island, is a small island developing state (SIDS) in the central Pacific Ocean with a land area of 21 square kilometers.

10. Nauru gained self-government in 1966 following a period as a mandated territory under the League of Nations and later, the United Nations and became fully independent on 31 January 1968. Its constitution established it as a republic with a Westminster style parliamentary system of government.

11. The resident population of Nauru was 9,872 at the time of the last census undertaken in 2002. A mini-Census conducted in December 2006 indicated a population of 9,275 persons as at end-2006. The next census and a Household Income and Expenditure Survey are scheduled to be held in 2011.

12. Following its independence, Nauru enjoyed a very high standard of living in the 1980's and early to mid 1990's as a result of income from its strong phosphate exports and the associated royalty income which flowed to the Nauru Phosphate Royalties Trust (NPRT), a mechanism designed to manage long-term investments to support Nauruans once the phosphate reserves were exhausted. The government's fiscal management deteriorated in the late 1980's as Nauru entered an era of budget deficits where the government borrowed extensively from the BoN and used the NPRT's assets as collateral. The NPRT's deteriorating financial position was exacerbated by losses arising from numerous poor investments.

13. By 1995, following the collapse of the BoN, the country found itself facing a serious financial crisis. Difficulties in servicing interest payments led to further government borrowing and indebtedness that is now very substantial. Government debt amounted to \$520.9 million as at 30 June 2010⁷. The NPRT's overseas investments were heavily mortgaged and there was little ability to pay for infrastructure and basic services. A reformist government, elected in 2004, initiated an ongoing process of economic and fiscal consolidation for the Nauru economy.

The decline in Nauru's fiscal position in the mid 1990's was accompanied by a severe downturn in the volume of phosphate exports which had been declining from the late 1980's as primary phosphate reserves became substantially mined out. Negligible phosphate export volumes were achieved in the 1999-2006 periods. Some increase in phosphate exports is now taking place; estimated phosphate exports of 520,000 tons are forecast for the 2010-11 year compared with 17,200 tons in 2005-06 and 319,000 tons in 2009-10. The world phosphate rock market is improving after declining in 2008-09. The long-term outlook is favourable at present with demand expected to trend upward with an average growth of around 3% per annum in the ten-year period 2009-19⁸.

⁷ The Department of Finance advised that as at 30 June 2010 debts owed to individuals and entities outside Nauru amounted to \$257.6 million whilst debts owed to individuals within Nauru amounted to \$263.3 million. The Department of Finance also advised that all debts between the government and SOEs have been written off.

⁸ "Phosphate Rock Ten Year Outlook September 2010", CRU International

14. The Nauruan economy has traditionally had a narrow export base comprising phosphate exports and more recently some income from fishing licenses. With phosphate mining and exports undertaken by government owned companies, the Nauruan economy is dominated by the public sector. There is relatively minimal private sector activity. Remittances from Nauruans living overseas are modest⁹. Nauru relies on imports for almost all of its material needs (food, consumer goods, plant and equipment, fuel, and building materials). Most of these goods are imported from Australia. No recent trade statistics are available.

15. The decline in phosphate exports since the late 1990's has meant that there has been no real growth in the Nauruan economy for over a decade. Cautious assessments of trends in Nauru GDP and per capita income are necessary as the quality of income statistics is relatively poor, particularly for the period prior to 2005. ADB estimates¹⁰ suggest there was no overall growth in the Nauru economy in the 2005-2009 periods (June years); modest growth was expected in 2009-10. Some growth is possible in 2010-2011 provided forecasted phosphate exports are achieved (where contracts are written in US dollars) and revenues are realized at reasonable exchange rates when export receipts are converted from US dollars to Australian dollars. ADB reported per capita income statistics of US\$2,440 in 1997-98 and again in 2008-09¹¹ suggest there has been negligible growth in per capita income for at least a decade.

16. Primary phosphate reserves are estimated to be enough for 3–4 years of production, and deeper, secondary reserves might last 20 years. An intergenerational trust fund is being established so that income from phosphate mining can be saved for when the reserves are exhausted. Full exploitation of the phosphate resource, however, requires considerable investment to refurbish the necessary infrastructure. Improved governance, especially of the state-owned enterprises that dominate the economy, is also needed to encourage the public and private investment required.

17. There has been no reported evidence of absolute poverty in Nauru¹². UNDP data¹³ reported a relatively low Human Poverty Index figure of 12.1 in 1998 which had increased slightly to 15.0 in 2008. No UNDP Human Development index values are available for Nauru due to the poor quality of statistics for the period prior to 2005. The preparation of a poverty report is planned for 2011.

18. Nauru's use of the Australian dollar as its means of exchange has allowed it to enjoy a relatively low inflation rate since 2004. The average inflation rate for 2008-09 was estimated at 2.2%¹⁴. A slight increase in the inflation rate is projected for the 2009-10 and 2010-11 years due to higher estimated fuel prices¹⁵. Nauru's use of the Australian dollar has, however, had a negative impact on phosphate export revenues which are realized in US\$.s.

19. The Nauru government's development policies are based on its National Sustainable Development Strategy (NSDS) 2005-2025 which seeks to create an improved quality of life for all Nauruans through individual, community, business and government partnerships. The major development challenges facing Nauru when the NSDS was prepared in 2005 remain today, namely (i) the role of the public sector that currently dominates the Nauruan economy

⁹ This could not be quantified as Remittance income was not specifically addressed in the "Nauru Household Income and Expenditure Survey Report 2006"

¹⁰ Asian Development Outlook 2010, Figure 3.35.7 p250

¹¹ Asian Development Bank & Nauru FACTSHEET, Table 2

¹² "Beyond "Subsistence Affluence": Poverty in Pacific Island Countries", Marin Yari, ESCAP Bulletin on Asia-Pacific Perspectives 2003/04

¹³ "2010 Pacific Regional MDG Tracking Report", Pacific Islands Forum Secretariat, Table 3: Pacific Human Poverty Indicators

¹⁴ "ADB Pacific Economic Monitor February 2010", Asian Development Bank

¹⁵ "ADB Pacific Economic Monitor February 2010", Asian Development Bank

must be reduced as a result of private sector growth and its productivity increased if a more sustainable economic base is to be achieved; (ii) Nauru's tremendous debt burden must be first stabilized and then progressively reduced and (iii) the Nauruan government must enhance the country's savings in preparation for the eventual cessation of phosphate mining.

20. With the government now having brought its fiscal position under control, the ongoing performance of the Nauruan economy in the short to medium term is closely linked to its phosphate exporter (Ronphos)'s ability to export reasonable phosphate volumes and subsequently realize its US dollar revenues at relatively favorable exchange rates in Australian dollars.

2.1.2 Overall government reform programme

21. The reformist government elected in 2004 initiated a process of economic and fiscal consolidation for the Nauru economy. This process has been sustained since its commencement and is a key influence on the conduct of public financial management in Nauru. The economic and fiscal consolidation process has three broad components: i) fiscal restraint, (ii) sustainable service delivery and (iii) debt management.

(i) Fiscal Restraint: the government has sought to achieve budget surpluses since 2004 through increases in, and diversification of, revenues. To achieve fiscal restraint, the government has exercised tight control over its own expenditure focusing spending on the core areas of government services and meeting the goals of the NSDS. The domestic revenue base has become slightly more diversified in the three years ended 30 June 2010. In addition, the government has sought to improve the financial governance and results of its SOES but performance in this area has been relatively modest to date.

(ii) Sustainable Service Delivery: the Government has focused on its NSDS objectives of providing sufficient funding to ensure basic services such as hospital, schools and law and order are maintained.

(iii) Debt management: A debt management strategy was developed during 2006-08 to address Nauru's significant debt burden. The value of the Nauru government's debt to individuals and organizations outside of government was estimated at A\$524 million as at June 2010 (A\$263.3 million owed to individuals on Nauru excluding government entities¹⁶ and A\$260.87 million owed to individuals and entities outside of Nauru¹⁷). Government led negotiations to reduce the value of some major outstanding external debts are continuing. The government is endeavoring to commit approximately 1.5% of annual domestic revenue to debt repayment.

22. The abovementioned components of the government's economic and fiscal consolidation process have an ongoing influence on the selection of new PFM reforms.

2.1.3 Rationale for PFM reforms

23. The Nauru government's current public financial management strategies are based on a desire to avoid a repeat of the prior practices in public financial management experienced in the 1980's and much of the 1990's that severely undermined the government's fiscal position and the Nauruan economy. The new reformist 2004 Nauru government had no alternative other than to progressively implement a series of measures to stabilize the government's fiscal position.

¹⁶ Source: Department of Finance communication 11 November 2010

¹⁷ "2010-11 Budget: Budget Paper 2", Government of Nauru, 2010

24. Whilst some progress has been made since 2004 in improving the quality of public financial management compared with that prevailing previously, there are a considerable number of outstanding issues to be addressed to achieve a more satisfactory overall standard of public financial management. A major improvement is also required in the financial performance and governance of Nauru's major SOEs.

2.2 Description of Budgetary Outcomes

2.2.1 Fiscal performance

25. Data constraints do not allow a detailed analysis of budgetary outcomes for the three years ended 30 June 2010. No robust GDP data is available for any of the three years ended 30 June 2010.

26. Comprehensive central government budget data (which has not been audited) is only available for the most recent financial year due to the data for the two previous years being incomplete¹⁸. Total expenditure increased from \$27.3 million in 2007-08 to \$35.8 million in 2008-09 but declined by 11.9% to \$31.5 million in 2009-10 as a result of the global financial crisis. Donor-funded cash grant expenditure was steady in 2009-10 (at \$11,228,068 compared with \$11,245,126 in 2008-09) but domestic expenditure declined by 17.3% (from \$24,527,531 in 2008-09 to \$20,288,100 in 2009-10). A surplus of \$3.5 million was achieved in 2007-08. Data for the 2009-10 financial year¹⁹, presented in Table 3, shows a small overall deficit was recorded in this period.

Table 3: Central government budget out-turn 2009-10

Central government budget	
	2009-10
Total revenue	31,362,995
-Own revenue	16,259,538
-Donor Grants	15,103,457
Total expenditure	31,516,168
-Non-interest expenditure	31,516,168
-Interest expenditure	
Aggregate deficit (incl. grants)	- 153,173
Net financing	- 153,173
-external	3,875,389
-domestic	- 4,028,562

Source: Department of Finance management report

2.2.2 Allocation of resources:

27. Resource allocation data is available for the 2008-09 and 2009-10 financial years. Reported total expenditure by budget head for the 2008-10 periods, categorized by the functions of government for the purposes of this report, is presented in Table 4.

Table 4: Budgetary sector allocations 2008-2010

¹⁸ Donor cash grant expenditure is not available for the 2007-08 year. Domestic revenue data for the 2008-09 year is incomplete.

¹⁹ Public debt expenditure incurred in 2009-10 covered expenditure payment arrears and not debt interest

	2008-09	2009-10
General Public Services	36.66%	46.02%
Public Order and Safety	4.74%	6.67%
Education	10.19%	10.72%
Health	14.99%	15.69%
Social Protection	1.85%	2.01%
Recreation, Culture and Religion	0.50%	0.58%
General Economic Affairs	2.61%	2.05%
Fuel and Energy	22.48%	4.56%
Fishing	1.71%	1.71%
Transport	3.91%	8.67%
Communications	0.37%	1.32%
Total	100.00%	100.00%

Source: Department of Finance management report

28. Although the expenditure shares of most budget heads varied considerably between the 2008-09 and 2009-10 financial years the shares of spending for education and health were relatively stable. This outcome is consistent with the government's NSDS for maintaining basic services including those applicable to education and health. A major reduction occurred in the level of fuel expenditure in 2009-10 with total expenditure declining by 11.9%, resulting in a major decline in the fuel and energy expenditure share²⁰. The expenditure share for general public services increased as a result of increased actual expenditure in a year when total expenditure fell. The transport share of expenditure in 2009-10 was boosted by major plant and equipment spending.

29. Expenditure for the 2008-10 periods, reported by economic classification, is presented in Table 5²¹.

Table 5: Budgetary allocations by economic classification 2008-2010

	2008-09	2009-10
Total expenditure	100.00%	100.00%
Current expenditure	68.57%	64.37%
<i>Wages and salaries</i>	20.91%	25.85%
<i>Goods and services</i>	45.80%	36.52%
<i>Interest payments</i>	0.00%	0.00%
<i>Transfers</i>	1.85%	2.01%
<i>Others</i>	0.00%	0.00%
<i>Capital expenditures</i>	0.00%	0.00%
Donor-funded expenditure	31.43%	35.63%

Source: Department of Finance management report

²⁰ The total reported value of petrol and diesel purchases charged to the Department of Finance's budget declined from \$8,038,576 in 2008-09 to \$1,465,052 in 2009-10. No data is available in respect of the composition of donor-funded grant expenditure by sub-head for 2009-10. . No data is available in respect of the composition of donor in-kind expenditure by either head or sub-head for 2009-10. It is likely that a considerable amount of petrol and diesel purchases in 2009-10 were funded on an in-kind basis by donors.

²¹ Capital expenditure is not recorded

30. Wages and salaries' expenditure share rose in 2009-10 as a result of staff increases, particularly in health. Goods and services share of expenditure declined in 2009-10 due to the reduction in domestic expenditure whilst the donor-funded expenditure share increased in 2009-10 as a result of donor-funded grant expenditure remaining relatively stable in a year when total expenditure fell by 11.9%.

2.3 Description of the legal and institutional framework for PFM

2.3.1 The legal framework for PFM

31. The current legal framework for PFM is presented in Table 6.

Table 6: Nauru PFM legal framework

Description of Act/Regulations	
Public Finance	PFM topics are addressed in Part VI of the Constitution. This part sets out the provisions with respect to the operation of the Treasury fund, taxation, withdrawal of moneys in advance of appropriation law, the establishment of a long-term investment fund, the distribution of phosphate royalties, the establishment of a contingencies fund, payment of remuneration to certain office holders and the payment of government debt expenses. The Public Finances (Control and Management) Act 1997 (PFA) provides for the control and management of the public finances of Nauru. No supporting regulations have been promulgated. An Accounting and Budget Manual, last revised in 1979, previously provided guidance on accounting and budget matters but is redundant. There are also two acts addressing the operation of the Treasury Fund (the Treasury Fund Investment Act 1971 and the Treasury Fund Protection Act 2004).
Audit	Section 66 (1) of the Constitution establishes the office of the Director of Audit as a public office. The duties and powers of the Director of Audit in the audit and examination of the public accounts are prescribed in the Audit Act 1973. These are also applicable to the accounts of all statutory bodies.
Legislative Scrutiny	The Public Accounts Committee Act 1992 prescribes the operation of the Public Accounts Committee.
Procurement	No procurement legislation or regulations have been enacted. The Accounting and Budget Manual prescribed rules for the processing of purchases but did not address stores topics.
Revenue Administration	Nauru has no tax legislation. Tax revenues are limited to customs duties. There are four customs acts which form part of the PFM legal framework (the Custom & Adopted Laws Act 1971, the Customs Act 1921-2009, the Customs Ordinance 1922-1967 and the Customs Tariff Act 1997-2007) together with regulations issued under the Customs Act 1921-2009 and the Customs Tariff Act 1997-2007.
State owned enterprises	No overarching legislation covering the governance of SOEs exists. Some SOEs have their own legislation (Nauru Air Corporation Act 1995, Nauru Fisheries & Marine Resources Authority Act 1997, Nauru Rehabilitation Corporation Act 1997, RONPHOS Act 2005) whilst the remainder are governed by the Companies Act.
Other	An Anti Money Laundering Act was passed in 2008. There is no local government in Nauru.

32. The current PFA is out dated, and therefore does not reflect current PFM practices and an update of this legislation is planned in the short to medium term. A set of draft Financial Instructions was prepared in May 2010 by the PFTAC but to date these have not been submitted to Cabinet for approval.

33. The present customs legislation is also dated and a major update of this legislation is also planned in the short to medium term.

34. The Department of the Chief Secretary issued new procurement procedures in September 2009 that sought to centralize all government procurement activity through the government warehouse and replace the purchasing rules set out in the Accounting and Budget Manual.

35. At present there is no procurement legislation or regulations in force in Nauru.

2.3.2 The institutional framework for PFM

36. The Nauru government has three branches (executive, legislative and judicial). Nauru has no local government system.

37. The President is the head of state and government. The President is elected by Parliament and must be a member of Parliament. The President and the Cabinet comprise the executive branch. Section 19(1) of the constitution provides for the President to appoint four or five members of Parliament to be Ministers of the Cabinet. There are five ministers appointed at the present time. The President also acts as a minister. Currently there are thirteen ministries. A unicameral Parliament is the legislative branch of government with 18 members elected every 3 years by Nauruan citizens over the age of twenty. The President is also elected every 3 years by Parliament. As there are no political parties in Nauru, all MPs stand as independents.

38. The legal branch of government is rather complicated for such a small country, and includes (i) a Supreme Court presided over by a chief justice; (ii) an appellate court; (iii) lower courts consisting of a district court; and (iv) a family court presided over by a resident magistrate who is also a registrar of the Supreme Court. The office of the Director of Audit is a public office. The Supreme Court deals exclusively with constitutional matters. Appeals can be made from the appellate court to the high court of Australia, but in practice this rarely happens. The management of the Public Service is vested in the Chief Secretary. The chief justice also presides over a public service appeals tribunal and a police tribunal.

39. The conduct of the Nauru government's PFM activities is substantially undertaken by the Department of Finance which consists of five divisions: the Treasury (including the Cash Office), the Development Planning and Policy Division (DPPD), the Aid Management Unit (AMU), the Bureau of Statistics, and the Directorate of Payments. Line ministries principally participate in budget preparation and implementation activities. The Customs function is controlled by the Justice Department rather than the Department of Finance. There are currently thirteen government ministries and only one constitutional body, namely the Public Service Appeals Board.

40. There are eighteen SOEs in Nauru of which seven are either non-functional or being wound down whilst another three are subsidiaries of one of the operative SOEs.

2.3.3 Key features of the PFM system

41. Nauru operates a highly centralized PFM system with line ministry officials generally having limited delegated powers to approve expenditures but they cannot make any payments; these are made by the Department of Finance.

42. The government audit function is undertaken by the Director of Audit who reports directly to the Minister of Finance who must subsequently table the Director of Audit's reports in Parliament.

43. The GoN uses a July to June financial year and will use the cash basis of accounting for its pending financial statements. These will not comply with the International Public Sector Accounting Standards (IPSAS) cash accounting convention. There is no computerised accounting system in place at present and financial records are maintained by the Department of Finance in Excel spreadsheets. The payroll system is computerised but is not integrated with the Department of Finance's records. Budgeted staff costs represent 30.92% of estimated 2010-11 domestic expenditure.

47. Political impasses have resulted in the government often operating under emergency powers provided for in sections 77 to 79 of the Constitution during the three years ended 30 June 2010. These have disrupted the conduct of PFM, particularly delaying Parliament's budget sessions and have also resulted in the Public Accounts Committee (PAC) meeting infrequently over the last three years.

III. ASSESSMENT OF THE PFM SYSTEMS, PROCESSES AND INSTITUTIONS

3.1 Budget Credibility

Indicator 1: Aggregate Expenditure Out-turn Compared to Original Approved Budget

44. The PI-1 indicator compares the aggregate actual expenditure with the budgeted expenditure to examine the ability of the Government to implement the expenditures voted by the legislature and deliver the public services based on the Government policy statements and programs outlined by the administrative ministries/departments in their budget proposals. The total expenditure figure used for the indicator is net of loan principal and interest payments and donor funded expenditure.

Dimension (i) The difference between actual primary expenditure and the originally budgeted primary expenditure

45. This indicator has not been scored as aggregate central government expenditure budget data (which has neither been formally reported nor audited) is only available for the 2008-09 and 2009-10 financial years due to the expenditure data for the previous year being incomplete²². Details of recurrent expenditure deviations for 2008-10 are presented in Table 6.

Table 7: Recurrent expenditure deviations 2008-10

Expenditure	2008-09		2009-10	
	Original budget A\$ Million	Actual expenditure A\$ Million	Original budget A\$ Million	Actual expenditure A\$ Million
Total recurrent expenditure	25.257599	24.527531	28.705028	20.288100
% deviation		-2.89%		-29.32%

Source: Department of Finance management reports

46. Actual primary expenditure was slightly less than the budgeted amount in 2008-09. The government was forced to reduce its expenditure markedly in 2009-10 in response to a downturn in revenues as a result of the global financial crisis which resulted in a considerable deviation between budgeted and actual recurrent expenditure.

Indicator	Aggregate expenditure out-turn compared to original approved budget	Score	Justification
PI-1		N/R	
(i)	The difference between actual primary expenditure and the originally budgeted primary expenditure (i.e. excluding debt service charges, but also excluding externally financed project expenditure)	N/R	Actual expenditure deviated from budgeted expenditure by more than 15% of budgeted expenditure in 2009-10.

²² Although total expenditure is available for the 2007-08 year, no data is available for donor-funded expenditure. Consequently the value of 2007-08 recurrent expenditure cannot be identified.

Indicator 2: Composition of expenditure outturn compared to original approved budget

47. The PI-2 indicator measures the extent to which reallocations between budget lines have contributed to variance in expenditure composition beyond the variance resulting from changes in the overall level of expenditure. Variance is measured as the sum of the absolute deviations between actual and originally budgeted expenditure for each main area of expenditure calculated as a percentage of total budgeted expenditure. In order to be compatible with the assessment in PI-1, the calculation excluded loan principal and interest payments and donor funded project expenditure.

Dimension (i) Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure

48. This indicator has not been scored as the variance in primary expenditure composition is only available for two financial years under review as stated in the review of PI-1.

Table 8: Variance in primary expenditure composition 2008-10

Year	Total expenditure deviation (PI-1)	Total expenditure Variance	Variance in excess of total deviation
2008-09	2.89%	10.15%	+7.26%
2009-10	29.32%	29.63%	+0.31%

Source: Department of Finance management reports

Indicator	Composition of expenditure out-turn compared to original approved budget	Score	Justification
PI-2		N/R	
(i)	Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years	N/R	Variance in expenditure composition exceeded overall deviation by 7.26% and 0.31% in 2008-09 and 2009-10.

Indicator 3: Aggregate revenue outturn compared to original approved budget

49. The PI-3 indicator assesses the accuracy of revenue forecasting by comparing domestic revenue estimates in the original approved budget to actual domestic revenue collection.

Dimension (i) Actual domestic revenue collection compared to domestic revenue estimates in the original approved budget

50. This indicator has not been scored due to the incomplete nature of domestic revenue records for 2008-09 noted earlier in section 2.2. Revenue data for 2008-10 has not been formally reported. No audit of revenue records for the last three years has been undertaken.

51. The deviation between budgeted and actual domestic revenue in 2007-08 was minimal. There was, however, a major deviation in 2009-10. The domestic revenue deviations for these periods are presented in Table 8.

Table 9: Domestic revenue deviations 2007-08 and 2009-10

Domestic revenue	2007-08		2009-10	
	Original budget A\$ Million	Actual expenditure A\$ Million	Original budget A\$ Million	Actual expenditure A\$ Million
Total domestic revenue	13.673850	13.582282	27.137325	16.259538
% deviation		-0.67%		-40.08%

Source: Department of Finance management reports

52. The projections and realizations for the major components of Nauru's domestic revenue for 2007-08 and 2009-10 are presented in Table 9. Ronphos' failure to pay a dividend in 2009-10 due to the impacts of the global financial crisis and extremely adverse weather in Nauru that affected the loading of exports had a major impact on domestic revenue in the last financial year. The inaccurate budgeting of fuel sales also contributed to the poor domestic revenue out-turn in 2009-10.

Table 10: Domestic revenue flows 2007-08 and 2009-10

Domestic revenue flows	2007-08		2009-10	
	Original Budget	Actual revenue	Original budget	Actual expenditure
Investment income	204,000	133,450	4,400,000	
Fisheries	5,918,651	4,035,848	7,306,161	5,969,866
User charges	3,039,699	3,171,750	5,315,285	3,680,545
Customs and Excise Duty	1,811,500	2,243,581	5,846,942	4,730,387
Fuel sales	2,700,000	3,945,480	4,268,937	1,878,740
Total	13,673,850	13,530,109	27,137,325	16,259,538

Source: Department of Finance management reports

Indicator	Aggregate revenue out-turn compared to original approved budget	Score	Justification
PI-3		N/R	
(i)	Actual domestic revenue collection compared to domestic revenue estimates in the original approved budget	N/R	Actual domestic revenue was more than 8% less than budgeted revenue in 2009-10.

Indicator 4: Stock and monitoring of expenditure arrears

53. The PI-4 indicator measures the extent of any stock of arrears and the degree to which this problem is being brought under control and addressed.

54. Expenditure payment arrears constitute a form of non-transparent financing that affects the credibility of the budget. A high level of arrears could indicate a number of different financial management problems.

Dimension (i) Stock of expenditure arrears

55. The present PFA and draft Financial Instructions do not make any reference to the measuring of or reporting on expenditure arrears.

56. At present the Department of Finance does not compile any formal reports on current expenditure arrears.

57. In spite of the absence of current expenditure arrears reporting, the Department of Finance advised that minimal expenditure arrears were incurred in the 2008/2009 and 2009/2010 financial years. Following the end of the 2008-09 financial year, three weeks were allowed for the processing of all unpaid payment vouchers and the charging of the associated expenditure against the 2008-09 budget. Following the end of the 2009-10 financial year, a period of one week was allowed for the processing of unpaid payment vouchers and the charging of the associated expenditure to the 2009-10 budget. There were two instances where payment vouchers remained unpaid in the 2009-10 year and provision was included in the 2010-11 budget for these items.

58. The modest level of current expenditure arrears is a direct result of the prevailing process employed for the approval of all government expenditure whereby no financial commitments are incurred without the prior approval of the Department of Finance. Ministry payment vouchers are not approved unless funds are available in the respective budgets and the government has the cash resources to fund the value of each payment voucher.

59. Whilst the stock of current expenditure arrears is minimal, there are very significant aged expenditure arrears arising from weak fiscal management prior to 1 July 2007. Aged expenditure arrears as at 30 June 2010, excluding loan arrears, amounted to A\$41.4 million, more than 130% of total 2009-10 actual government expenditure. Outstanding salaries owed to Nauruan public servants amounting to \$28.2 million as at 30 June 2010 represent the largest proportion of aged expenditure arrears.

60. The government of Taiwan has been providing funding for partial payments of outstanding salary payments to Nauruan public servants since 1 July 2008. A\$ 1 million was provided in the 2008-09 and 2009-10 financial years whilst A\$1.4 million was budgeted in the 2010-11 budget.

Dimension (ii) Availability of data for monitoring stock of expenditure arrears

61. The Department of Finance's present spreadsheet based accounting system does not readily allow the extraction of data for monitoring current expenditure arrears.

62. The Department of Finance's Public Debt spreadsheet report lists all categories of arrears including aged expenditure arrears. These are listed in two sections of the Department of Finance's Public Debt spreadsheet report that is prepared by the Department of Finance several times each year. This report does not show an actual total for aged expenditure arrears.

Indicator	Credibility of the Budget: Stock and monitoring of expenditure arrears	Score	Justification
PI-4		D+	
(i)	Stock of expenditure payment arrears (as a % of actual total expenditure for the corresponding fiscal year) and any recent change in stock	D	Aged expenditure arrears exceeded more than 10% of total 2009-10 government expenditure
(ii)	Availability of data for monitoring the stock of expenditure payment arrears	B	Information on the stock of aged expenditure arrears is generated several times a year. There is no regular reporting of current expenditure arrears.

Sources: Department of Finance Public Debt spreadsheet and Department of Finance

3.2 Transparency and Comprehensiveness

63. The purpose of indicators five to ten is to provide an assessment of the relative comprehensiveness of the budget documentation and oversight of fiscal risk to the government and the level of public accessibility to budget and fiscal information.

Indicator 5: Classification of the budget

64. The PI-5 indicator measures the extent to which the budgeted expenditure classification system used in budget documentation is consistent with the respective international standard GFS system and the UN-supported Classification of Functions of Government (COFOG) which provides the functional classification applied to GFS. A robust classification system allows better tracking and management of proposed and actual expenditure.

Dimension (i) Classification used in budget documentation

65. An administrative classification system is currently used for the formulation, execution and reporting of the Nauru government's budget. Revenue and expenditure data is reported by revenue or expenditure head and respective subheads.

66. The present classification system has a limited correlation to the accepted classification of government functions (COFOG) and is not compatible with the Government Finance Statistics (GFS) methodology.

67. Data estimates compiled by the Nauru Bureau of Statistics use data from annual budget reports and unaudited final budget outcome (FBO) reports. No Government finance statistics (GFS) are produced at this stage.

Indicator	Comprehensiveness and Transparency: Classification of the Budget	Score	Justification
PI-5		D	
(i)	The classification system used for formulation, execution and reporting of the central government's budget	D	The budget formulation and execution is based on an administrative classification system that is not GFS/COFOG compatible.

Source: Director of Statistics

Indicator 6: Comprehensiveness of information included in the budget

68. Annual budget documentation (the annual budget and supporting documents) submitted to the legislature for scrutiny and approval should provide a complete picture of the government's fiscal forecasts, budget proposals and previous year's outturns. Indicator PI-6 measures the amount of additional economic and financial information that is included in budget documentation to enable readers of this documentation to acquire a complete picture of the government's fiscal forecasts, budget proposals and previous year's outturns.

Dimension (i) Information benchmarks achieved in Budget documentation

69. The format of the Budget documentation was changed in the 2009-10 Budget. Formerly, the Budget documentation comprised one document. Commencing with the 2009-10 Budget, two Budget Papers are now prepared. Budget Paper 1 focuses on commentaries on revenue and expenditure proposals and supporting tables showing details of the respective revenue and expenditure forecasts. Budget Paper 2 reviews economic and PFM topics together with a review of planned donor funded activity.

70. The 2009-10 and 2010-11 Budget documentation had a limited proportion of the required information benchmarks (see Table 10). This outcome is partly due to historic difficulties encountered in the preparation of the government's financial statements, discussed in more detail in indicator PI-25.

Table 11: Elements of budget documentation 2010-11 Budget

Elements of budget documentation	2010-11	Comment
1. Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate	No	An externally produced aggregate growth figure was published. No exchange rate or inflation forecasts were published.
2. Fiscal deficit, defined according to GFS or other internationally recognized standard	No	The fiscal deficit was not presented in a GFS format.
3. Deficit financing, describing anticipated composition	Yes	There is a specific reference to the financing of the Budget deficit from cash reserves.
4. Debt stock, including details at least for the beginning of the current year	No	No information was provided about the opening value of debt stock.
5. Financial assets, including details at least for the beginning of the current year	Yes	There is a specific reference to the value of cash reserves brought forward from the 2009-10 year.
6. Prior year's budget out-turn, presented in the same format as the budget proposal	No	There is no information about the 2008-09 budget out-turn.
7. Current year's budget (revised budget or estimated out-turn), presented in the same format as the budget proposal	Yes	Total actual revenue and expenditure out-turns for the 2009-10 year were provided. No out-turns by budget head or sub-head were provided.
8. Summarized budget data for both revenue and expenditure according to the main heads of the classification used, including data for current and previous year	No	Revised budget data for the 2009-10 year and data for the 2010-11 year were presented by the main heads and subheads; no information was presented by the main heads and subheads for the 2008-09 out-turn.
9. Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs	Yes	Explanations and estimates of the respective budgetary impact were provided for the principal new domestic revenue and expenditure measures as well as donor funded expenditure measures.

Sources: 2009-10 and 2010-11 Budget documents

Indicator	Comprehensiveness and Transparency: Comprehensiveness of information included in the Budget	Score	Justification
PI-6		C	
(i)	Shares of the above listed information in the budget documentation most recently issued by the central government	C	The recent 2010-11 budget documentation fulfils four of the nine information benchmarks.

Indicator 7: Extent of unreported government operations

71. Indicator PI-7 measures the amount of extra-budgetary expenditure (other than donor funded projects financed on a cash basis) which is not reported in the government's fiscal reports and the proportion of cash receipts for donor funded projects financed on a cash basis that are disclosed in the government's fiscal reports.

72. This indicator has not been scored as it was not possible to score dimension (i).

Dimension (i) The level of extra-budgetary expenditure (other than donor funded projects financed on a cash basis) which is unreported i.e. not included in fiscal reports

73. This dimension has not been scored as no audited financial statements are currently available for the last three financial years. Consequently, it is inappropriate to score this dimension even though inquiries to date suggest that the level of extra-budgetary expenditure (other than donor funded projects financed on a cash basis) which is unreported is insignificant (below 1% of total expenditure).

Dimension (ii) Income/expenditure information on donor-funded projects which is included in fiscal reports

74. At present only preliminary fiscal reports are available for the 2009-10 financial year. These reports do show all cash receipts for donor-funded projects and the associated expenditure funded from these receipts for the 2009-10 financial year.

Indicator	Comprehensiveness and Transparency: Extent of unreported government operations	Score	Justification
PI-7		N/R	
(i)	The level of extra-budgetary expenditure (other than donor funded projects financed on a cash basis) which is unreported i.e. not included in fiscal reports	N/R	
(ii)	Income/expenditure information on donor-funded projects which is included in fiscal reports	A	Preliminary fiscal reports for the 2009-10 financial year show all cash receipts for donor-funded projects and the associated expenditure funded from these receipts for this particular financial year.

Sources: 2009-10 and 2010-11 Budget documents

Indicator 8: Transparency of Intergovernmental Fiscal Relations

75. This indicator is not able to be scored as Nauru does not have a sub-national government system.

Indicator	Comprehensiveness and Transparency: Transparency of Intergovernmental Fiscal Relations	Score	Justification
PI-8		Not applicable	
(i)	Transparent and rules based systems in the horizontal allocation among SN governments of unconditional and conditional transfers from central government (both budgeted and actual allocations)	Not applicable	
(ii)	Timeliness of reliable information to SN governments on their allocations from central government for the coming year	Not applicable	
(iii)	Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories	Not applicable	

Indicator 9: Oversight of aggregate fiscal risk from other public sector entities

76. Indicator PI-9 measures the extent of central government's oversight of public sector entities and their monitoring and managing of fiscal risks with national implications arising from the activities of sub-national (SN) governments, autonomous government agencies (AGAs) and public enterprises (PEs). This indicator is assessed against two dimensions: i) extent of central government monitoring of AGAs and PEs and ii) extent of central government monitoring of SN governments' fiscal position.

77. Dimension (ii) is not able to be scored as Nauru does not have a sub-national government system. Consequently this indicator has been scored using dimension (i).

Dimension (i) Extent of central government monitoring of AGAs and PEs

78. Nauru has two significant autonomous government agencies and seven major SOEs as presented in Table 11 below.

Table 12: Major Nauru autonomous government agencies and SOEs

Autonomous government agencies	Major SOEs
Central Utilities	EIGIGU Holdings Corporation (EHC) and its subsidiaries**
Nauru Fisheries & Marine Resources Authority (NFMRA) (being absorbed back into a government ministry)	Nauru Agency Corporation (NAC)**
Nauru Phosphate Royalties Trust (NPRT)*	Nauru Air Corporation *

Autonomous government agencies	Major SOEs
	Nauru Rehabilitation Corporation (NRC) *
	Pacific Aircraft Leasing Holding Corporation (PALCO)**
	RONPHOS Corporation *
	Yarren Aircraft Holding Corporation (YALCO)**

*N.B. * denotes that the organization must submit financial reports to Parliament*

*** denotes that the organization was established as a private company and has no reporting obligations to Parliament*

79. Most of the above-mentioned public sector organizations (with the exception of the Central Utilities and NFMRA which is being absorbed back into a government ministry) have statutory obligations to submit audited financial statements annually to the Parliament. Although the major autonomous government agencies and SOEs presented their 2010-11 budgets to the government during the preparation of the 2010-11 budget, few of these organizations have submitted audited financial statements for the 2006-09 financial years to the government. Technical assistance with financial reporting is being provided to some of Nauru's public sector organizations but to date major improvements in external financial reporting have not been achieved.

80. Details of the status of the preparation and auditing of the financial statements of the major autonomous government agencies and SOEs as at 11 November 2010 are presented in Table 12.

Table 13 Status of Nauru public sector organizations financial reporting as at 11 November 2010

Organization	Year accounts prepared up to	Date of most recent audit report by office of the Director of Audit
Nauru Air Corporation	30 June 2009	Audit has been undertaken by external audit firms.
Central Utilities	30 June 2008	Issued Disclaimer for years 2005-06, 2006-07. Now undertaking audit for the 2007-08 year.
EIGIGU Holdings Corporation (EHC) and its subsidiaries	No accounts have been prepared for each subsidiary. No consolidated accounts have been prepared.	Audit work undertaken in July 2008 to look into transactions and examining internal control.
Nauru Agency Corporation (NAC)	30 June 2005. No recent accounts available.	No audit has been undertaken since 2005.
Nauru Fisheries & Marine Resources Authority (NFMRA)	FY2001-02 and FY2002-03 financial reports are available. No accounts have been prepared recently.	Undertaken audit work – however, audit certificate has not been issued – due to non-compliance (on certain issues).
Nauru Phosphate Royalties Trust (NPRT)	No consolidated accounts have been prepared	No audit undertaken External auditor preferred by NPRT. External Auditor is appointed by the President.
Nauru Rehabilitation Corporation (NRC)	No accounts have been prepared since 1997/1998	No audit undertaken. PKF International has been engaged.
Pacific Aircraft Leasing Holding Corporation (PALCO) (subsidiary of Air Nauru Corporation)	30 June 2009	Audit has been undertaken by external auditors.
RONPHOS Corporation	30 June 2009	2005/2006 financial statements have been audited but not finalized.
Yarren Aircraft Holding Corporation (YALCO) (subsidiary of Air Nauru Corporation)	30 June 2009	Audit has been undertaken by external auditors.

Source: Director of Audit

Currently, there is no provision in the PFA requiring the Department of Finance to regularly monitor all autonomous government agencies and SOEs.

81. The Department of Finance does not currently have a mechanism for conducting formal regular reviews of the fiscal risks posed by the major autonomous government agencies and SOEs. No consolidated report on the fiscal risks posed by the major public sector organizations is submitted annually to the government.

Dimension (ii) Extent of central government monitoring of sub-national governments' fiscal position

82. This dimension is not applicable in Nauru.

Indicator	Comprehensiveness and Transparency: Oversight of aggregate fiscal risk from other public sector entities	Score	Justification
PI-9		D	
(i)	Extent of central government monitoring of AGAs and PEs	D	Few major SOEs are currently submitting annual financial statements to the government so it is not possible for the Department of Finance to monitor fiscal risks comprehensively
(ii)	Extent of central government monitoring of sub-national governments' fiscal position	Not applicable	

Sources: Director of Audit, Department of Finance

Indicator 10: Public access to key fiscal information

83. The PI-10 indicator measures the extent to which key fiscal information covering the government's budgets, financial performance and statements are easily accessible to the general public or at least to interested groups.

84. There are six elements to the sole dimension for this indicator which are presented in Table 13 below.

Dimension (i) Elements of key fiscal information made available to the public

85. Budget documentation is the only key fiscal information element currently made available to the public. The two Budget Papers are available on request immediately following the tabling of the Budget in the Parliament. Limited quantities of the Budget Papers are distributed.

86. For the 2009-2010 Budget, the government also published an excellent one-page easy to understand "Budget at a Glance" document that summarized the 2009-10 Budget. This document outlined the central tasks of the government's fiscal strategy and the key initiatives set out in the 2009-10 Budget. The distribution of this document was relatively limited and could have easily been distributed more widely on Nauru.

87. Currently, in-year monthly and quarterly budget execution reports are not made regularly available to the public although mid-year budget execution reports are theoretically available to the public immediately after these have been tabled in the Parliament but limited quantities are available.

88. No financial statements have been prepared or audited since the late 1990's.

89. There is no regular publishing of major contract awards on at least a quarterly basis.

90. No information in respect of resources available to primary service units with national coverage in at least two sectors is published.

91. It is important to note that there is radio and television coverage of all parliamentary sessions.

Table 14: Elements of key fiscal information available to the public

Elements of information	2006-07	2007-08	2008-09	2009-10
Annual budget documentation: A complete set of documents can be obtained by the public through appropriate means when it is submitted to the legislature	Y	Y	Y	Y
In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion	N	N	N	N
Year-end financial statements: The statements are made available to the public through appropriate means within six months of completed audit	N	N	N	N
(iv) External audit reports: All reports on central government consolidated operations are made available to the public through appropriate means within six months of completed audit	N	N	N	N
(v) Contract awards: Award of all contracts with value above approx. USD 100,000 equiv are published at least quarterly through appropriate means	N	N	N	N
(vi) Resources available to primary service units: Information is publicized through appropriate means at least annually, or available upon request, for primary service units with national coverage in at least two sectors (such as elementary schools or primary health clinics).	N	N	N	N

Source: Department of Finance

Indicator	Comprehensiveness and Transparency: Public Access to key fiscal information	Score	Justification
PI-10		C	
(i)	Number of elements of key fiscal information made available to the public	C	One of the six listed information benchmarks is made available to the public.

3.3 Policy Based Budgeting

Indicator 11: Orderliness and participation in the annual budget process

92. Indicator PI-11 examines the quality of the budget preparation process by assessing the quality of the budget preparation process and the involvement of budget end users in the process. There are three dimensions to assess: i) existence of and adherence to a fixed budget calendar; ii) clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent) and iii) timely budget approval by the legislature (within the last three years).

93. The present PFA provides no guidance for the budget process. Redundant guidance is provided in the outdated "Accounting and Budget Manual" due for replacement with new financial instructions. The draft financial instructions does not prescribe a budget calendar.

Dimension (i) Existence of and adherence to a fixed budget calendar

94. A detailed clear budget calendar is prepared by the Department of Finance in March each year and included in a circular discussing the budget process and timetable.

95. Ministries and public enterprises had slightly less than four weeks to prepare their 2009-10 budget submissions and more than one month in the 2010-11 budget round.

96. The budget calendar was not adhered to in the 2008 and 2010 budget rounds due to short-term political difficulties arising from an inability to form a government. These led to delays in the advised budget calendar.

Dimension (ii) Guidance on the preparation of budget submissions

97. The budget circular is issued annually to all Nauruan ministries and public enterprises in March. The circulars are clearly written and provide guidance on the required format for budget submissions and new project proposals.

98. The budget circulars do not, however, provide any budget ceilings that have been pre-approved by Cabinet. Rather there are negotiations at an individual ministry level when ministries negotiate their budgets with Cabinet. The Cabinet may make further budget adjustments when it meets to approve the budget before the Minister of Finance tables the Budget in the Nauruan Parliament.

Dimension (iii) Timely budget approval by the legislature

99. The 2007-08 and 2009-10 Budgets were passed by the Nauruan Parliament prior to the commencement of the new financial year. The 2008-09 Budget was not passed until mid-July 2008 due to previous short-term political difficulties that prevented a government from being formed and allowing timely approval of the 2008-09 Budget. Interim supply arrangements to provide for expenditure in the 2008 September quarter were approved prior to the commencement of this quarter, on 13 June 2008.

Indicator	C. Budget Cycle – C(i) Policy-Based Budgeting: Orderliness and participation in the annual budget process	Score	Justification
PI-11		C+	
(i)	Existence of and adherence to a fixed budget calendar	B	A clear annual budget calendar has been determined over the last three Budget rounds. This has usually

			allowed MDAs and PEs at least four weeks from receipt of the budget circular to prepare detailed budget estimates. Political difficulties undermined adherence to the budget calendar in two of the last three budget rounds.
(ii)	Guidance on the preparation of budget submissions	D	The absence of budget ceilings significantly weakens the quality of guidance and results in a D score
(iii)	Timely budget approval by the legislature	B	Parliament approved the 2007-08 and 2009-10 before the start of the respective fiscal years but the approval of the 2008-09 budget was delayed by three weeks.

Source: 2008, 2009 and 2010 Budget circulars

Indicator 12: Multi-year perspective in fiscal planning, expenditure policy and budgeting

100. Indicator PI-12 examines whether expenditure policy decision-making is linked to multi-year budget and sectoral perspectives. The indicator is assessed against four dimensions: i) preparation of multi-year fiscal forecasts and functional allocations; ii) the scope and frequency of debt sustainability analysis; iii) the existence of sector strategies with multi-year costings of recurrent and investment expenditure and iv) the linkages between investment budgets and forward expenditure estimates.

101. The present PFA does not require the preparation of multi-year budgets.

Dimension (i) Multi-year fiscal forecasts and functional allocations

102. No multi-year budgets are currently prepared.

Dimension (ii) Scope and frequency of debt sustainability analysis

103. A debt management strategy was prepared for the Nauru government during 2007-08 by external consultants. Although a formal debt sustainability analysis was not prepared, the work undertaken was similar to that of a conventional debt sustainability analysis as it did determine the degree of write-down to return Nauru's debt to sustainable levels based on the IMF and World Bank indicators²³.

104. The debt data used in the formulation of the debt management strategy comprised:

- External Debt AUD 371.4 million (includes AUD 322.4 million formal debt)
- Internal Debt AUD 264.8 million (includes AUD 243.5 million formal debt)
- Total Debt AUD 636.2 million (includes AUD 565.9 million formal debt)

105. Using the ADB's estimate for 2006-07 Gross Domestic Product (GDP) of AUD 25 million, the total reported debt represented a ratio of Net Present Value (NPV) of debt to GDP of 2,545 percent. NPV of debt to government revenue excluding grants was over 7,000 percent. If only the formal debt is included (i.e., loans with a formal loan agreement and deposits with BON, the ratio of NPV of debt to GDP is 2,264 percent. Additionally, AUD 367.6 million of interrelated debt was reported by various instrumentalities.

106. The consultants commented that Nauru's debt situation of RON could be very simply summarized as 'a small island nation in severe debt distress.' The maximum NPV of a

²³ Ian Storkey private communication 2nd October 2010

sustainable debt burden was estimated at AUD 46.2 million (equivalent to around 185 percent of GDP).

Dimension (iii) Existence of costed sector strategies

107. Sector strategies have been prepared for the education and health sectors outside of the 2010-11 budget process but these have not been costed.

Dimension (iv) Linkages between investment budgets and forward expenditure estimates

108. The budgeting processes for the domestic (recurrent) and donor (investment) components of the recently completed 2010-11 budget were totally separate. Ministries were requested to address recurrent cost implications arising in donor (investment) proposals in the 2009-10 and 2010-11 budget rounds but they generally gave little attention to these request.

Indicator	C. Budget Cycle – C(i) Policy-Based Budgeting: Multi-year perspective in fiscal planning, expenditure policy and budgeting	Score	Justification
PI-12		D	
(i)	Multi-year fiscal forecasts and functional allocations	D	Multi-year budgets are currently not prepared.
(ii)	Scope and frequency of debt sustainability analysis	C	Work similar to a debt sustainability analysis was undertaken in 2007-08
(iii)	Existence of costed sector strategies	D	Costed sector strategies have not been prepared
(iv)	Linkages between investment budgets and forward expenditure estimates	D	Budgeting for investment and recurrent expenditure are currently essentially separate processes; few recurrent cost estimates arising from donor (investment) projects are provided.

Sources: 2008-09 Budget, Department of Finance

3.4 Predictability and Control in Budget Execution

109. The purpose of indicators thirteen to twenty-one is to provide an assessment of the extent to which the budget is implemented in an orderly and predictable manner and that the degree to which arrangements exist for the exercise of control and stewardship in the use of public funds.

110. At present Nauru has only one form of taxation, customs duties. Consequently the assessments for indicators PI-13, PI-14 and PI-15 cover only customs duties.

111. The NSDS has proposed the introduction of a Broad based goods and services tax in 2012.

PI-13 Transparency of Customs' Obligations and Liabilities

112. Indicator PI-13 examines the level of transparency of customs obligations and liabilities on Nauru as this has a major impact on the extent to which importers and the public comply with existing customs rules. To assess the relative transparency of customs obligations and liabilities this indicator addresses: i) the clarity and comprehensiveness of customs liabilities; ii) the level of importer access to information on customs liabilities and

administrative procedures and iii) the existence and functioning of a customs appeals mechanism.

Dimension (i) Clarity and comprehensiveness of customs liabilities

113. Customs duties legislation and procedures are set out in four principal acts. Although the current customs legislation is reasonably comprehensive, the government views this legislation as outdated and is planning a major consolidation and updating of this legislation in the near term. Some customs legislation was amended recently to improve the government's ability to collect outstanding customs duties.

114. The actual levying of customs duties is variable. A major weakness in the current customs legislation is the significant administrative discretion available to the government in determining the value of customs duty penalties.

Dimension (ii) Importers' access to information on customs liabilities and administrative procedures

115. Importers' access to information about customs duty rates is limited to posters displayed at Nauru's international airport. There is minimal information available regarding customs administrative procedures.

116. The major importers in Nauru are familiar with the current customs duty rates due to their frequent dealings with customs officials. The level of understanding amongst the general public is, however, very limited.

117. The government has not undertaken any campaigns to improve the public's overall awareness of customs duty rates and administrative procedures.

Dimension (iii) Existence and functioning of a tax appeal mechanism

118. The present customs legislation establishing liability for customs duty penalties (the General Customs Duties (Mode of Collection Regulations) 1997) does not prescribe a transparent customs duty appeal mechanism or any procedure for paying refunds.

Indicator	Budget Cycle – Predictability and control in Budget Execution: Transparency of Importer Obligations and Liabilities	Score	Justification
PI-13		D+	
(i)	Clarity and comprehensiveness of customs liabilities	D	The customs legislation is out-dated and there is significant discretion for determining customs duty penalties.
(ii)	Importers' access to information on customs liabilities and administrative procedures	C	There is access to information about customs duty rates. No information is provided about customs administrative procedures.
(iii)	Existence and functioning of a customs duty appeal mechanism	D	No functioning customs duty appeals system has been established.

Sources: Customs legislation, Department of Finance, Secretary for Justice

PI-14 Effectiveness of measures for importer registration and customs duties assessment

119. Indicator PI-14 assesses the effectiveness of importer registrations and customs duty assessment processes by reviewing: i) controls in importer registration; ii) effectiveness of penalties for non-compliance with registration and declaration obligations and iii) planning and monitoring of customs duty audit and fraud investigation programs.

Dimension (i) Controls in the importer registration system

120. No importer registration system exists for customs duties. The major importers are well known to customs officials.

121. At present the data on customs liabilities is maintained in an Excel spreadsheet in the Department of Finance's computer system.

122. No surveys of potential payers of customs duties have been undertaken.

Dimension (ii) Effectiveness of penalties for non-compliance with registration and declaration obligations

123. Although there are penalties for the non-payment of customs duties, there are no penalties in the current customs regulatory framework should importers make false customs duty declarations. This omission creates difficulties as there is evidence demonstrating that some importers have previously made false declarations and avoided significant payments of customs duties.

Dimension (iii) Planning and monitoring of tax audit and fraud investigation programs

124. No customs audits have been undertaken to date. A limited number of customs duty fraud investigations have been undertaken.

Indicator	Budget Cycle – Predictability and control in Budget Execution: Effectiveness of measures for taxpayer registration and tax assessment	Score	Justification
PI-14		D	
(i)	Controls in the importer registration system	D	Importer registration for customs duties is not subject to any effective controls or enforcement systems.
(ii)	Effectiveness of penalties for non-compliance with registration and declaration obligations	D	There are no penalties for making false customs declarations.
(iii)	Planning and monitoring of customs duty audit and fraud investigation programs	D	No customs duty audits have been undertaken. Some fraud investigations have been undertaken on an ad hoc basis.

Sources: Department of Finance, Secretary for Justice

PI-15 Effectiveness in collection of customs duties

125. Indicator PI-15 examines the effectiveness of customs duties collection procedures using the following criteria: i) customs duty arrears collection ratios for the past two years; ii) effectiveness of transfer of customs duty collections to the Treasury and iii) frequency of complete accounts reconciliation.

Dimension (i) Collection ratio for gross customs duty arrears

126. No customs duty is collected from any individual or organization on their arrival in Nauru. Any customs duty payable is billed either at the airport or port and the Department of Finance's revenue office subsequently issues and sends out invoices. Invoice numbers serve as the initial reference point with the Department of Finance. Payment is required within thirty days of goods being cleared by customs but this allows importers to default on their obligations to pay customs duties. Customs duty is usually paid on a deferred basis. Payments are made either at the Department of Finance's revenue or cash offices.

127. Payment data is recorded on an Excel spreadsheet in the Department of Finance's computer system. During the 2008-10 financial years a report showing an aged analysis of arrears by individual custom duty payers was usually printed monthly and forwarded to the Minister of Finance. The latter report does not show any data summarizing trends in the collection of customs duty arrears. No updates of arrears trends including data showing the percentage of gross arrears at the beginning of each fiscal year that was collected during that fiscal year are prepared.

128. A preliminary analysis of reported customs duty arrears undertaken for the PEFA study estimated that the average customs duty arrears collection ratio improved from approximately 60% in 2008-2009 (for 2007-08 arrears) to 81% in 2009-10 (for 2008-09 arrears). This improvement in 2009-10 occurred in a period when the annual value of customs duty billed declined by approximately 17% from the 2008-09 figure.

129. Procedures to recover customs duty from importers who have not met their previous payment obligations, on a regular instalment basis, were introduced in 2010 following the enactment of regulations to promote the recovery of customs duties arrears (General Customs Duties (Mode of Collection) (Amendment) Regulations 2010).

Dimension (ii) Effectiveness of transfer of tax collections to the Treasury

130. Importers pay their customs duty bills either at the government's revenue or cash offices. Cash received by the revenue office is deposited at the cash office each afternoon.

Dimension (iii) Frequency of complete accounts reconciliations

131. Currently the Treasury is not undertaking complete accounts reconciliations between customs duty assessments, collections, arrears records and receipts.

Indicator	Budget Cycle – Predictability and control in Budget Execution: Effectiveness in collection of tax payments	Score	Justification
PI-15		D+	
(i)	Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years)	C	The average customs duty arrears collection ratio was approximately 60% in 2008-2009 (for 2007-08 arrears) and 81% in 2009-10 (for 2008-09 arrears resulting in an average collection ratio of 71% in the 2008-10 period.
(ii)	Effectiveness of transfer of tax collections to the Treasury by the revenue	A	Customs receipts are deposited by the revenue office at the Treasury cash office daily. Large importer payments are made directly at the Treasury cash

	administration authority		office.
(iii)	Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury	D	Complete accounts reconciliation between tax assessments, collections, arrears records and receipts are currently not being undertaken by the Treasury.

Sources: Department of Finance, Import Duty Report spreadsheet

Indicator 16: Predictability in the availability of funds for the commitment of expenditure.

132. The effective execution of the budget, in accordance with work plans, requires that the spending ministries, departments and agencies (MDAs) receive reliable information on the availability of funds within which they can commit expenditure for recurrent and capital inputs.

133. The PI-16 indicator assesses the extent to which the Department of Finance provides reliable information on the availability of funds to MDAs that manage budget heads in the government's budget. The following dimensions are assessed: (i) the extent to which cash flows are forecast and monitored; (ii) the reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment and (iii) the frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs.

Dimension (i) Forecasting and monitoring of cash flows

134. Due to the difficult ongoing economic environment facing Nauru, the Department of Finance spends a considerable effort on cash flow management. Cash flow forecasts are prepared, monitored and updated on a weekly basis. The Department of Finance submits a weekly report on cash balances and a cash flow forecast to the Minister of Finance.

Dimension (ii) Reliability and horizon of periodic in-year information provided to MDAs

135. The passing of the annual Appropriation Act grants ministries the ability to incur expenditure as proposed in the budget. Consequently ministries are able to make forward commitments at least six months in advance. The quality of detailed information regarding the availability of funds supplied by the Department of Finance to ministries is reasonably reliable.

136. The Department of Finance will occasionally delay the approval of payment vouchers and/or purchase orders when the government's immediate cash resources are unacceptably low.

Dimension (iii) Frequency and transparency of adjustments to budget allocations decided above the level of management of MDAs

137. The PFA allows the government to undertake additional expenditure in excess of that set out in the Appropriation Act provided such expenditure has been approved by way of Supplementary Appropriation Acts. The PFA also gives Cabinet the power to authorize the Minister of Finance to approve changes to approved levels of sub-head expenditures during any financial year provided total expenditure for the respective budget head does not exceed the amount appropriated in the Budget. The Minister of Finance must subsequently table details of such sub-head expenditure changes on the next convenient parliamentary sitting day after giving such approvals. These rules are respected.

138. Significant in-year budget adjustments at a ministry level are made one or two times per year in a transparent manner by way of Supplementary Appropriation Acts. The government makes provision for a Contingency Fund in its annual appropriation legislation which will usually be substantially utilized prior to the introduction of a Supplementary Appropriation Act. Statements disclosing the use of the contingency fund are made to Parliament either within one month of the end of the respective financial year or, where Parliament does not meet within one month after the end of the financial year, at the next meeting of Parliament.

Indicator	Budget Cycle – Predictability and control in Budget Execution: Predictability in the availability of funds for the commitment of expenditure	Score	Justification
PI-16		A	
(i)	Extent to which cash flows are forecast and monitored	A	Cash flow forecasts are prepared, monitored and updated on a weekly basis.
(ii)	Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment	A	Ministries are able to make forward commitments at least six months in advance.
(iii)	Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs	A	Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a transparent and predictable way

Sources: Department of Finance, PFA, cash balance and cash flow spreadsheet reports, Department of Finance Public Debt spreadsheet

PI-17: Recording and management of cash balances, debt and guarantees

139. Good fiscal management requires proper recording and management of cash balances, debt and guarantees. The PI-17 indicator assesses: (i) the quality of debt data recording and reporting; (ii) the extent of consolidation of the government's cash balances and (iii) the systems employed for contracting loans and issuance of guarantees.

Dimension (i) Quality of debt data recording and reporting

140. A comprehensive debt database was prepared in 2006-08 to assist the development of a debt management strategy for the Nauru government. All domestic and external debt data is recorded on an Excel spreadsheet in the Department of Finance computer system. The data is considered complete but it has not been audited to date.

141. The debt spreadsheet sets out opening debt balances for the most recent financial year, details of debt repayment and debt relief transactions undertaken during the period under review, closing debt balances and budgeted debt payments for the following financial year. The debt spreadsheet is now updated several times during each financial year and submitted to the Minister of Finance.

142. No separate debt data is published on the Department of Finance's website.

Dimension (ii) Extent of consolidation of the government's cash balances

143. No formal banking services are available on Nauru. The government's main bank account is the RON Treasury Account maintained with a bank in Brisbane, Australia. There are fifty donor bank accounts. Overall, there are only six active bank accounts. There are no unknown bank accounts.

144. The government's cash resources outside of Nauru are consolidated into the Brisbane RON Treasury Account. The Department of Finance prepares a weekly report on the government's cash balances that is submitted to the Minister of Finance.

145. The government also operates two cash accounts in Nauru using the former BoN premises through which all local receiving and paying transactions are conducted; the principal account is for Treasury transactions and the second account is for fuel transactions conducted by the government. Details of transactions and closing balances are emailed to the Treasury section of the Department of Finance after the close of business each afternoon.

146. Small receipts received by the government revenue office in Nauru are deposited in the local cash account each afternoon and details of deposits made are given to the Department of Finance each afternoon. Larger local cash receipts sums are deposited direct into the local RON Treasury Account on Nauru.

147. Local cash transactions are usually reconciled within three business days.

148. Government cash balances are consolidated at least weekly in RON Treasury Account Brisbane.

Dimension (iii) Systems for contracting loans and issuance of guarantees

149. The current legal framework in Nauru covering government borrowing and the issuing of guarantees is relatively weak.

150. There is no formal comprehensive debt management framework in place to guide government borrowing transactions and the issuing of guarantees by the government.

151. Section 11(1) of the PFA allows the Minister of Finance to undertake initial bank borrowings of up to A\$10 million for short term purposes. Additional loans in excess of A\$10 million must be approved by the Parliament.

152. The PFA makes no reference to the issuing of guarantees. No detailed listing of all government guarantees was available. There is no regular reporting of government guarantees that have been issued.

Indicator	Budget Cycle – Predictability and control in Budget Execution: Recording and management of cash balances, debt and guarantees	Score	Justification
PI-17		C	
(i)	Quality of debt data recording and reporting	C	Domestic and foreign debt data records are considered complete, updated and reconciled at least annually. The data quality is considered good.

(ii)	Extent of consolidation of the government's cash balances	B	All revenue collections on Nauru are deposited into the local RON Treasury account at least weekly. All offshore funds are consolidated regularly into the RON Treasury Brisbane account.
(iii)	Systems for contracting loans and issuance of guarantees	D	No unified mechanism is in place to control government borrowing and the issuing of government guarantees.

Sources: Department of Finance; PFA; cash balance, cash flow and Public Debt spreadsheet reports

Indicator 18: Effectiveness of payroll controls

153. Indicator PI-18 addresses the effectiveness of payroll controls for permanent public servants by assessing: (i) the degree of integration and reconciliation between personnel records and payroll data; (ii) the timeliness of changes made to personnel records and the payroll; (iii) the internal controls applicable to changes to personnel records and the payroll and (iv) the existence of payroll audits to identify control weaknesses and/or ghost workers.

Dimension (i) Degree of integration and reconciliation between personnel records and payroll data

154. The Human Resources & Labour division of the Chief Secretary's Department is responsible for the government's personnel management which is managed on a centralized basis. Separate sections of the latter division maintain the government's personnel records and manage the government payroll.

155. The payroll records were maintained using Excel spreadsheets until 1 July 2010 when they were computerized. The MYOB payroll module has been installed. Circulars were issued by the Chief Secretary's Department and Department of Finance in July 2010 outlining the supporting payroll processes to be employed in association with the use of the MYOB software.

156. The government's personnel records are maintained in a manual form; no records are kept in a computerized database and there is no direct linkage between the payroll and personnel records.

157. The payroll data appears to be reasonably robust as considerable checking is undertaken during the preparation of the payroll. Heads of government departments and ministries authorize the timesheets submitted for their staff, advise details of required payroll variations and confirm all proposed salary payments to their staff. The Department of Finance subsequently approves the proposed salary payments.

158. The personnel records and payroll are reconciled between payrolls.

159. The Human Resources & Labour division officials commented that personnel records are of a good quality. A March quarter 2010 MYOB implementation report sighted during the preparation of the PEFA, however, suggests there may be some gaps in the personnel records, particularly in the areas of records for leave and time off in lieu balances. Ministry of Education officials made similar remarks.

160. The payroll is centrally operated with the Treasury making payments directly to all government employees; state owned enterprises have separate arrangements for paying their employees.

161. Payments to employees are made by cheque which employees cash at the cash office managed by the Directorate of Payments. It is not possible to make payments directly to employees' local bank accounts as there is no bank on Nauru as discussed in PI-17.

Dimension (ii) Timeliness of changes to personnel records and the payroll

162. The average or typical delay between a personnel change and the corresponding payroll change is less than one month as errors are normally corrected within one fortnightly payroll cycle.

163. Retroactive payroll adjustments are occasional. The official managing the payroll advised that the number of payroll variations recorded in each payroll was relatively modest.

Dimension (iii) Internal control of changes to personnel records and the payroll

164. The controls on changes to existing personnel remuneration records are relatively robust as these must be initiated in writing by heads of departments or ministries signing off NPS6 forms that address variations to personnel records. These controls should on average minimize payment errors and ensure a high level of data integrity.

165. The new MYOB should result in an enhanced audit trail for payroll matters. The government's personnel records continue to be maintained on a manual basis which allows scope for errors to be made.

Dimension (iv) Existence of payroll audits to identify control weaknesses and/or ghost workers

166. No significant audits of government payrolls have been undertaken to date due to the absence of a viable internal audit capability. In addition, no external audits have been undertaken for some years.

Indicator	Budget Cycle – Predictability and control in Budget Execution: Effectiveness of payroll controls	Score	Justification
PI-18		D+	
(i)	Degree of integration and reconciliation between personnel records and payroll data	C	Personnel data and payroll not directly linked but payroll changes are documented and checked each month; there is external evidence that personnel files may not be entirely complete
(ii)	Timeliness of changes to personnel records and the payroll	A	Changes to personnel records and payroll are updated monthly; retroactive adjustments are modest
(iii)	Internal control of changes to personnel records and the payroll	A	Internal controls restrict authority to change payroll records, creating an audit trail
(iv)	Existence of payroll audits to identify control weaknesses and/or ghost workers	D	No annual payroll audits have been undertaken within the last three years

Sources: Chief Secretary's Department, Department of Finance

Indicator 19: Competition, value for money and controls in procurement

167. The PI-19 indicator examines the government's procurement system. It assesses the following attributes: (i) evidence on the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the

number of contracts awards that are above the threshold); (ii) the extent of justification for use of less competitive procurement methods; and (iii) the existence and operation of a procurement complaints mechanism.

168. There is no current legislation in force in Nauru to regulate public procurement.

169. The Nauru Chief Secretary's Department introduced new procurement procedures effective from 14 September 2009 to centralize all government procurement through the Government Warehouse with the exception of Health Department procurement of medicines and medical consumables, Land Transport procurement of vehicles, the ICT Department procurement of ICT equipment and supplies (both hardware and software), services and goods for donor-funded projects where the donor or an external agent is undertaking the procurement. The new procedures do not apply to public enterprises who continue to arrange their own procurements.

Dimension (i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases

170. The monetary threshold for small purchases is A\$1,000; all purchases in excess of this figure should be procured using open competition.

171. Procurement data is not readily available due to undeveloped reporting systems. It is not possible to quantify the proportion of contracts above the threshold that were given on the basis of competition in the 2009-10 year.

172. There is negligible use of public contracting procedures.

173. Open competition for goods purchased by the Government Warehouse is limited as these purchases are made on the basis of three quotations rather than genuine open bidding. The Government Warehouse's 2009-10 Budget was A\$736,000. Expenditure for which quotations were sought amounted to approximately \$414,000 or approximately 56% of budgeted expenditure.

174. Open competition for goods purchased by the Health, Land Transport and ICT Departments is also limited.

Dimension (ii) Justification for use of less competitive procurement methods

175. The new procurement procedures introduced by the Nauru Chief Secretary's Department in September 2009 contains no reference to the use of less competitive procurement methods. The new procurement procedures do not effectively establish open competition as the preferred method of procurement.

Dimension (iii) Existence and operation of a procurement complaints mechanism

176. There is no formal process in place to receive and address complaints regarding the conduct of procurement processes by the Government Warehouse, or those Departments handling their own procurements and public enterprises.

Indicator	Budget Cycle – Predictability and control in Budget Execution: : Competition, value for money and controls in procurement	Score	Justification
PI-19		D	
(i)	Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases	D	Available data suggests that use of open competition is limited.
(ii)	Justification for use of less competitive procurement methods	D	The current procurement procedures do not give guidance on the use of less competitive methods nor establish open competition as the preferred procurement method.
(iii)	Existence and operation of a procurement complaints mechanism	D	No process is defined to enable submitting and addressing of complaints regarding the implementation of Nauru government procurements.

Sources: Chief Secretary's Department, Procurement & Supply Manager, and Department of Finance

Indicator 20: Effectiveness of internal controls for non-salary expenditure.

177. Indicator PI-20 reviews the effectiveness of the internal control framework and assesses: (i) the effectiveness of expenditure commitment controls; (ii) the comprehensiveness, relevance and understanding of other internal control rules/ procedures and (iii) the degree of compliance with rules for processing and recording transactions.

Dimension (i) Expenditure commitment controls

178. A conventional expenditure commitment control system is not operating in Nauru government ministries as noted earlier in the discussion on PI-4 as ministries are unable to make commitments on their own account. All payment vouchers and purchase orders must be approved by the Department of Finance prior to being processed to ensure that there are funds remaining in the respective budget sub-heads and that supporting funds are available to cover the respective payments or purchases; no exceptions are made to these arrangements. Financial delegations are therefore extremely limited; the Department of Finance must approve all transactions less than A\$200 whilst all transactions in excess of A\$200 must be approved by the Minister of Finance.

Dimension (ii) Other internal controls

180. An internal control system exists but the standard of controls are relatively weak. The current "Accounting and Budget Manual" drafted in 1979 is outdated, A significant proportion of the rules provided for the accounting of expenditure and revenue, procurement, budget preparation, budget heads and subheads is redundant as it is inconsistent with current practices. A revised and more appropriate set of financial instructions, incorporating more effective internal controls, has been drafted by PFTAC. The procurement regulatory framework is considerably underdeveloped as discussed in PI - 19. This is recognized by the government and the Department of Finance has recently introduced improvements to the present procurement arrangements.

181. The management of advances has been weak in recent years. Insufficient effort has been made to recover outstanding advances.

182. Previously weak controls on the collection of customs revenue were strengthened in 2010 as noted earlier in the discussion of PI-15.

183. There is a relatively modest level of understanding of the current financial management controls in key ministries.

Dimension (iii) Compliance with transaction rules

184. The present spreadsheet based accounting system is prone to errors. The Department of Finance has reported that error rates in the processing and recording of transactions have declined materially recently in the 2010 December half-year following guidance provided during the recent technical assistance associated with the reconciliation of the main bank accounts. The overall transaction error rate is now likely to be less than 20% of all transactions. Some ministries are continuing to maintain their own records of payment vouchers and purchase orders due to the past incidence of transaction errors in the Department of Finance.

185. External and internal audit reports provide independent assessments of the overall level of compliance with transaction rules. The latter assessments are generally unavailable in Nauru due to the absence of external audit reports on the government's financial statements and limited internal audit activity.

Indicator	Budget Cycle – Predictability and control in Budget Execution: Effectiveness of internal controls for non-salary expenditure	Score	Justification
PI-20		D+	
(i)	Effectiveness of expenditure controls	B	Comprehensive expenditure commitment controls are in place and limit commitments to actual cash availability and approved budget allocations (as revised)
(ii)	Comprehensiveness, relevance and understanding of other internal control rules/procedures	D	Numerous internal controls/procedures are neither comprehensive nor relevant.
(iii)	Degree of compliance with rules for processing and recording of transactions	C	The rules for the processing and recording of transactions are complied with in a significant majority of transactions.

Sources: Department of Finance, Director of Audit

Indicator 21: Effectiveness of Internal Audit

186. An effective internal audit function can provide regular feedback on the performance of an organization's internal control systems. Indicator PI-21 assesses the coverage, quality of the internal audit function; the frequency and distribution of reports; and extent of management response to internal audit findings.

Dimension (i) Coverage and quality of internal audit function

187. The Nauru government has not formally established an internal audit capability. The office of the Director of Audit has undertaken some modest internal audit activity covering parts of three ministries' activities (Education, Foreign Affairs and Transport) and the Ministry of Health. The work in the Ministry of Education comprised reviews of control procedures and

transactions for donor and scholarship funds. The quality of the present internal audit function falls well short of international standards such as the ISPPA.

Dimension (ii) Frequency and distribution of internal audit reports

188. To date, internal audit reports have been prepared on an irregular basis for four government ministries. No formal arrangements exist for the distribution of internal audit reports.

Dimension (iii) Management response to internal audit findings

189. To date the sole ministry that has been subject to a sizeable internal audit undertaken by the Audit Department has provided a very low response to the findings and recommendations that have been issued.

Indicator	Budget Cycle – Predictability and control in Budget Execution: Effectiveness of internal audit	Score	Justification
PI-21		D	
(i)	Coverage and quality of the internal audit function	D	Few internal audits are undertaken. There is little internal audit focused on systems monitoring.
(ii)	Frequency and distribution of reports	D	Internal audit reports are currently prepared on an irregular basis for a very limited number of government ministries. No formal arrangements exist for the distribution of internal audit reports. Internal audit reports prepared by the Directorate of Audit have not been widely distributed.
(iii)	Extent of management response to internal audit function	D	To date internal audit recommendations have generally been ignored.

Source: Director of Audit

3.5 Accounting, recording and reporting

190. The purpose of indicators twenty-two to twenty-five is to provide an assessment of the extent to which adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes.

PI-22 Timeliness and regularity of accounts reconciliation

191. Reliable reporting of financial information requires constant checking and verification of the recording practices. This is an important part of internal control and a foundation for good quality information for management and for external reports. Timely and frequent reconciliation of data from different sources is fundamental for data reliability. Indicator PI-22 assesses: (i) the regularity of bank reconciliations and (ii) the regularity of reconciliations and clearance of suspense accounts and advances.

Dimension (i) Bank reconciliations

192. As at 30 August 2010, all five principal Nauru government bank accounts²⁴ had been reconciled to 31 July 2010 by Department of Finance officials. Most of this work was

²⁴ The five principal bank accounts are: (i) RoN Treasury (RoNCash) Account – Directorate of Payments Cheque Account (Nauru); (ii) RoN Fuel Account – Directorate of Payments (DOP) Bank Account (Nauru); (iii) RoN Treasury Account – Westpac Bank Account (Brisbane/Melbourne); (iv) RoN Fuel Account – Westpac Bank Account (Brisbane/Melbourne) and (v) RoN US Dollar Account – Westpac Bank Account (Brisbane).

undertaken during the 2010 June quarter and is a direct result of the preparation of cash books for the period beginning 1 July 2007 during the 2009-10 year by an external consultant. The latter cash books will provide the basis for the preparation of financial statements for the 2007-08, 2008-09 and 2009-10 financial years. There were no significant unresolved differences between the Department of Finance's bank records and bank account information as at 30 August 2010.

193. Each main bank account is now reconciled at least monthly. The five principal bank accounts are reconciled at least weekly or more regularly if required.

Dimension (ii) Suspense and advance accounts

194. The Department of Finance does not maintain any suspense accounts.

195. Advance accounts for approved government travel activities are maintained. The Department of Finance has not undertaken any reconciliation or clearance of advance accounts since February 2010 due to a temporary loss of records. About 5% of public servants had not repaid accountable allowances as at 30 June 2010.

196. All advance payments are approved by the Secretary of Finance based on agreed guidelines/criteria.

Indicator	Budget Cycle – Accountability and Recording and Reporting: Timeliness and regularity of accounts reconciliation	Score	Justification
PI-22		C+	
(i)	Regularity of bank reconciliations	A	Bank reconciliations for all government bank accounts now take place at least monthly, usually within 4 weeks of the end of period.
(ii)	Regularity of reconciliations and clearance of suspense accounts and advances	D	Advance accounts have not been reconciled since February 2010.

Source: Department of Finance

Indicator 23: Availability of information on resources received by service delivery units

197. Indicator PI-23 examines the degree of recording of information by service delivery units regarding the receipt of resources (cash and in-kind) supplied by the authorizing entity (either central or local governments). In Nauru, the government provides the resources used by service delivery units.

Dimension (i) Availability of information on resources received by service delivery units

198. To date no data has been collected on resources received by service delivery units. Difficulties with the receipt of resources by service delivery units may be identified when the proposed audits of the government's financial statements for the three years ended 2009-10 are undertaken in the 2010-11 financial year.

199. The Department of Finance's current spreadsheet based accounting system does not record any meaningful resource information in the budgets for ministries such as education

and health that have front-line service delivery units at the community level. The chart of accounts does not currently link revenue and expenditure subheads to outputs and hence cannot facilitate the provision of more useful information to service delivery units.

200. The general recording of information by schools is compromised by capacity constraints in schools. The Ministry of Education commented on recent difficulties in receiving good information on the content of donor assistance from the AMU Aid Management Unit (part of the Department of Finance).

Indicator	Budget Cycle – Accountability and Recording and Reporting: Availability of information on resources received by service delivery units	Score	Justification
PI-23		D	
(i)	Collection and processing of information to demonstrate that resources were actually received by the most common front-line service delivery units	D	No comprehensive data collection on resources to service delivery units in any major ministry has been collected and processed within the last three years

Sources: Department of Finance, Ministry of Education

Indicator 24: Quality and timeliness of in-year budget reports

201. Indicator PI-24 focuses on the government accounting system's ability to produce comprehensive reports on all aspects of the budget. Assessments are made of the following attributes of in-year budget reports: i) the scope of reports in terms of coverage and compatibility with budget estimates; ii) the timeliness of the issue of the reports and iii) the quality of information in these reports.

Dimension (i) Scope of reports

202. The Department of Finance produces and issues all in-year government budget reports as it maintains the Nauru government's accounting system. These are prepared from the current spreadsheet based accounting system using the same classification format as used in the Budget revenue and expenditure estimates. The in-year budget reports identify revenue and expenditure by a head, sub-head and sub sub-head basis and report actual revenue and expenditure outcomes compared with the approved budget figures allowing direct comparisons to be made to the original budget figures. These reports are produced for expenditure control and general management purposes and are distributed to the staff of the Department of Finance, ministry officials and the Minister of Finance.

203. The in-year budget reports do not address in-kind donor transactions as these are not included in the Nauru government's Budget revenue and expenditure estimates. There is no regular consolidated reporting of in-kind transactions.

204. There is negligible submission of in-year budget reports to the Department of Finance by the major public enterprises.

205. No commitment information is presented in the in-year budget reports, reflecting the current payment procedure employed discussed in PI-4 (that does not record commitments).

Dimension (ii) Timeliness of reports

206. The Department of Finance is required to issue regular monthly budget reports to ministries within two weeks after the end of each month but this often does not occur, particularly during budget preparation. The education and health ministry's disputed the incidence of significant regular monthly reporting claimed by the Department of Finance.

207. Reports compiled at the end of each quarter are usually issued within eight weeks of the end of the quarter.

Dimension (iii) Quality of information

208. Difficulties do arise with the quality of information in the spreadsheet based quarterly reports. During the 2009-10 year, ministry officials have had to spend some time reconciling differences with the Department of Finance.

209. Data input delays by the Department of Finance are now relatively modest as commented earlier in the assessment of PI-20.

210. Difficulties have been experienced with the recording of information for donor-funded projects. These are currently being addressed.

Indicator	Budget Cycle – Accountability and Recording and Reporting: Quality and timeliness of in-year budget reports	Score	Justification
PI-24		C+	
(i)	Scope of reports in terms of coverage and compatibility with budget estimates	A	Classification of data allows direct comparison to the original budget. Information includes all head, sub-head and sub head information set out in budget estimates. Expenditure is covered at payment stage (no commitment expenditure is incurred or recorded).
(ii)	Timeliness of the issue of reports	C	Reports compiled at the end of each quarter are usually issued within eight weeks of the end of the quarter.
(iii)	Quality of information	C	There are some concerns about the accuracy of information, which are not highlighted in the reports, but this does not fundamentally undermine their basic usefulness.

Sources: Department of Finance, Ministries of Health and Education

Indicator 25: Quality and timeliness of annual financial statements

211. Government annual financial statements must be of a satisfactory standard to be useful to users. The PI-25 indicator assesses the quality and timeliness of annual financial statements by measuring: i) the completeness of financial statements, ii) the timeliness of submission and iii) the accounting standards used.

212. This indicator cannot be scored as the Department of Finance has not prepared any annual financial statements since the late 1990's.

213. Work completed in the 2009-10 year on the preparation of updated government cash books for the period since 1 July 2007 has provided the Department of Finance with the data for deriving the annual financial statements for the 2007-10 financial years which are forecast to be completed by 30 June 2011.

Indicator	Budget Cycle – Accountability and Recording and Reporting: Quality and timeliness of annual financial statements	Score	Justification
PI-25		N/R	
(i)	Completeness of the financial statements	N/R	
(ii)	Timeliness of submissions of the financial statements	N/R	
(iii)	Accounting standards used	N/R	

3.6 External scrutiny and audit

214. The purpose of indicators twenty-six to twenty-eight is to provide an assessment of the extent to which arrangements for scrutiny of public finances and follow up by officials are operating.

Indicator 26: Scope, nature and follow up of external audit

215. The purpose of Indicator PI-26 is to assess the quality of audits by measuring (i) the scope and coverage of the audit, adherence to auditing standards, including the independence of the external audit institution; (ii) the timeliness of submission of audit reports to the legislature and (iii) the evidence of follow up on audit recommendations.

216. The PFA has no specific reference to the scope and nature of external audits to be undertaken by the office of the Director of Audit. Section 6(1) of the Audit Act 1973 gives the Director of Audit the authority to “examine, inquire into and audit the accounts of all accounting officers in Nauru and in the offices of the Republic outside Nauru”. Section 11 (1) of the Audit Act, 1973 requires the Director of Audit to submit his report on the government financial statements to the Minister of Finance within a period of five months after the close of each financial year, or such longer period as Parliament may determine.

217. This indicator could not be scored as the Department of Finance has not submitted any annual financial statements to the Director of Audit for external audit since the 1997-98 financial year²⁵.

²⁵ Republic of Nauru, Department of Audit, “Special Report of the Director of Audit (Under Section 11(3) of the Audit Act, 1973) 1998-2008”, 2008

Indicator	Budget Cycle – External Scrutiny and Audit: Scope, nature and follow up of external audit	Score	Justification
PI-26		N/R	
(i)	Scope/nature of audit performed (including adherence to auditing standards)	N/R	
(ii)	Timeliness of submission of audit reports to legislature	N/R	
(iii)	Evidence of follow up on audit recommendations	N/R	

Indicator 27: Legislative scrutiny of the annual budget law

218. Indicator PI-27 examines the legislative scrutiny and debate of the annual budget law by assessing: i) the scope of the legislature's scrutiny; ii) the extent to which procedures are well established; iii) the adequacy of the time provided for scrutiny; iv) the rules for in year amendments without ex ante approval.

Dimension (i) Scope of legislature's scrutiny

219. The draft Budget papers are usually presented to the Cabinet and the government caucus by early June where they are considered over a period of one week, subsequently finalized by the Department of Finance and the Minister of Finance and then submitted to Cabinet for their final consideration and approval. The proposed Budget and supporting revenue and expenditure estimates are typically presented to Parliament in late June where these are debated for a period of about two days and then passed. The latter processes applied in 2007 and 2009. In 2008, an interim Supply Act was passed in late June to cover expenditure for the 2008 September quarter and the 2008-09 Budget was passed later in mid-July 2008.

220. The 2010-2011 Budget was not tabled in Parliament until November 1 and approved that day due to the recent State of Emergency situation. Supply for the December 2010 half-year was approved under Presidential Order 20 on 15 September 2010.

221. The standard parliamentary process for dealing with the Budget results in a relatively limited review of the Budget papers by the legislature. Typically, Parliament makes few adjustments to the revenue and expenditure estimates presented to Parliament.

222. The present format of the Budget papers tabled in Parliament does not include a medium term fiscal framework or any detailed discussion of medium term expenditure priorities. They have, however, generally included some commentary on fiscal policies for the coming financial year.

Dimension (ii) Legislature's budget procedures

223. Section 5 of the PFA prescribes the format to be employed for presenting the revenue and expenditure estimates to Parliament and requires the supporting proposals for the respective expenditure to be presented to Parliament as a Bill for an Appropriation Act.

224. Parliament scrutinizes the government's revenue and expenditure proposals by way of debate. Following the delivery of the Budget Speech, there is an immediate debate on the Budget, usually for a maximum of two days.

225. The Budget debate is conducted under special procedures of the Standing Orders of the Nauru Parliament; these are respected. The Budget is not referred to any parliamentary committee. Any Supplementary Estimates are reviewed timely by the Parliament.

Dimension (iii) Adequacy of time for legislature to provide a response to Budget proposals

226. The 2010 Budget circular anticipated that Parliament would consider the Budget over a period of two days. The 2010-11 Budget was passed in one day.

227. Supplementary budgets have traditionally been considered within a short timeframe by Parliament.

228. The current public finance legislation does not impose any other fiscal policy reporting obligations. The usual length of the Budget sessions in Parliament where the Budget estimates are debated is very limited giving opposition members of Parliament relatively little time to review the Budget.

Dimension (iv) In-year budget amendment rules

229. The PFA provides very transparent rules for the executive for performing in-year budget amendments.

230. Sections 6(1) and 6(3) of the PFA allows the government to undertake additional, new or reductions to expenditures and revenues set out in the Appropriation Act provided such expenditure and revenue changes have been approved by way of Supplementary Appropriation Acts. Section 8(5) of the PFA also gives Cabinet the power to authorize the Minister of Finance to approve changes to approved levels of sub-head expenditures during any financial year provided total expenditure for the respective budget head does not exceed the amount appropriated in the Budget as required by section 8(6) of the PFA. The PFA does not impose a limit on the number of amendments that may be made to sub-head expenditures in any financial year. Section 8(7) of the PFA requires the Minister of Finance to subsequently table details of such sub-head expenditure changes on the next convenient parliamentary sitting day after giving such approvals.

231. There are no specific ceilings for the amount of additional total revenue and expenditure that may be appropriated by supplementary budgets. Section 13(4) of the PFA limits the amount of the expenditure which may be committed to incur in respect of any service in future financial years to “such amount as is reasonable, having regard to the existing provision for expenditure on that service and any expenditure previously authorized”.

232. On average, a reasonable number of adjustments are made each financial year to the approved levels of sub-head expenditures.

233. Available legislation suggests that the in-year budget amendment rules are respected but it is not possible to confirm that these rules have been strictly complied with in the 2007-10 period as no audit of the government’s financial statements for this period has been undertaken to date.

Indicator	Budget Cycle – Legislative scrutiny of the annual budget law	Score	Justification
PI-27		D+	
(i)	Scope of the legislature’s scrutiny	C	Parliament’s review of the budget covers details of

			proposed revenue and expenditure but only after proposals have been finalized.
(ii)	Extent to which the legislature's procedures are well-established and respected	B	Simple procedures exist for the legislature's budget review and are respected.
(iii)	Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined)	D	The time allowed for the legislature to review the budget proposals is considerably less than one month. The usual period of a week allowed for Parliament to consider the Budget is considered relatively modest.
(iv)	Rules for in-year amendments to the budget without ex-ante approval by the legislature	B	Clear rules exist for in-year budget amendments by the executive, and are usually respected, but they allow extensive administrative reallocations.

Sources: Department of Finance, PFA

Indicator 28: Legislative scrutiny of external audit reports

234. The legislature has a key role in scrutinizing the execution of the budget. The PI-28 indicator examines the procedures employed by the legislature to review external audit reports of the government and public enterprises and assesses: i) the timeliness of the examination of audit reports; ii) the extent of hearings conducted to review external audit report and iii) the issuance of recommendations by the legislature regarding issues raised in the external audit reports.

235. Neither the PFA nor the Audit Act, 1973 impose any deadlines for the legislature to review the audit reports of either the government or public enterprises.

236. This indicator is not able to be scored as the Director of Audit has not submitted any audit reports on the financial statements of the government or public enterprises to Parliament since the late 1990's.

237. The Director of Audit did, however, present a Special Report to Parliament on 31 December 2008 discussing his audit work including comments on the failure of government entities to prepare financial statements and the status of the respective audit reports.

Indicator	Budget Cycle – External Scrutiny and Audit: Legislative scrutiny of external audit reports	Score	Justification
PI-28		N/R	
(i)	Timeliness of examination of audit reports by the legislature (for reports received within the last three years)	N/R	
(ii)	Extent of hearings on key findings undertaken by the legislature	N/R	
(iii)	Issuance of recommended actions by the legislature and implementation by the executive	N/R	

3.7 Donor Practices

238. The purpose of indicators D1 to D3 is to provide an assessment the impact of financial management practices associated with donor activity on the overall performance of Nauru's PFM system.

Indicator D1: Predictability of Direct Budget Support

239. Indicator D1 examines the degree of deviation and timeliness of donor disbursements provided for direct budget support.

240. The timeliness of donor direct budget support disbursements is measured on a quarterly basis. The donor providing budget support to Nauru (Taiwan) provides direct budget support forecasts on a six-monthly rather than a quarterly basis and this dimension has been scored on the latter basis.

Dimension (i) Annual deviation of actual budget support from the forecast provided by donor agencies

241. Taiwan is the sole donor providing budget support to Nauru and provides more than twelve months notice of proposed budget support flows to be made in each calendar half-year. Taiwan provided cash funding of \$2.46 million in 2009-10 of which approximately \$1.62 million represented general budgetary support funding.

242. Taiwan commenced providing budget support in the December 2008 half-year. The Department of Finance has advised that the value of each scheduled payment in each half-year period in the two fiscal years ended 30 June 2010 exceeded the forecasted amount.

Dimension (ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)

243. Taiwan provides only six-monthly direct budget support forecasts; all six-monthly payments were made on a timely basis in the last two fiscal years.

Indicator	Indicators of Donor Practices: Predictability of Direct Budget Support	Score	Justification
D1		A	
(i)	Annual deviation of actual budget support from the forecast provided by donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body)	A	The value of direct budget support in the last two fiscal years exceeded the forecasted amount.
(ii)	In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)	A	All scheduled six-monthly payments were made on a timely basis in the last two fiscal years.

Source: Department of Finance

Indicator D2: Financial Information provided by donors for budgeting and reporting on project and program aid

244. Indicator D2 reports on the quality of reporting by donors for budgeting and accounting purposes in the most recent completed financial year (30 June 2010).

Dimension (i) Completeness and timeliness of budget estimates by donors for project support

245. Cash and in-kind donor contributions received by Nauru in 2009-10 amounted to A\$15.1 million and A\$17.49 million respectively according to the Department of Finance and its AMU. The distribution of aid received from donors in cash and in-kind is presented in Table 14.

Table 15: Distribution of aid received 2009-10 by donor

Donor	Cash	In kind	Total
AusAID	21.38%	22.28%	43.67%
Taiwan	7.56%	19.43%	26.99%
NZAID	5.12%	1.84%	6.96%
SOPAC	0.00%	0.47%	0.47%
UNDP	0.00%	3.25%	3.25%
EU	1.91%	2.21%	4.12%
Japan	0.40%	3.07%	3.47%
Italy	0.00%	0.12%	0.12%
WHO	0.00%	0.06%	0.06%
SPC	0.02%	0.92%	0.95%
Other	9.94%	0.00%	9.94%
	46.34%	53.66%	100.00%

Sources: Aid Management Unit and Department of Finance reports

246. Taiwan and NZAID provided information on their projected cash receipts at least three months prior to the commencement of the 2009-10 financial year. Australia, Nauru's major donor, provided data on their projected 2009-10 cash receipts in May 2009. Consequently, not all major donors provided budget estimates at least three months prior to the commencement of the 2009-10 financial year.

247. Data published in the 2009-10 Budget included projections titled "Full details Head by Head" which identified the donor component of projected 2009-10 revenue and expenditure across all budget heads. About half of the donor flows are projected using the same budget classification methodology as the government.

248. No additional information is available in respect of the composition of 2009-10 cash receipts recorded as "other".

Dimension (ii) Donor reporting

249. During 2009-10 the Government of Australia provided 46% of all donor cash revenue - and 44% of the total estimated donor funding. They were the only major donor providing regular reports to the Nauru government on its aid flows. The AusAID reports employ similar budget heads to those set out in the government's budget 2009-10. The AusAID office in Nauru usually reconciles its cash flows with the Department of Finance on a monthly in arrears basis.

Indicator	Indicators of Donor Practices: Financial Information provided by donors for budgeting and reporting on project and programme aid	Score	Justification
D2		D	
(i)	Completeness and timeliness of budget estimates by donors for project support	D	Not all major donors provided budget estimates at least three months prior to the commencement of the 2009-10 financial year. Australia's submission of its budget forecast less than three months prior to 1 July 2009 results in a D score rather than a B score if this information had been provided by 31 March 2009
(ii)	Frequency and coverage of reporting by donors on actual flows for project support	D	Regular donor reports on aid disbursements, submitted within two months of the end of each quarter, covered less than 50% of total donor aid flows in 2009-10.

Sources: Aid Management Unit and Department of Finance reports

Indicator D3: Proportion of aid that is managed by use of national procedures

250. Indicator D3 reports on the proportion of aid funds to central government that are managed through national procedures in accordance with the principles of the Paris Declaration in the most recent completed financial year (30 June 2010).

Dimension (i) Proportion of aid that is managed by use of national procedures

251. In Nauru all aid funds received in cash are managed using current national PFM procedures. These cover procurement, payment / accounting and reporting activities but do not cover audit activities as limited audit activities have been undertaken as discussed earlier in the review of the PI-26 indicator.

252. The proportion of aid funds received in cash in the 2009-10 year was presented in Table 14. This table showed that 46.34% of aid funds were received in cash whilst in kind aid funds amounted to 53.66% of total aid funds. Consequently the proportion of aid funds managed through national procedures was less than 50% of total aid funds.

Indicator	Indicators of Donor Practices: Proportion of aid that is managed by use of national procedures	Score	Justification
D3		D	
(i)	Overall proportion of aid funds to central government that are managed through national procedures	D	Less than 50% of aid funds to central government are managed through national procedures.

Sources: Aid Management Unit and Department of Finance reports

IV. GOVERNMENT REFORM PROCESS

4.1 Description of recent and on-going reforms

253. The government's major recent reform initiative has been the adoption and ongoing maintenance of a prudent fiscal management strategy, first initiated in 2004, which has again been emphasized in the recent 2010-11 Budget. The government's conservative fiscal strategy has ended a long period of fiscal recklessness and stabilized the government's financial position. This strategy has included achieving a balanced budget, directing government expenditure to the provision of basic services, commencing the widening of the government's revenue base, stabilizing its very high debt position through debt write-offs and negotiated settlements with creditors and reducing the size of the public service and the value of subsidies provided to public enterprises.

254. Donor-funded technical assistance, particularly that provided by the Australian government, has played a significant role in sustaining the government's prudent fiscal strategy and providing a platform for further PFM improvements. Australian assistance is financing several senior management positions in the Department of Finance. It has also contributed to the development of the government's debt management strategy, verification of cash transactions since 1 July 2007 to provide a basis for the preparation of annual financial statements for the financial years commencing 1 July 2007 and the restructuring of key SOEs that were previously performing very poorly. Australian assistance is also currently contributing to the promotion of improvements in the financial governance of several other smaller SOEs. The ADB has assisted in the development of the 2005 NSDS and the planning associated with the establishment of the proposed new Nauru Trust Fund.

255. The Indian government has provided an auditor to act as the Director of Audit and strengthen the standard of government auditing practices in Nauru.

256. The budget preparation process has been strengthened with noticeable improvements evident in the preparation of the 2010-11 budget. Controls to protect customs revenues have been enhanced. Initial improvements in procurement procedures were instituted in September 2009. Improved monitoring of aid projects also commenced in the 2009-10 financial year. The government has endeavored to make the Public Accounts Committee more active in 2010 but its efforts were thwarted by the political difficulties experienced for much of this year.

257. The government's has indicated that the outstanding financial statements for the 2007-10 financial years will be completed by the end of the 2010-11 financial year and provide a level of financial disclosure that will be welcomed by Nauruans.

258. Although the Government has successfully stabilized its fiscal position over the last six years, there is considerable amount of work still to complete as the PFM system is undergoing a period of development.

259. The Department of Finance's plan to implement a new computerized financial accounting system in the 2010-11 financial year. This will facilitate significant improvements in financial controls, the quality of in-year financial reporting to the Cabinet and ministries and in the preparation of annual financial statements.

260. The planned establishment of a new National Revenue Office in the Department of Finance is expected to accelerate the Government's efforts to widen its revenue base. The PFM, customs and procurement regulatory frameworks require revision and/or development to provide a sensible ongoing framework for PFM activity, commensurate with Nauru's needs

as a SIDS. Draft revised Financial Instructions have been prepared recently by PFTAC and require confirmation and approval by the Cabinet.

4.2 Institutional factors supporting reform planning and implementation

261. The 2004 government initiated the strategy of fiscal consolidation in response to Nauru's extremely difficult financial position at that time. This strategy remains the dominant feature of the Government's ongoing approach to economic management.

262. The Government's revised NSDS, prepared in 2009, sets out Sector Goals that collectively will contribute to the achievement of the NSDS' Long Term Goals. The revised NSDS lists a number of PFM strategies designed to assist the achievement of the macroeconomic management Sector Goal which demonstrate the Government's ongoing commitment to improving PFM in Nauru; these include: (i) responsible management of government's budget including aid programs; (ii) the introduction of a broad based revenue system; (iii) the development of a coherent strategy to deal with government debt; (iv) implementing public sector reforms to reduce the size of the public sector and improve its efficiency and the establishment of the Nauru Intergenerational Fund.

263. To date, the government's PFM improvements have been achieved with significant donor assistance. In view of the government's ongoing limited financial resources, Nauru's major donors stand ready to continue assisting the planning and implementation of PFM reforms.

264. The Department of Finance continues to lead the implementation of PFM reform measures. It has sought to promote a co-ordinated approach when implementing reforms by regularly briefing and consulting with all ministries and SOEs to provide opportunities for them to contribute to the reform decision-making process.

265. The government's progress in achieving the PFM strategies set out in the 2009 NSDS review will be monitored through the proposed Annual Development Report that will describe the progress made in all NSDS strategies including PFM strategies.

266. The Government plans to hold a donor coordination meeting during the 2010-2011 financial year to discuss the findings of the 2010 PEFA study and chart a way forward for implementing further PFM improvements.

267. Building PFM capacity remains a major challenge for the Department of Finance. The current long-term technical advisors employed in the Department of Finance are providing considerable on-the-job training but additional initiatives are required. No significant actions in terms of new incentives have been introduced to retain local financial management staff who are currently receiving extensive training.

Annex 1: Summary Table of PFM Performance Indicator Ratings

No	PEFA Indicator	Scoring Method	Overall Rating	Brief Explanation and Cardinal Data used
A. Credibility of the budget				
PI-1	Aggregate expenditure out-turn compared to original approved budget	M1	N/R	This indicator was not scored as expenditure data for the 2007-08 year was incomplete. Actual expenditure deviated from budgeted expenditure by more than 15% of budgeted expenditure in 2009-10.
PI-2	Composition of expenditure out-turn compared to original approved budget	M1	N/R	This indicator was not scored as expenditure data for the 2007-08 year was incomplete. Variance in expenditure composition exceeded overall deviation by 7.26% and 0.31% in 2008-09 and 2009-10.
PI-3	Aggregate revenue out-turn compared to original approved budget	M1	N/R	This indicator was not scored as revenue data for the 2008-09 year was incomplete.
PI-4	Stock and monitoring of expenditure payment arrears	M1	D+	Aged expenditure arrears exceeded more than 10% of total 2009-10 government expenditure. Information on the stock of aged expenditure arrears is generated several times a year. There is no regular reporting of current expenditure arrears.
B. Comprehensiveness and Transparency				
PI-5	Classification of the budget	M1	D	The budget formulation and execution is based on an administrative classification system that is not GFS compatible.
PI-6	Comprehensiveness of information included in budget documentation	M1	C	The recent 2010-11 budget documentation fulfils four of the nine information benchmarks.
PI-7	Extent of unreported government operations	M1	N/R	This indicator was not scored as no audited financial statements were available for any of the last three financial years.
PI-8	Transparency of inter-governmental fiscal relations	M2	N/A	This indicator was not scored as Nauru does not have any local governments.
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	M1	D	Few major public enterprises currently submit annual financial statements to the government so it is not possible for the Department of Finance to comprehensively monitor fiscal risks.
PI-10	Public access to key fiscal information	M1	C	Public access to key fiscal information is very limited with only one of the six listed information benchmarks being made available to the public.

No	PEFA Indicator	Scoring Method	Overall Rating	Brief Explanation and Cardinal Data used
C. Budget Cycle				
C(i) Policy-Based Budgeting				
PI-11	Orderliness and participation in the annual budget process	M2	C+	A clear annual budget calendar has been determined over the last three Budget rounds usually allowing MDAs and PEs at least four weeks from receipt of the budget circular to prepare detailed budget estimates. Political difficulties undermined adherence to the budget calendar in two of the last three budget rounds. Budget ceilings are not prescribed in Budget circulars. Two of the budgets for the last completed fiscal years were approved before the commencement of the respective fiscal year.
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	M2	D+	Multi-year budgets are currently not prepared. Work similar to a debt sustainability analysis was undertaken in 2007-08. Costed sector strategies have not been prepared. Budgeting for investment and recurrent expenditure are currently essentially separate processes; few recurrent cost estimates arising from donor (investment) projects are provided.
C(ii) Predictability and Control in Budget Execution				
PI-13	Transparency of taxpayer obligations and liabilities	M2	D+	Customs duty is the only form of taxation in Nauru. The customs legislation is out-dated and there is significant discretion for determining customs duty penalties. There is access to information about customs duty rates but no information is provided about customs administrative procedures. No functioning customs duty appeals system has been established.
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	M2	D	Importer registration for customs duties is not subject to any effective controls or enforcement systems. There are no penalties for making false customs declarations. No customs duty audits have been undertaken. Some fraud investigations have been undertaken on an ad hoc basis.
PI-15	Effectiveness in collection of tax payments	M1	D+	The average customs duty arrears collection ratio was approximately 71% in the 2008-10 period. Customs receipts are deposited by the revenue office at the Treasury cash office daily. Large importer payments are made directly at the Treasury cash

No	PEFA Indicator	Scoring Method	Overall Rating	Brief Explanation and Cardinal Data used
				office. Complete accounts reconciliation between tax assessments, collections, arrears records and receipts are currently not being undertaken by the Treasury.
PI-16	Predictability in the availability of funds for commitment of expenditures	M1	A	Cash flow forecasts are prepared, monitored and updated on a weekly basis. Ministries are able to make forward commitments at least six months in advance. Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a transparent and predictable way.
PI-17	Recording and management of cash balances, debt and guarantees	M2	C	Domestic and foreign debt data records are considered complete, updated and reconciled at least annually. The data quality is considered good. All revenue collections on Nauru are deposited into the local RON Treasury account at least weekly. All offshore funds are consolidated regularly into the RON Treasury Brisbane account. No unified mechanism is in place to control government borrowing and the issuing of government guarantees.
PI-18	Effectiveness of payroll controls	M1	D+	Personnel data and payroll are not directly linked but payroll changes are documented and checked each month; there is external evidence that personnel files may not be entirely complete. Changes to personnel records and payroll are updated monthly; retroactive adjustments are modest. Internal controls restrict authority to change payroll records, creating an audit trail. No annual payroll audits have been undertaken within the last three years.
PI-19	Competition, value for money and controls in procurement	M2	D	Available data suggests that use of open competition is limited. The current procurement procedures do not give guidance on the use of less competitive methods nor establish open competition as the preferred procurement method. No process is defined to enable submitting and addressing of complaints regarding the implementation of Nauru government procurements.
PI-20	Effectiveness of internal controls for non-salary expenditure	M1	D	Comprehensive expenditure commitment controls are in place and limit commitments to actual cash availability and approved budget allocations (as revised). Numerous internal controls/procedures are neither comprehensive nor relevant. . The rules for the processing

No	PEFA Indicator	Scoring Method	Overall Rating	Brief Explanation and Cardinal Data used
				and recording of transactions are complied with in a significant majority of transactions.
PI-21	Effectiveness of internal audit	M1	D	There is no formal internal audit capability. Few internal audits are undertaken. There is little internal audit focused on systems monitoring. Internal audit reports are currently prepared on an irregular basis for a very limited number of government ministries. No formal arrangements exist for the distribution of internal audit reports. Internal audit reports prepared by the Directorate of Audit have not been widely distributed. To date internal audit recommendations have generally been ignored.
C(iii) Accounting, Recording and Reporting				
PI-22	Timeliness and regularity of accounts reconciliation	M2	C+	Bank reconciliations for all government bank accounts now take place at least monthly, usually within 4 weeks of the end of period. Advance accounts have not been reconciled since February 2010.
PI-23	Availability of information on resources received by service delivery units	M1	D	No comprehensive data collection on resources to service delivery units in any major ministry has been collected and processed within the last three years.
PI-24	Quality and timeliness of in-year budget reports	M1	C+	Classification of data allows direct comparison to the original budget. All head, sub-head and sub head information is shown in in-year budget reports. Expenditure is covered at payment stage (no commitment expenditure is incurred or recorded). Reports compiled at the end of each quarter are usually issued within eight weeks of the end of the quarter. There are some concerns about the accuracy of information, which are not highlighted in the reports, but this does not fundamentally undermine their basic usefulness.
PI-25	Quality and timeliness of annual financial statements	M1	N/R	This indicator was not scored as no financial statements have been prepared for any of the last three financial years.
C(iv) External Scrutiny and Audit				
PI-26	Scope, nature and follow-up of external audit	M1	N/R	This indicator was not scored as no financial statements have been submitted for audit for any of the last three financial years.
PI-27	Legislative scrutiny of the annual budget law	M1	D+	Parliament's review of the budget covers details of proposed

No	PEFA Indicator	Scoring Method	Overall Rating	Brief Explanation and Cardinal Data used
				revenue and expenditure but only after proposals have been finalized. Simple procedures exist for the legislature's budget review and are respected. The time allowed for the legislature to review the budget proposals is considerably less than one month and is usually a week. Clear rules exist for in-year budget amendments by the executive, and are usually respected, but they allow extensive administrative reallocations.
PI-28	Legislative scrutiny of external audit reports	M1	N/R	This indicator was not scored as no audit reports were available for any of the last three financial years.
D. Donor Practices				
D-1	Predictability of Direct Budget Support	M1	A	The value of direct budget support in the last two fiscal years exceeded the forecasted amount. All payments were made on a timely basis.
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	M1	D	Not all major donors provided budget estimates at least three months prior to the commencement of the 2009-10 financial year. Regular donor reports on aid disbursements, submitted within two months of the end of each quarter, covered less than 50% of total donor aid flows in 2009-10.
D-3	Proportion of aid that is managed by use of national procedures	M1	D	Less than 50% of aid funds to central government are managed through national procedures.

Annex 2: Sources of Information

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Audit Act 1973

Constitution of Nauru 1968

Custom & Adopted Laws Act 1971

Custom and Adopted Laws (Amendment) Act 1972

Custom and Adopted Laws (Amendment) Act 1976

Custom and Adopted Laws (Amendment) Act (No.2) 1976

Customs Ordinance 1921 (Territory of New Guinea, adopted) (Applied to Nauru by the Customs Regulation Ordinance 1922)
Customs Tariff Act 1997
Customs (Amendment) Act 2009
Customs Regulations —Landing of Goods from Vessels A/Order
General Customs Duties (Mode of Collection) Regulations 1997-2010
Customs Duties on Petroleum Products (Mode of Collection) Regulations 1997
Customs Proclamation No.2 1999
Customs Regulation Ordinance 1922
Customs Regulations Amendment Ordinance 1936
Ordinances Revision Ordinance 1967
Customs Tariff Act 1997
Customs Tariff Act 1997
Customs Tariff (Amendment) Act 1999
Customs Tariff Act 2006
Customs Tariff (Amendment) Act 2007
Customs Tariff (Exemptions) Regulations 2006
Nauru Air Corporation Act 1995
Nauru Air Corporation (Amendment) Act 2006
Nauru Air Corporation (Amendment) Act 2007
Nauru Fisheries & Marine Resources Authority Act 1997
Nauru Fisheries & Marine Resources Authority (Amendment) Act 2004
Nauru Rehabilitation Corporation Act 1997
Public Finances (Control and Management) Act 1997
RONPHOS Act 2005

Annex 3: List of People Met

Name	Position	Organisation
HE Marcus Stephen, MP	President	
Hon. Dr. Kieren Keke MP	Minister for Finance & Sustainable Development	Ministry of Finance & Sustainable Development
Norman Kapun	Director of ICT	Transport Telecommunication Department
Dr Sunia Soakai	Secretary for Health	Health Department
Phillipina Seymour	Budget Officer	Health Department
Katy Leroy	Parliamentary Counsel	Parliament
Catriona Steele	Assistant Parliamentary Counsel	Parliament
Darice Ephraim	Administrative Officer	Chief Secretary's Department
Bernard Grundler	Manager Employee Relations	Chief Secretary's Department
Alexander Stephen	Manager Salary & Entitlements Officer	Chief Secretary's Department
B.R. Mondal	Director of Audit	Department of Audit
Romina Atto	Chief Clerk	Ministry of Finance & Sustainable Development
Ipia Gadabu	Director of Statistics	Ministry of Finance & Sustainable Development
David Lambourne	Secretary for Justice	Justice Department
Tazil Gideon	Managing Director	Ronphos Limited
Rod Henshaw	Director of Media	Home Affairs Department
Knut Ostby	UN Resident Coordinator and UNDP Resident Representative	
Dr. Isiye Ndombi	UNICEF Pacific Representative	
Dirk Jena,	UNFPA Representative and Pacific Sub-Regional Director	
Bernard Blazkiewicz	European Union Third Secretary Kiribati & Nauru	

Annex 4: Workshop Attendance

PEFA Assessment
(ADB-NAURU)
Half Day Workshop
Thursday 2nd September 2010
9.30am – 1.00pm

Parliament Members Lounge Room, Parliament House, Nauru

Stakeholder List

Name	Title	Organisation	Email
GOVERNMENT			
Hon. Dr. Kieren Keke MP	Minister for Finance & Sustainable Development	Ministry of Finance/Sustainable Development	Kieren.keke@naurugov.nr
Seve Paeniu	Secretary for Finance	Ministry of Finance/Sustainable Development	Seve.paeniu@naurugov.nr
Taiatu Ata'ata	Deputy Secretary for Economic Development & Monitoring	Ministry of Finance/Sustainable Development	Taiatu.ataata@naurugov.nr
Javan Tamakin	A/Chief Accountant	Ministry of Finance/Sustainable Development	Javan.tamakin@naurugov.nr
Shonadeen Dowabobo	Senior Budget Officer	Ministry of Finance/Sustainable Development	Shonadeen.dowabobo@naurugov.nr
Samuel Grundler	Director for Sector Planning (DPPD)	Ministry of Finance/Sustainable Development	Samuel.grundler@naurugov.nr
Greta Harris	Asst. Director for Bilateral (AMU)	Ministry of Finance/Sustainable Development	Greta.harris@naurugov.nr
Berilyn Jeremiah	Asst. Director for Multilateral (AMU)	Ministry of Finance/Sustainable Development	Berilyn.jeremiah@naurugov.nr
Sasi Kumar	Director of Administration	Department of Chief Secretary	Sasi.kumar@naurugov.nr

Alexander Stephen	Manager Salary & Entitlements Benefits	Department of Chief Secretary	Alexander.stephen@naurugov.nr
Angelo Dimapilis	Procurement & Supply Manager	Department of Chief Secretary	Angelo.dimapilis@naurugov.nr
Sunia Soakai	Secretary for Health	Department of Health	Sunia.soakai@naurugov.nr
Dr. Maria Gaiyabu	Secretary for Education	Department of Education	Maria.gaiyabu@naurugov.nr
Joanne Crawford-Bryde	Education Advisor	Department of Education	Joanne.crawford-bryde@naurugov.nr
Frankie Ribauw	A/Secretary for Commerce, Industry & Environment	Department of Commerce, Industry & Environment	Frankie.ribauw@naurugov.nr
Bryan Star	Director of Projects	Department of Commerce, Industry & Environment	Bryan.star@naurugov.nr
Renos Agege	Senior Examiner of Accounts (A/Director of Audit)	Directorate of Audit	
DEVELOPMENT PARTNERS			
George Fraser	High Commissioner	Australian High Commission, Nauru	George.Fraser@dfat.gov.au
Jason Wan	Ambassador	Taiwan Embassy	
CIVIL SOCIETY			
Manfred Depaune	President	Nauru Island Association of NGOs (NIANGO)	
Lochley Denuga	President	Nauru Private Business Sector Organisation	
Peta Gadabu	President	Nauru Women's Council	Peta.gadabu@naurugov.nr
Ann-Nerida Hubert	President	Nauru National Youth Council	Ann.hubert@nauru.gov.nr
Sean Oppenheimer	General Manager	Capelle & Partner	cp@sub.net.au
JP Dixon	General Manager	Digicel Nauru Corporation	JP.Dixon@digicelgroup.com
Alamanda Lauti	Director	USP Centre	Lauti_a@usp.ac.fj

Attendance List

PEFA Presentation of Preliminary Findings – 28 September 2010

1. Seve Paeniu – Secretary for Finance
2. Maurie Williams – Deputy Secretary for Treasury
3. Tai'atu Ata'ata – Deputy Secretary for Economic Planning & Monitoring
4. Javan Tamakin – Acting Chief Accountant
5. Greta Harris – Assistant Director for Bilateral Relations (Aid Management Unit)
6. Rainer Kleffel – UN Coordinator and Aid Management Specialist (UN Joint Presence Office)
7. Robert Sisilo – Secretary for Foreign Affairs
8. Russ Kun – Secretary for Commerce, Industry & Environment (A/Chief Secretary)
9. Frankie Ribauw – Director for Agriculture
10. Angelo Dimapilis – Procurement & Supply Manager
11. Gillian Itsimaera – Audit Office representative
12. Justin Togoran – Audit Office representative
13. Dr. Maria Gaiyabu – Secretary for Education
14. H.E. Jason Wan – Ambassador for Taiwan
15. Mark Skinner – First Secretary for Development Cooperation (Ausaid)
16. JP Dixon – General Manager for DIGICEL
17. Manfred Depaune – NIANGO President
18. Julie Olsson – NIANGO Secretary
19. Lochley Denuga – NPBSO President
20. Peta Gadabu – Women's Council President