

# Vanuatu Public Expenditure and Financial Accountability

Final report

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## Abbreviations and Acronyms

ADB	Asian Development Bank
AFD	Agence Française de Développement
AG	Auditor General
AGA	Autonomous Government Agencies
ASMP	Assistance for Strengthening Management in the Pacific
AusAID	The Australian Agency for International Development
BOP	Balance of Payments
BPS	Budget Policy Statement
CIRD	Customs and Inland Revenue Department
COFOG	Classification of Functions of Government
COM	Council of Ministers
CRP	Comprehensive Reform Programme
CS-DRMS	Commonwealth Secretariat Debt Recording and Management System
CTS	Customs Tax System
DCO	Development Committee of Officials
DESP	Department of Economic and Sector Planning
DG	Director General
DOF	Department of Finance
DSF	Donor Survey Form
DSA	Debt Sustainability Analysis
DSM	Department of Strategic Management
EC	European Commission
EMIS	Education Management Information System
FED	Foreign Exchange Differences
FF	Fiscal Framework
FMIS	Financial Management Information System
FRX	Financial Reporting (software for financial reporting and budgeting)
FSR	Fiscal Strategy Report
FSF	Fiscal Strategy Framework
FY	Financial Year
GBEU	Government Business Enterprise Unit
GDP	Gross Domestic Product
GFS	Government Financial Statistics
GIP	Government Investment Programme
GIS	Geographical Information System
GoV	Government of Vanuatu
GRT	Government Remuneration Tribunal
JICA	Japan International Cooperation Agency
HDI	Human Development Index

HRMIS	Human Resource Management Information System
IAU	Internal Audit Unit
IFAC	International Federation of Accountants
IMF	International Monetary Fund
INTOSAI	International Organisation of Supreme Audit Institutions
ISP	Institutional Strengthening Project
IT	Informational Technology
LPO	Local Purchase Order
MBC	Ministerial Budget Committee
MCA	Millennium Challenge Account
MoE	Ministry of Education
MoFEM	Ministry of Finance and Economic Management
MTEF	Medium Term Expenditure Framework
MYOB	Mind Your Own Business (an entry-level accounting software package)
NAO	National Audit Office
NSO	National Statistics Office
NZAID	New Zealand's International Aid and Development Agency
PAA	Priorities and Action Agenda
PAC	Public Accounts Committee
PE	Public Enterprise
PEFA	Public Expenditure and Financial Accountability
PFEMA	Public Finance and Economic Management Act
PFM PMF	Public Finance Management Performance Management Framework
PFM PR	Public Financial Management Performance Report
PI	Performance Indicator
RBV	Reserve Bank of Vanuatu
SAF	Structural Adjustment Facility
SAI	Supreme Audit Institution
SASP	Structural Adjustment Support Programme
SE	State Enterprise
SERP	Support to Economic Reform Program
SN	Sub-National
SPSAI	South Pacific Supreme Audit Institutions
SWAP	Sector Wide Approach to Planning
TA	Technical Assistance
TIN	Tax Identification Number
UN	United Nations
UNICEF	United Nations Children's Fund
VAT	Value Added Tax
VNPF	Vanuatu National Provident Fund
WHO	World Health Organisation

# Executive Summary

## *Assessment of performance*

This assessment of Public Financial Management (PFM) in Vanuatu is based on the PFM Performance Measurement Framework (PMF). The PFM PMF has been developed by the Public Expenditure and Financial Accountability (PEFA) partners as a tool that can provide reliable information on the performance of PFM systems, processes and institutions over time. It is intended to form the basis of a strengthened approach to PFM issues, to build consensus on particular strengths and weaknesses, to encourage government ownership and to eliminate duplicate assessments.

The analysis has been carried out for the period 2003 to 2005 based on a review of a wide range of documentation, reports and interviews with a large number of stakeholders. Whilst not the first PEFA exercise<sup>1</sup> to be carried out in the region, it is notable for the high level of participation of government and donors. The results of the analysis are set out in table 1 below.

Table 0.1 Overall summary of results

PFM Performance Indicator		Scoring Method	Dimension Ratings				Overall Rating
			i.	ii.	iii.	iv.	
<b>A. PFM-OUT-TURNS: Credibility of the budget</b>							
PI-1	Aggregate expenditure out-turn compared to original approved budget	M1	A				<b>A</b>
PI-2	Composition of expenditure out-turn compared to original approved budget	M1	A				<b>A</b>
PI-3	Aggregate revenue out-turn compared to original approved budget	M1	A				<b>A</b>
PI-4	Stock and monitoring of expenditure payment arrears	M1	A	A			<b>A</b>
<b>B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency</b>							
PI-5	Classification of the budget	M1	B				<b>B</b>
PI-6	Comprehensiveness of information included in budget documentation	M1	A				<b>A</b>
PI-7	Extent of unreported government operations	M1	C	D			<b>D+</b>
PI-8	Transparency of inter-governmental fiscal relations	M2	A	B	D		<b>B</b>
PI-9	Oversight of aggregate fiscal risk from other public sector entities	M1	D	D			<b>D</b>
PI-10	Public access to key fiscal information	M1	C				<b>C</b>
<b>C. BUDGET CYCLE</b>							

<sup>1</sup> PEFA exercises have also been carried out in Fiji and Papua New Guinea.

PFM Performance Indicator		Scoring Method	Dimension Ratings				Overall Rating
			i.	ii.	iii.	iv.	
<b>C(i) Policy-Based Budgeting</b>							
PI-11	Orderliness and participation in the annual budget process	M2	B	A	B		<b>B+</b>
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	M2	C	D	D	C	<b>D+</b>
<b>C(ii) Predictability and Control in Budget Execution</b>							
PI-13	Transparency of taxpayer obligations and liabilities	M2	C	C	B		<b>C+</b>
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	M2	C	B	B		<b>B</b>
PI-15	Effectiveness in collection of tax payments	M1	D	A	D		<b>D+</b>
PI-16	Predictability in the availability of funds for commitment of expenditures	M1	B	C	A		<b>C+</b>
PI-17	Recording and management of cash balances, debt and guarantees	M2	C	B	C		<b>C+</b>
PI-18	Effectiveness of payroll controls	M1	A	B	A	C	<b>C+</b>
PI-19	Competition, value for money and controls in procurement	M2	D	C	D		<b>D+</b>
PI-20	Effectiveness of internal controls for non-salary expenditure	M1	B	C	C		<b>C+</b>
PI-21	Effectiveness of internal audit	M1	C	C	D		<b>D+</b>
<b>C(iii) Accounting, Recording and Reporting</b>							
PI-22	Timeliness and regularity of accounts reconciliation	M2	B	B			<b>B</b>
PI-23	Availability of information on resources received by service delivery units	M1	C				<b>C</b>
PI-24	Quality and timeliness of in-year budget reports	M1	A	A	B		<b>B+</b>
PI-25	Quality and timeliness of annual financial statements	M1	A	B	A		<b>B+</b>
<b>C(iv) External Scrutiny and Audit</b>							
PI-26	Scope, nature and follow-up of external audit	M1	D	D	D		<b>D</b>
PI-27	Legislative scrutiny of the annual budget law	M1	C	C	C	B	<b>C+</b>
PI-28	Legislative scrutiny of external audit reports	M1	D	D	D		<b>D</b>
<b>D. DONOR PRACTICES</b>							
D-1	Predictability of Direct Budget Support	M1	D	D			<b>D</b>
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	M1	D	D			<b>D</b>
D-3	Proportion of aid that is managed by use of national procedures	M1	D				<b>D</b>

A descriptive summary of the key findings is set out in the following paragraphs.

#### *Credibility of the budget*

During the period under review, budget credibility both at an aggregate level and in terms of expenditure composition was good. Actual revenue was greater than budgeted revenue. It is generally recognised however that the reliability of the Gross Domestic Product (GDP) figures is poor and therefore revenue targets (budgets) may be understated. The Government has a centralised payments system and commitment control system and the level of outstanding arrears is not material. The Government also has a number of other

measures in place to minimise the potential generation of arrears in central government including prepaid telephone accounts.

#### *Comprehensiveness and transparency*

In terms of comprehensiveness and transparency, its ability to oversee fiscal risk remains a concern to the GoV as many of the State Enterprises and Statutory Bodies have not submitted accounts for several years. In order to help address this problem, a first draft of a Public Enterprise Accountability Bill has been prepared and assistance in finalising the Bill is to be provided by the Asian Development Bank (ADB). Enforcement of the legislation will clearly be key to resolving the issue. Decentralisation to the Provinces is in its infancy and although charged with the legal responsibility, activities at the sub national level are relatively small. There is no Freedom of Information Act in Vanuatu and public access to information on public financial management is limited. Demand for government accountability by the public in Vanuatu is also not well developed.

#### *Policy-based budgeting*

The GoV has a clear budget calendar which is broadly followed. The Executive (through the Ministerial Budget Committee) is actively involved in the process and the legislature has generally approved the budget in a timely manner. Unfortunately, the multi year perspective for financial planning and budgeting is weak, similarly links between national and sector policies and the budget remain under developed.

#### *Predictability and control in budget execution*

Currently tax revenues constitute approximately 90% of Government of Vanuatu (GoV) overall domestic revenues. Legislation for Value Added Tax (VAT) is relatively clear, exemptions in relation to import duties do allow a degree of discretion and are being reviewed. For import duties, GoV has implemented Ayscuda software and major importers have access to the system. For VAT and other rates and taxes, a separate customs and taxes system is maintained. In addition to the VAT audit section, the Customs and Inland Revenue Department has an Investigations and Legal Section to follow up on defaulting taxpayers and to check compliance. The Department recognises that revenue is not being maximised particularly on the outlying islands, although capacity constraints are a limiting factor. Other measures are being considered to improve tax revenue collection rates e.g. introduction of large taxpayer unit and introduction of a single Tax Identification Number (TIN).

Non tax revenues represent about 10% of domestic revenue. Penalties for non compliance are insufficient and outstanding arrears are a major problem e.g. port and wharfage, land rents. GoV is considering a number of measures to redress the problem e.g. private debt collectors. The GoV is determined to follow a prudent approach to financial management, consequently the MFEM still operates a monthly warrant system. However, in the period under review, 2003 – 2005 amounts warranted were in accordance with individual ministry cash flow requests.

Debt administration in Vanuatu should be fairly straightforward with relatively few external loans and domestic debts, there is however a recognised need to be more proactive in overall debt management and establish a more precise debt management policy for all public sector loans and guarantees.

Payroll accounting procedures are fairly robust, but are undermined by delays at the Service Commissions (e.g. Public Service, Police and Teachers) to process recruitments and terminations. Procurement in excess of VT5million has to go out to tender and be approved by the Council of Ministers on the basis of recommendations from the Tender Board. However, maintenance of adequate records to assess the use of open competition and justification for non use is weak. There also does not appear to be a process of actively using this information to improve procurement processes.

The centralised payments system facilitates improved commitment control and financial regulations/circulars and manuals exist to guide sound financial management. Areas of weakness have been identified and are to be addressed in the amendments to the PFEM Act. These include control of virements and improved information on Aid in Kind. There are some concerns about the level of compliance, particularly at the ministry/department level and the role of internal audit in assuring management that systems are working and highlighting areas of non compliance is being developed in response.

#### *Accounting, recording and reporting*

The GoV operates a centralised payments and payroll system using SmartStream financial software. Line ministries and some provincial offices in Santo have direct access to the system through a Wide Area Network (WAN). Bank account reconciliations for the key Treasury managed bank accounts are done on a regular basis<sup>2</sup>. Comprehensive and detailed in year budget execution reports can be extracted as required by all users and financial accounts are now being prepared on an accrual basis and in accordance with the majority of International Public Sector Accounting Standards. Parliamentary appropriations (on a cash basis) are included in the financial statements to Parliament<sup>3</sup>.

#### *External scrutiny and audit*

Although the formal committee structure for the review of estimates has not been operational, general procedures for the timely review of the budget by Parliament have been followed. The basic legal framework for external scrutiny and audit is in place, although there are some concerns over true independence of the audit function. However, the key concerns are in relation to the capacity of the National Audit Office to meet its legal reporting obligations. No audit reports have been tabled with Parliament since 2000 and the Public Accounts Committee has not met since 2003.

Some progress in addressing the backlog is being made and the Auditor General is in the process of finalising the financial audit of the 1998- 2001 accounts and the newly formatted 2002-2004 accounts. A Public Accounts Committee is in place and is due to start work in the next Parliamentary session in June 2006.

#### *Donor practices*

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<sup>2</sup> Transactions in Vila are reconciled with the cash book on a weekly basis, transactions from Santo are reconciled on a monthly basis.

<sup>3</sup> GoV is still operating strict control over its cash and has made the decision not to prepare accrual based budgets.

Currently there is no donor co-ordination strategy in place<sup>4</sup>. Budget support in Vanuatu is in its infancy. However, as noted below there has been a gradual move to improved relations and an Education Partners Group is working together in the preparatory phase of a SwAP. In the period under review, only two donors provided “general” support to the budget. EC’s budget support has been based on loosely defined conditions. Chinese contributions to GoV’s budget were more ad hoc and did not follow the formal planning process. The GoV has not therefore been able to budget for this type of support with any degree of confidence.

Bilateral and multilateral programme and project assistance by most traditional donors is in support of projects incorporated in the Government Investment Programme (GIP), although a few donors including multilateral agencies, as well as NGOs, charitable organisations and volunteer agencies respond to ad hoc requests from line ministries. However, Vanuatu is also the recipient of funds from a number of global and regional funds which tend to fall outside the budgetary process. The GIP process (and databases held by the Department of Economic and Sector Planning and the Ministry of Foreign Affairs) is being reviewed with assistance from the ADB.

Some donors provide information on forecast assistance to a project only at the initiation of the project. Subsequent changes in forecast cash flows are therefore not incorporated into the planning process. Actual disbursements for all types of assistance are requested by the Reserve Bank of Vanuatu on a quarterly basis for balance of payments purposes. Most donors provide some information, although the completeness and accuracy of the information is in doubt<sup>5</sup>. This information is now being shared with the MFEM, but does not meet the requirements of the MFEM for management, planning or budgeting purposes.

Currently only about –15 - 20% of donor assistance is captured in the government’s accounts and is managed using national procedures<sup>6</sup>. The majority of other support<sup>7</sup> is provided in the form of technical assistance, aid in kind, direct purchases and separately administered projects.

#### *Assessment of the current strengths and weaknesses and their impact on PFM*

Strengths and weaknesses in PFM have a direct impact on the budgetary outcomes of aggregate fiscal discipline, strategic allocation of resources and efficient service delivery. In the period under review, 2003 – 2005, it is clear that there have been a number of improvements in PFM in Vanuatu. In particular, the new financial management system provides improved reporting capabilities for both internal management and external financial reporting purposes. More timely and more comprehensive reporting capacity should facilitate both improved service delivery, better resource allocation and more effective oversight. The system has also enabled improved control of commitments and mitigation of the accumulation of arrears.

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<sup>4</sup> Assistance has been provided by ADB which has reviewed aid co-ordination and made recommendations for improvement.

<sup>5</sup> Several donors expressed confusion as to what exactly they should report e.g. including or excluding off shore expenditure.

<sup>6</sup> National procedures mean that banking, authorisation, procurement, accounting, audit, disbursement and reporting arrangements used by government.

<sup>7</sup> This refers to “on budget” support, which is in support of GIP projects and “off budget” support which is outside this planning process.

In the last twelve months, there have been a number of developments in relation to the internal audit function. Continued focus in this area will help government ensure that resource utilisation is not significantly different from original allocations. Over the period, there has also been an improved dialogue between government and donors on PFM issues which should set the foundations for increased budget support.

In terms of PFM, the main weaknesses in Vanuatu relate to: i) the lack of up to date information on state enterprises; ii) the poor link between the budget and policy/policy instability; iii) lack of effective external scrutiny and audit and availability of information for public scrutiny; and iv) inadequate information on the totality of donor resources.

Without comprehensive and up to date information on state enterprises and potential liabilities, the ability of central government to manage resources effectively is severely compromised. Efforts to maintain aggregate fiscal discipline can be undermined and delivery of essential services could be adversely affected.

Whilst budget credibility is good in Vanuatu because of strong central control, if government policy is not linked to the budget more effectively, money may not be directed towards the efficient delivery of actual services. A lack of a multi year perspective undermines allocative decisions as the time span of an annual budget is too short to introduce significant changes in expenditure allocations, leading to potential under funding of new policy initiatives. The work carried out to date on the development of the medium term expenditure framework (MTEF) provides a sound basis for improvements in this area.

Limited scrutiny by external audit, the legislature and public can impact adversely on both strategic resource allocation and efficient service delivery. In particular, lack of scrutiny may result in a situation where the government is not held accountable for the allocation and execution of the budget in line with its stated policy. Improved access to financial information, particularly at the community level can assist in improved financial management, particularly in more remote areas, where centralised controls are inappropriate and counter productive.

Donor support to GoV is significant, however, as noted below, the current lack of an agreed donor co-ordination strategy does mean that the maximum benefit is not being achieved from those funds. There is also a lack of information on available regional funds and cumbersome request processes. Whilst there are regular meetings between donors and the government, and between donors, this does not yet translate to effective resource allocation and efficient service delivery.

#### *Prospects for reform planning and implementation*

The GoV has a formal structure for planning and implementing reforms, which involves the Council of Ministers, a Development Committee of Officials, the Department for Strategic Management, the Department of Economic and Sector Planning and the relevant implementing body. Efforts to improve the monitoring and evaluation capabilities are ongoing and would be strengthened by greater adherence to the requirement for annual



reporting by individual ministries including the reporting on the achievement of specified service targets.

The focus of the government's reforms in PFM has been to improve the legal and regulatory framework. Donors have supported the government reform programme by concentrating on the actual implementation of this improved legal and regulatory framework, which is based on international best practice. In particular, Australian Aid's institutional strengthening project provided significant support to the finance function in implementing the FMIS, training staff both in the MFEM and in line ministries.

Assistance to the CIRD was also provided by New Zealand Aid through the secondment of personnel from the New Zealand Customs and Inland Revenue Department. The EC has provided support to both the development of a medium term expenditure framework and internal audit, whilst ADB continues to provide assistance in aid management and revenue forecasting. Whilst individual projects have made a positive impact, it is generally recognised that discrete projects have not always achieved their full potential because of the lack of proper co-ordination.

As noted earlier progress on PFM reforms can be monitored using these high level PEFA performance indicators on a two or three yearly basis. However as the government and donors move towards a Sector Wide Approach (SwAP) in education, they may wish to review progress in procurement management and aid co-ordination in more detail. Whilst the risk associated with lack of up to date information on State Enterprises may warrant more detailed monitoring.



# 1 Introduction

## 1.1 Objective of the PFM-PR

The overall objective of the report is to provide all stakeholders with an assessment of Public Financial Management (PFM) in Vanuatu using the Public Expenditure and Financial Accountability (PEFA) methodology. This methodology allows measurement of country PFM performance over time and is an important element of the strengthened approach to PFM, which recognises the need for strong government ownership.

This assignment is specifically designed to: (i) provide relevant information to orient dialogue between the government and main donors on PFM and to help facilitate improved donor co-ordination; and (ii) contribute to determining the eligibility of the country to further budget support in line with article 61(2) of the Cotonou Agreement. Detailed terms of reference are attached as Annex 1.

## 1.2 Process of preparing the PFM-PR

The report has been prepared by two external consultants from ECORYS appointed under an EC framework contract. Mr N Cumpston from Australian Aid and Mr D Chandler from the World Bank also participated in some of the interviews. The report could not have been prepared without the significant assistance and co-operation of all Government of Vanuatu (GOV) officials, particularly the Director of Finance Mr B Shing for co-ordinating the whole process and to Mr L August for arranging interviews and facilitating the collection of information.

### 1.2.1 Methodology

In the last four years, there have been numerous project and programme assessments and technical assistance reports which have looked at different aspects of PFM. These studies and reports together with relevant and available government reports and publications have formed the initial basis of this assignment. A list of the documentation reviewed is included as Annex 2 and the people interviewed as Annex 3. In addition, the team has conducted a wide range of interviews with officials from central government ministries and departments, the National Audit Office (NAO), the Ombudsman's office, representatives from various development partner agencies, statutory bodies and non governmental organisations.

### 1.2.2 Scope of the assessment

The assessment covers all central government expenditure; on average this represented more than 92% of total government expenditure. Budgeted expenditure on state enterprises /statutory bodies and provincial government represented 5% and 2.5 % respectively. The assessment does review intergovernmental relationships and reporting structures as well as the government's oversight of fiscal risk with respect to state enterprises and provincial governments/ municipal councils.

## 2 Country background information

### 2.1 Description of country economic situation

#### 2.1.1 Country context

Vanuatu is a Y shaped chain of islands, extending 1176km in a north south direction between the equator and the tropic of Capricorn. It is located in the South West Pacific, approximately 2,250 kms north east of Sydney and 800 kms west of Fiji. Its land area comprises 83 islands, divided since 1994 into six provinces Malampa, Samma, Tafea, Torba, Penama and Shefa. Frequent cyclones (average 2.5 per year), volcanic activity and earthquakes make the country extremely susceptible to natural disasters.

Vanuatu gained independence in 1980 following 74 years of being administered as the Anglo- French condominium, the New Hebrides. It has a population of approximately 205,000 with a population growth rate of 2.6%. Per capital income is US\$ 1360<sup>8</sup> and Vanuatu is ranked 118<sup>th</sup> on the UN's Human Development Index (HDI) for 2005.

The economy is based primarily on subsistence or small-scale agriculture, which provides a living for 65% of the population. Fishing, offshore financial services, and tourism (with about 60,000 visitors per year plus an additional 60,000 cruise ship visitors), are other mainstays of the economy. Mineral deposits are negligible; the country has no known petroleum deposits. A small light industry sector caters to the local market. The main exports are copra, coconut oil, beef, kava and timber. In Vanuatu, there is no income tax, no corporation tax and no inheritance tax. Tax revenues come mainly from import duties and a 12.5 percent Value Added Tax (VAT) on goods and services. Free trade agreements are reducing income from import duties and are expected to be negligible by the year 2013.

Economic development is hindered by dependence on relatively few commodity exports, vulnerability to natural disasters, and long distances from main markets and between constituent islands. Political instability has also deterred private sector investment. In 2001 and 2002 real GDP declined. However the Vanuatu economy recovered in 2003–04. Real GDP growth rebounded to 2.4 percent in 2003 and the recovery continued in 2004 with growth of an estimated 2.6%, notwithstanding the crop damage caused by Cyclone Ivy early in the year. Estimates for 2005 showed a similar increase.

In recent years, Australia, New Zealand, the European Commission (EC) and the Asian Development Bank (ADB) have been the main suppliers of Vanuatu's foreign aid. The

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<sup>8</sup> Pacific Islands – Regional Issues IMF Asia and Pacific Department May 2005.

Pacific Island states are particularly important development partners for both New Zealand and Australian Aid. Indeed both countries have played a significant part in assisting Vanuatu, through hands on assistance, with the development of its new financial management systems, generally accepted to be based on regional best practice. Support from the Chinese Government was also significant in 2004 and 2005. In 2004, Vanuatu was one of 16 countries identified as eligible for Millennium Challenge Account funds (MCA). After submission of a proposal by the GoV, funds were approved in 2005 by the MCC and US Congress. Total funds are valued at US\$65.69 million over a 5 year period. MCA funds, which will be directed at infrastructure assistance, are expected to start to flow from the second half of 2006. The Department of Finance in the MFEM has been appointed as fiscal agent for the assistance. In addition to direct country funding, Vanuatu is also eligible for a variety of regional funds e.g. French Pacific Fund and Global funds.

## 2.2 Description of budgetary outcomes

### 2.2.1 Fiscal performance

The fiscal policy objective for the last three years was, and remains, to sustain fiscal discipline. The Government has announced a policy of achieving an overall fiscal surplus for the medium-term that will be used to retire domestic debt outstanding. In the same context, the policy is to increase development expenditure.

The fiscal deficit has decreased over the last three years from -1.7% of GDP in 2003 to a surplus of about 1% (based on preliminary figures) in 2005. The primary deficit has reduced from -2.7% in 2003 to less than -1% of GDP in 2004, and further improved in 2005. In terms of tax revenue as a percentage of GDP, Vanuatu's tax burden is in line with those of the similar-income countries<sup>9</sup>. During the last three years the wage bill represented around 11.5% of GDP.

Table 2.1 Central government budget (in percent of GDP)

	2003	2004	2005
Total revenue	20.9%	23.2%	23.3%
- <i>Own revenue</i>	19.8%	20.8%	21.7%
- <i>Grants</i>	1.1%	2.4%	1.6%
Total expenditure	22.6%	22.3%	22.3%
- <i>Wages and salaries</i>	12.1%	11.5%	11.5%
- <i>Capital expenditure</i>	1.3%	1.6%	1.8%
Aggregate deficit (incl. grants)	-1.7%	0.9%	1.0%
Primary deficit (excl. interest payments)	-2.7%	-0.1%	0.0%
Net financing	1.7%	-0.9%	-1.0%
- <i>external</i>	-0.3%	-0.5%	-0.3%
- <i>domestic</i>	2.0%	-0.4%	-0.7%

<sup>9</sup> IMF, Article IV Consultation Report, March 2005.

Source: MFEM, Budget Section, Un-audited consolidated financial accounts for 2003-2004; and preliminary financial accounts for 2005.

In 2003, the delayed receipt of the EU Budget Support made the management of government cash resources harder and contributed to the budget deficit. In 2004, the significant surplus of revenues over expenditure, with the subsequent increase in cash reserves, was due to improved revenue collections as well as to the receipt of almost double the amount of budgeted grants. In 2005 the government has used its cash surplus to retire one domestic bond and eliminate its overdraft at the Reserve Bank of Vanuatu (RBV), thus using its savings to reduce its debt burden.

From 2004 the government debt has accounted for about 36% of GDP, from which 25% is external debt and 11% domestic debt. In the medium-term, it is expected that external debt service will rise sharply, for principal and interest. The increase in external debt service is due to loans from the ADB, mainly connected with the Comprehensive Reform Programme (CRP) and Urban Infrastructure upgrading. In terms of domestic debt, since the capital market in Vanuatu is rather shallow, the rollover of domestic debt could represent theoretically a fiscal risk to cash management. However, given the Government's effort to retire debt in the last years and the relatively low number of bonds held by the private sector this fiscal risk is not a major one. The Government also pursue an open and equitable bond auction process in line with international best practice.

### 2.2.2 Allocation of resources

The PAA is the government's strategic document, which underlines policy priorities for the medium-term. Sectoral budget allocations tend generally to reflect the overall priorities of the government, however as discussed in PI 12 the link between the budget and more detailed sectoral policy is poor.<sup>10</sup>

Budget allocations (for recurrent expenditure) over the last three years are shown in table 2.2. In terms of budgeted figures for 2005, the share of recurrent resources to health and education was reduced slightly, preliminary actual figures indicate a similar trend.

Table 2.2 Actual and original budget allocations by sectors (as a percentage of total recurrent expenditures)

	Budget			Actual		Prel.
	2003	2004	2005	2003	2004	2005
Constitutionals	8%	9%	10%	8%	9%	10%
Prime Minister	2%	1%	1%	2%	2%	2%
Ministry of Comprehensive Reform Program	0%	0%	0%	0%	0%	0%
Ministry of Foreign Affairs	2%	2%	2%	2%	2%	2%
Ministry of Internal Affairs	13%	14%	14%	14%	14%	15%
Ministry of Finance and Economic Management	15%	12%	16%	11%	11%	13%
Ministry of Industry and Commerce	1%	1%	1%	1%	1%	1%
Ministry of Ni Vanuatu Business	0%	1%	1%	0%	1%	1%

<sup>10</sup> A public expenditure review has not been carried out in Vanuatu so more detailed analysis was not available.

	Budget			Actual		Prel.
	2003	2004	2005	2003	2004	2005
Ministry of Health	14%	14%	13%	14%	14%	13%
Ministry of Education	29%	29%	26%	31%	30%	26%
Ministry of Youth and Sports <sup>11</sup>	0%	0%	1%	0%	0%	1%
Ministry of Agriculture, Forestry and Fisheries	4%	4%	4%	4%	4%	4%
Ministry of Lands, Geology, Mines, Water Resources	2%	3%	3%	2%	3%	3%
Ministry of Infrastructure and Public Utilities	8%	9%	9%	9%	9%	9%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: MFEM Financial statements, 2002-2004 and preliminary data from the Budget Section spread-sheet.

Note: The calculations are based on consolidated data from Financial Statements and it covers only recurrent expenditure.

Budget allocation by economic classification is shown in table 2.3. The budgeted and actual share of wages and salaries, responsible for the biggest part of the expenditures, has been declining in the last three years, which underscores the government efforts to control the unplanned growth of this element of the budget.

Table 2.3 Actual and budget allocations by economic classification (as percentage of total expenditures)

	Budget			Actual		Prel.
	2003	2004	2005	2003	2004	2005
Recurrent expenditures	95.1%	94.9%	95.4%	94.3%	92.6%	92.0%
- Goods and services	76.4%	78.7%	76.3%	73.9%	71.1%	72.5%
incl. salary and wages	53.6%	55.4%	52.6%	53.4%	51.8%	51.3%
- Interest payments	4.1%	5.5%	5.0%	4.6%	4.8%	4.2%
- Subsidies and other transfers	14.1%	10.1%	9.9%	14.6%	14.7%	10.9%
- Acquisition of fixed capital assets	0.5%	0.5%	4.2%	1.1%	2.1%	4.3%
Non-recurrent expenditures	4.9%	5.1%	4.6%	5.7%	7.4%	8.0%
- Non-recurrent transfers to Government bodies	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
- Development Budget	4.9%	5.1%	4.6%	5.7%	7.4%	8.0%

Source: MFEM Financial statements, 2002-2004 and preliminary data from the Budget Section spread-sheet.

An increase in salaries and wages was recommended by the Government Remuneration Tribunal (GRT) after the Appropriation Act for 2006 was passed. The MFEM is currently holding discussions with the GRT as to the precise financial implications of the proposed award. The increase will not be universally applied and will depend upon achievement of certain criteria (not yet in place).

### 2.2.3 Overall government reform program

The Comprehensive Reform Programme (CRP) began in 1997 with support from a US\$20 million loan from the ADB and technical assistance and grant funding from other donors. The reform programme focused on two inter linked areas: i) public sector reform and; ii) financial and economic reform. The CRP document contained an exhaustive list

<sup>11</sup> Prior to 2005 the Youth and Sports activities were appropriated under the Ministry of Education.



of reform measures. Limited resources and capacity constraints meant however that a number of the objectives of the CRP were not being achieved. In 2003, a Priorities and Action Agenda was prepared to set out the government's priorities for the medium term.

This PAA has recently (May 2006) been revised and updated. It was presented to the Council of Ministers (CoM) for approval on the 1<sup>st</sup> June and then presented to the donor community.

#### 2.2.4 Rationale for PFM reforms

The impetus for PFM reforms stemmed from the need to restore macro-economic prudence. The main objective of the CRP in terms of PFM was to develop a legal and regulatory framework that was accountable, free of political interference and incorporating independent oversight and regulatory bodies. In particular, the reforms were aimed at reducing leakage from the Finance system and improving the level of control and management of Government finances.

The implementation of the legal and regulatory framework<sup>12</sup> has been carried forward in the PAA 2003 and draft PAA 2006.

### 2.3 Description of the legal and institutional framework for PFM

#### 2.3.1 The legal framework for PFM

##### *Constitution*

The 1980 Constitution amended in 1988 provides the basis for sound PFM in Vanuatu. Section 25 sets out the provisions in relation to public finance including the appointment and function of the Auditor General.

##### *Public Finance and Economic Management Act 1998 (amended 2000)*

The PFEM Act is designed to: i) ensure effective economic, fiscal, and financial management and responsibility by Government; ii) provide accompanying accountability arrangements, together with compliance with those requirements; and iii) requires the Government to produce a variety of financial and economic statements including a Budget Policy Statement (BPS), a Fiscal Strategy Report (FSR), Economic and Fiscal Update and Half year Economic and Fiscal Updates. A set of additional amendments have been formulated and these are due to be debated by Parliament in November 2006. In the interim the mandate for the internal audit unit has been formalised through a change in financial regulations.

##### *Expenditure Review and Audit Act 1998 (amended 2000)*

This Act provides for a committee to review public expenditure and sets out the objectives, functions and powers of the Office of the Auditor General. In particular it sets

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<sup>12</sup> The legal and regulatory framework is based on New Zealand legislation.

out reporting requirements of the Auditor General and the role of the Public Accounts Committee (PAC) in scrutinising public finances. Although the revised Act requires the submission of an annual report, it does not specify a particular timescale.

#### *Government Contracts and Tender Act 1998 (amended 2001)*

The Government Contracts and Tenders Act (as amended) and its associated regulations sets out the process of procurement. All contracts in excess of VT 5 million<sup>13</sup> must be considered by the Tender Board and be by open and competitive bidding unless another process is approved by that Board. The Tender Board reports to and is responsible to the Council of Ministers, who can accept or reject a Tender Board approval. The Chairman of the Board is appointed from the private sector.

#### *Other*

The Customs Act, Import Duties Act (as amended) and the Value Added Tax Act (as amended) set out the mandate of the Customs department and the administration of import duties and VAT respectively. Other Acts e.g. Shipping Act set out other licensing/charging requirements.

There is no Freedom of Information Act. The Leadership Code Act 1998 makes it a criminal offence for a Leader<sup>14</sup> to fail to disclose a personal interest in the awarding of a government contract. The Ombudsman, a Constitutional body with powers set out in the Ombudsman Act 1998 is charged with administering the Leadership Code. However, amendments to the Ombudsman's Act have reduced the power of the Ombudsman by removing the Office's ability to prosecute.

The Archives Act (1992) provides the basic requirements for management and storage of key documents. In support of the various Acts, there are a number of sets of regulations (financial and tender), financial circulars, procedures manuals (e.g. accounting) and operational manuals e.g. payroll.

### 2.3.2 The institutional framework for PFM

#### *Legislative*

The head of the Republic is the President who is elected for a period of 5 years by an electoral college consisting of Parliament and Regional Councils. Vanuatu's parliament is a unicameral 52 member body plus a Speaker of Parliament. MPs are elected by universal adult suffrage for a period of four years. There is one standing committee, the Public Accounts Committee, responsible for public financial matters. The Chairperson is a member of the Opposition and the committee comprises of an equal number of government and opposition members (maximum 6 members).

#### *Executive*

Executive authority is established in the office of the Prime Minister, who is responsible for the day to day running of government affairs. The Prime Minister is elected by

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<sup>13</sup> Approximately €35,000 or US\$50,000.

<sup>14</sup> As defined by the Act.

Parliament from amongst its members and appoints/dismisses other Ministers. The Council of Ministers can vary in size but must not exceed ¼ of the Parliament. Currently it comprises of 12 Ministers.

### *Judiciary*

The judiciary is constitutionally independent from the other two branches of government. It includes magistrates' courts, the supreme court, court of appeal and various other specialised courts.

### *Auditor General*

The Office of the Auditor General is a constitutional body with its powers, scope and nature of its activities derived from the Expenditure Review and Audit Act (amended 2000). In addition to its audit duties, it is currently charged with the additional responsibility of acting as the secretariat for the PAC<sup>15</sup>. The Constitution provides a degree of independence for its operations but budgetary and operational independence is potentially undermined by its reliance on allocation of funds by the government and appointment of personnel (including the Auditor General) by the Public Services Commission.

### *Ministry of Finance and Economic Management*

The Minister of Finance is responsible to the Council of Ministers and Parliament for ensuring compliance by the MFEM with its responsibilities under the Act. These include the formulation of sound and effective national economic policies and managing and co-ordinating the distribution of the Government's financial resources.

### *Line Ministries*

Director Generals of individual ministries are appointed as the administrative head of a Ministry under the Public Service Act (1998). This assigns specific responsibilities including compliance with the PFEM Act as well as sound economic and expenditure management of the Ministry's affairs.

## 2.3.3 The key features of the PFM system

The financial year for central and provincial government in Vanuatu is from January to December<sup>16</sup>. Vanuatu has a centralised payments and payroll system located in the MFEM. In 2002, it implemented a financial management information system (FMIS). The FMIS is the package software SmartStream. It includes modules for general ledger, funds control, accounts payable, accounts receivable, purchasing, payroll human resources, and assets register. Access to the system by line ministries is provided by a wide area network that covers all ministry headquarters in Port Vila and a number of provincial offices located in Luganville on the Island of Santo.

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<sup>15</sup> This could be viewed as a potential conflict of interest.

<sup>16</sup> The municipal councils in Luganville and Port Vila have a July to June financial year.

Financial reporting is facilitated through FRX an off the shelf ledger reporting tool and bank reconciliation is done using Excel. A new reporting tool is to be implemented in 2006.

The geography of Vanuatu poses particular difficulties for efficient and effective financial management. Whilst all main islands have branches of the National Bank of Vanuatu, distances and accessibility of these branches for officials posted to particular service delivery units e.g. schools, health centres is problematic. Infrastructure and communications are poor which pose particular difficulties in ensuring effective service delivery and sound financial management.

## 3 Assessment of the PFM systems, processes and institutions

### 3.1 Introduction

The following paragraphs provide the detailed assessment of the PFM indicators contained in the PFM PMF framework. The summary of scores is attached as Annex 4. As this is the first time that the final set of performance indicators (PIs) have been used in Vanuatu and shared with all stakeholders, the following paragraphs contain some additional details on the scoring methodology. It should be stressed that the scoring methodology does NOT recognise ongoing reforms or planned activities.

Each indicator contains one or more dimensions in order to assess the key elements of the PFM process. Two methods of scoring are used. Method 1 (M1) is used for all single dimensional indicators and for multi-dimensional indicators where poor performance on one dimension of the indicator is likely to undermine the impact of good performance on other dimensions of the same indicator (in other words, by the weakest link in the connected dimensions of the indicator). A plus sign is given, where any of the other dimensions are scoring higher

Method 2 (M2) is based on averaging the scores for individual dimensions of an indicator. It is prescribed for selected multi-dimensional indicators, where a low score on one dimension of the indicator does not necessarily undermine the impact of a high score on another dimension of the same indicator. Though the dimensions all fall within the same area of the PFM system, progress on individual dimensions can be made independent of the others and without logically having to follow any particular sequence. A conversion table is then provided for 2, 3 and 4 dimensional indicators to arrive at the overall score. In both scoring methodologies, the 'D' score is considered the residual score, to be applied if the requirements for any higher score are not met.

### 3.2 Budget credibility

The indicators in this group assess to what extent the budget is realistic and implemented as intended, particularly by comparing the actual revenues and expenditures with original approved ones, and analysing the composition of expenditure out-turn. The table below summarises the assessment of indicators relating to the “credibility of the budget” dimension of PFM performance.

No.	Credibility of Budget	Score	Dimensions	Scoring methodology
PI-1	Aggregate expenditure out turn compared to original approved budget	A	(i) A	M1
PI-2	Composition of expenditure out-turn compared to original approved budget	A	(i) A	M1
PI-3	Aggregate revenue out-turn compared to original approved budget	A	(i) A	M1
PI-4	Stock and monitoring of expenditure payment arrears	A	(i) A (ii) A	M1

### 3.2.1 PI-1 Aggregate expenditure out-turn compared to original approved budget

This indicator assesses the difference between actual primary expenditure and the originally budgeted primary expenditure and reflects the government's ability to implement the budgeted expenditure, which is an important factor in supporting the government's ability to deliver public services in line with policy statements.

Annex 5 shows the budget and original figures for the three years under review. The deviation for central government expenditure has been calculated on the basis of the information provided in the annual un-audited consolidated accounts for 2002-2004<sup>17</sup> and un-audited preliminary unconsolidated accounts for 2005. Total expenditure covers recurrent expenditure appropriated to line ministries and excludes public debt service and donor funded expenditure<sup>18</sup>. The deviation of the budget outturn was calculated against the original budget approved by the Parliament.

Table 3.1 Aggregate expenditure out-turn and approved budget (million Vatu)

	2003		2004		2005	
	Original budget	Actual expenditure	Original budget	Actual expenditure	Original budget	Actual expenditure
Total expenditure	9,358	8,638	8,516	7,819	8,967	8,382
- of which debt service	2,323	1,937	1,839	1,063	1,459	989
Total primary expenditure	7,036	6,701	6,677	6,756	7,507	7,393
Deviation (%)	4.8%		1.2%		1.5%	

Source: MFEM, Financial accounts 2002-2004, draft financial accounts 2005.

During the last three years the deviation for aggregate central government expenditure has been below 5%. This position has been achieved by the government following its strict expenditure control policy.

<sup>17</sup> The Financial Accounts for 2002-2004 have been presented to the Auditor General and are awaiting her approval.

<sup>18</sup> Development expenditure is primarily funded by donors

Score	Minimum requirements	Justification and cardinal data
A	i) In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 5% of budgeted expenditure.	The deviation has been calculated based on the un-audited consolidated financial accounts for 2003-2004, and preliminary unconsolidated accounts for 2005. The deviation has been calculated for the recurrent expenditures appropriated to line ministries. The deviation of the actual budget is against the original approved budget. Debt service payments and donor funds are excluded. Source of information: Accounts 2003 – 2005.

### 3.2.2 PI-2 Composition of expenditure out-turn compared to original approved budget

Changes in overall level of expenditure (assessed in PI-1) are reflected by changes in expenditure for administrative budget lines. This indicator measures the extent to which reallocations between budget lines have contributed to variance<sup>19</sup> in expenditure composition beyond the variance resulting from changes on the overall level of expenditures. The analysis of expenditure was done on administrative basis. Expenditure covers recurrent expenditure appropriated to line ministries and excludes public debt service and donor funded project expenditure.

A comparison between approved expenditure allocations across the main administrative budget lines and actual expenditure during the last three years is provided in Annex 6. Individual deviations show deviations ranging from 0.1 % to 35.1 %. It is understood that one of the main reasons for these deviations is the reallocation of resources as result of natural calamities. In 2005, 50 million Vt were reallocated from Ministry of Education (25 million Vt), Parliament (10 million Vt, and Ministry of Internal Affairs (15 million Vt) to departments responsible for natural calamities.

Nevertheless, as shown in table 3.2, expenditure composition variances (based on absolute deviations) did not differ from the aggregate figures by more than 4% indicating that at this level of detail the budget could be considered a useful indicator of intent.

Table 3.2 Expenditure composition variance in excess of total expenditure deviation

Year	For PI-1 total expenditure deviation	Total expenditure variance	For PI-2 variance in excess of total deviation
2003	4.8%	5.8%	1.1%
2004	1.2%	4.3%	3.1%
2005	1.5%	5.4%	3.9%

Source: Author's calculations based on data from MFEM.

The resulting score is shown in the following table:

<sup>19</sup> Variance is calculated as the weighted average deviation between actual and originally budgeted expenditure calculated as a percent of budgeted expenditure on the basis of administrative classification, using the absolute value of deviation.

Score	Minimum requirements	Justification and cardinal data
A	i) Variance in expenditure composition exceeded overall deviation in primary expenditure by no more than 5 percentage points in any of the last three years.	Variance in excess of total deviation amounts to 1.1%, 3.1% and 3.9% in the last three years correspondingly. Source of information: Accounts 2003 – 2005.

### 3.2.3 PI-3 Aggregate revenue out-turn compared to original approved budget

This indicator assesses the quality of revenue forecasting by comparing domestic revenue estimates in the original approved budget to actual domestic revenue collection based on tax and non tax recurrent revenues.

Responsibility for revenue forecasts lies with the Department of Economic and Sector Planning (DESP) of the MFEM and is based on input information provided by the Revenue Section of the Department of Finance (DoF), Customs and Inland Revenue Department (CIRD) and the National Statistics Office (NSO). Forecasts for tax revenues are mainly based on the levels collected in the previous years adjusted for GDP growth and inflation.

The data for the last three years in terms of the difference between the actual and forecast revenue collection suggest an improvement in revenue collection with the exception of revenue from entrepreneurial and property income.

However, this improvement is partly due to the unreliability of the GDP figures used in forecasting revenue and potential revenue could therefore be understated. Collection of VAT taxes has improved as result of the introduction of a Customs and Taxes system<sup>20</sup> aimed at strengthening tax audit and compliance procedures and recording tax arrears. The level of revenue from import duties is influenced by the existing tax exemptions. There are six categories for exemptions from customs duties, the majority of which are for economic relief purposes. The exemptions are administered by the CIRD and should be requested for each incoming shipment.

<sup>20</sup> This system is used for both VAT and other rates and taxes. Customs duties are administered using the Ayscuda system.



The table below presents the deviation of actual revenue from the original budget.

Table 3.3 Revenue performance over the period 2003 – 2005 (all figures in Vt million)

	2003		2004		2005	
	Revenue forecast	Actual revenue	Revenue forecast	Actual revenue	Revenue forecast	Actual revenue
<b>Total recurrent revenue</b>	<b>7190.6</b>	<b>6623.6</b>	<b>7091.4</b>	<b>7330.2</b>	<b>7406.3</b>	<b>7952.5</b>
Deviation recurrent (%)	92%		103%		107%	
<b>Tax revenue</b>	<b>6469.5</b>	<b>6021.7</b>	<b>6394.2</b>	<b>6621.8</b>	<b>6610.7</b>	<b>7095.2</b>
Taxes on income and profit	0	0	0	0	0	0
Taxes on property	50	74.8	104	106.5	110	154.5
Taxes on the use of goods	3910	3663.5	4066.5	3995.6	4241.7	4526.1
Taxes on international trade	2509.5	2283.4	2223.7	2519.7	2259	2414.6
<b>Non-tax recurrent revenue</b>	<b>721.1</b>	<b>601.9</b>	<b>697.2</b>	<b>708.4</b>	<b>795.6</b>	<b>857.3</b>
Entrepreneurial and property income	365.1	200.9	370.1	220.5	430.1	267.6
Administrative fees and charges	337.5	380.2	308.6	468.1	344.5	563.8
Other non-tax revenue	18.5	20.8	18.5	19.8	21	25.9
<b>Non-recurrent revenue</b>	<b>567.5</b>	<b>432.5</b>	<b>392.5</b>	<b>911.4</b>	<b>689.7</b>	<b>631.7</b>
Deviation non-recurrent (%)	76%		232%		92%	
Sales of fixed assets	17.5	51	17.5	59.9	2.7	49.5
Grants from abroad	550	381.5	375	851.5	687	582.2
<b>Total Revenue and Grants</b>	<b>7758.1</b>	<b>7056.1</b>	<b>7483.9</b>	<b>8241.6</b>	<b>8096</b>	<b>8584.2</b>

Source: Author's calculations based on data from MFEM, Financial accounts 2002-2004 and preliminary accounts for 2005.

The resulting score is shown in the following table:

Score	Minimum requirements	Justification and cardinal data
A	i) Actual domestic revenue collection was below 97% of budgeted domestic revenue estimates in no more than one of the last three years.	The calculation is based on recurrent revenue (tax and non tax) The actual revenue collection was 92%, 103% and 107% in 2003, 2004 and 2005 correspondingly. Source of information: Accounts.

#### *Ongoing and planned activities*

The FRS 2006 proposes a review of duty exemptions to be undertaken by CIRD and the Department of Trade and Industry, in consultation with the Chamber of Commerce, for implementation in 2007. The government started producing exemption data for the first time in 2005, which implies some commitment to address the problem of exemptions. The existing data suggests that the volume of exemptions has fallen slightly in 2004<sup>21</sup>.

<sup>21</sup> See Nikunj Soni (2005).

### 3.2.4 PI-4 Stock and monitoring of expenditure payment arrears

This indicator considers to what extent stock of arrears is a concern as well as to what extent it is addressed and consequently controlled. The GoV has a centralised payments system incorporating a commitment control system which does not allow commitments without budgetary provision. It also pursues a 30 day payment policy, consequently arrears are not considered a material problem in Vanuatu. Although there may be a few payments outside the system, other measures such as prepaid telephone accounts are also used to mitigate the potential for the accumulation of arrears. Other utility providers (water and electricity) disconnect for non payment, thus minimising the risk of uncommitted expenditure, whilst the MFEM also monitor ministry bills on a regular basis to ensure that arrears are not accumulating.

The GoV's accounts are produced on an accrual basis and include a statement of accounts payable and provisions. Figures from the 2003 and 2004 accounts include information on accounts payable and accruals, that is outstanding invoices for goods or services that have been provided and accruals for purchase orders that have been committed but not yet processed. These show accounts payable/accrued expenses<sup>22</sup> of approximately 400 million which overstate true outstanding amounts and when reduced by an average monthly payment of Vt 150 -180 million show that "true arrears" are likely to be less than Vt 200 million or < 2% of total expenditure.

Score	Minimum requirements	Justification and cardinal data
A	i) The stock of arrears is low (i.e. Below 2% of total expenditure).	Accounts payable figures in the accounts adjusted to reflect bills outstanding < 30 days and accrued expenses represents < Vt 200 million. Source of information: Accounts 2003 + 4.
A	ii) Reliable and complete data on the stock of arrears is generated annually through routine procedures.	GoV prepares accrual based accounts and operates a centralised payments system combined with a commitment control system which does not permit commitments without budgetary provision. Source of information: Accounts/Interviews.

## 3.3 Comprehensiveness and transparency

The indicators in this group assess to what extent the budget and the fiscal risk oversight are comprehensive, as well as to what extent fiscal and budget information is accessible to the public. The table below summarises the assessment of indicators relating to the "comprehensiveness and transparency" dimension of PFM performance.

<sup>22</sup> The Government of Vanuatu does not yet have a mechanism for recording accrued expenses in accordance with International Public Sector Accounting Standards.

No.	B. Key cross-cutting issues: Comprehensiveness and Transparency	Score	Dimensions	Scoring methodology
PI-5	Classification of the budget	B	(i) B	M1
PI-6	Comprehensiveness of information included in budget documentation	A	(i) A	M1
PI-7	Extent of un-reported government operations	D+	(i) C (ii) D	M1
PI-8	Transparency of inter-governmental fiscal relations	B	(i) A (ii) B (iii) D	M2
PI-9	Oversight of aggregate fiscal risk from other public sector entities	D	(i) D (ii) D	M1
PI-10	Public access to key fiscal information	C	(i) C	M1

### 3.3.1 PI-5 Classification of the budget

A robust classification system facilitates the tracking of expenditure, this indicator describes the classification system used for formulation, execution and reporting of the central government's budget.

In Vanuatu the central government's budget is based on economic, administrative and program classification for formulation, execution and reporting. In 1999 the government started to upgrade the accounting system to the full accrual and international standards. The Fiscal Framework (FF) and associated Fiscal Strategy Framework (FSF) are presented on the basis of international GFS reporting standards and a modified *cash* accounting basis. The chart of accounts for the centralised FMIS is based on functions of government (COFOG) and *accrual* (full accrual account codes) reporting. Both the chart of accounts for the centralised FMIS as well as FF encompass program classification. The level of detail in the programme classification is not equivalent to sub functional level.

Although the FMIS System chart of accounts set-up differs from the GFS economic reporting requirements, it can produce consistent documentation according to those standards. In terms of reporting, the Budget Section maintains separate Revenue, Expenditure and Financing spreadsheets in the same format as the FF tables which is linked to FMIS data by account code and converted to the GFS presentation.

Score	Minimum requirements	Justification and cardinal data
B	i) The budget formulation and execution is based on administrative, economic and functional classification using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards.	The budget formulation and execution is based on economic, administrative and program classification using standards that can produce consistent documentation according to GFS/COFOG standards but program classification is not at sub functional level. Source of information: Government of Vanuatu, MFEM, Revenue and expenditure codes, Fiscal Framework Strategy, Financial Accounts.

### *Ongoing and planned activities*

The FMIS Section is considering developing a facility to enable GFS economic reporting through a set of bridging tables.

#### 3.3.2 PI-6 Comprehensiveness of information included in budget documentation

This indicator assesses the comprehensiveness of information included in the budget documentation.

Budget documentation is fairly comprehensive, and consists of three components: i) Volume I: Fiscal Strategy Report (FSR), incorporating the Economic and Fiscal Update and the Budget Policy Statement; ii) Volume II: Program Budget Estimates; iii) Volume III: Program Budget Narrative.

The Budget Policy Statement (BPS) underscores the policy priorities for the respective budget year, and forms the basis for the Fiscal Strategy Report. The Economic and Fiscal Projections (Update) sets the macroeconomic framework and forecasts on which the budget is developed. Economic and Fiscal projections section includes the main assumptions and estimates underlying the Budget and the medium term forecasts regarding the rate of inflation, nominal increase in public sector wages, nominal GDP growth, real GDP growth, exchange rate, RBV 90 day note yields, current account balance and capital and financial account balance. The Fiscal Framework includes preliminary out-turn data on the previous and current financial years, and estimates for the coming budget years as well as two forward years. It forms the basis of the related fiscal tables included in the Government's annual Fiscal Strategy Report.

The program budget estimates particularly cover the appropriations by ministry, appropriations by economic classification, GIP and revenue by economic classification. The program budget narrative presents each program along with the key characteristics i.e. objectives, activities, performance targets.

The table below summarises the availability of budget information.

Table 3.4 Summary of budget information provided against set of information included in PMF

Elements of budget documentation	Availability	Notes
<b>Macro-economic assumptions</b> , incl. at least estimates of aggregate growth, inflation and exchange rate	Yes	The Economic and Fiscal Update sets the macroeconomic framework and forecasts on which the budget is developed (specifically, rate of inflation, nominal increase in public sector wages, nominal/real GDP growth, RBV 90 day note yields, exchange rate, current account balance and overall BOP balance).
<b>Fiscal deficit</b> , defined according to GFS or other internationally recognised standard	yes	Fiscal deficit is defined in Volume I: Fiscal Strategy Report and is reflected in table on statement of financial performance. The Budget Policy Statement included in FSR includes the narrative on fiscal framework.
<b>Deficit financing</b> , describing anticipated composition	yes	Debt financing is included in Volume 1, FSR, in Economic and Fiscal projections chapter.
<b>Debt stock</b> , incl. details at least for the beginning of the current year	yes	Budget documents (Volume 1: FSR) include information on external and internal debt stock, as well as a graph on Vanuatu's stock of debt in the last years.
<b>Financial assets</b> , incl. details at least for the beginning of the current year	no	No information is included in the budget documents,
<b>Prior year's budget out-turn</b> , presented in the same format as the budget proposal	yes	Volume 1: FSR of budget documents package includes actual figures prior year's outturn in the same format as the budget proposal.
<b>Current year's budget</b> (revised budget or estimated out-turn), presented in the same format as the budget proposal	yes	The current year's budget is presented in the same format and the same table as the budget proposal in Volume 1: FSR.
<b>Summarised budget data for both revenue and expenditure</b> according to the main heads of the classification used, incl. data for current and previous year	yes	The FSR includes summarised budget data for both revenue and expenditure for the current and previous years, the budget for the next year, and forecast for the next ulterior two years.
<b>Explanation of budget implications of new policy initiatives</b> , with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs	no	The link between policy and budget is very weak at the moment in the budget preparation process. Budget impact of new policy is generally not assessed.

Score	Minimum requirements	Justification and cardinal data
A	i) Recent budget documentation fulfils 7-9 of the 9 information benchmarks	Budget documentation fulfils 7 of 9 benchmarks. The Budget documents are quite comprehensive. Limited information is included on financial assets, and the budget implications of new policies. Source of information: Budget documentation.

### 3.3.3 PI-7 Extent of unreported government operations

One element of government operations which affects the efficient allocation of resources is reflected by unreported government operations. The extent of unreported government operations is assessed against two dimensions: i) unreported extra-budgetary expenditure, and ii) income/expenditure information on donor-funded projects which is included in fiscal reports.

Given their nature, it is difficult to quantify the extent of unreported government operations. The major potential sources of unreported government operations in Vanuatu are: i) revenues from individuals for school fees at government and government assisted schools; ii) revenues from individuals for hospital fees and medical charges at government and government assisted hospitals and clinics; and iii) donor funding of projects, the bank accounts for which the government is a signatory.

Although schools (secondary and primary) are supposed to produce accounts showing income (including parental and government contributions) and expenditure. This has not been done on a regular basis, particularly by primary schools. Based on the number of schools, average fees and number of pupils, a figure of Vt 620 million<sup>23</sup> has been estimated. Hospital and health centre fees are not considered to be large.

The amount of cash being provided by donors for grant financed projects for which the government can be held accountable can be broken down into two different types. The first set includes grant financed projects which are managed through the development fund (approximately Vt 450 million in 2004) and those grant financed projects which are managed outside the development fund through separate project accounts held by the line ministries.

Whilst the Director General of MFEM requested information in 2005, from the commercial banks of all accounts held in the name of the GoV, this information has not been forthcoming.

<sup>23</sup> Estimated by MoE internal auditor.

Score	Minimum requirements	Justification and cardinal data
C	i)The level of unreported extra budgetary expenditure (other than donor funded projects) is between 5 - 10% of total expenditure.	School fees/parental contributions for both primary and secondary schools are estimated to be Vt 620 million or between 5 and 10% of total government expenditure. Whilst the funds do not form part of the government's budget, lack of information on these fund sources undermines resource allocation. Source of information interviews
D	ii) Information on donor funded projects is seriously deficient	Information was requested by MFEM from the commercial banks but has not been forthcoming, Project funds that fall into this category include the global fund for tb, malaria and aids. Source of information interviews

### 3.3.4 PI-8 Transparency of inter-governmental fiscal relations

This indicator assesses the transparency of inter-governmental fiscal relations against the following dimensions: i) transparency and objectivity in the horizontal allocation among SN governments; ii) timeliness of reliable information to SN governments on their allocation; and iii) extent of consolidation of fiscal data for general government according to sectoral strategies.

Sub national government in Vanuatu is in its infancy, despite provisions with the Constitution and decentralisation legislation, many functions which are legally the responsibility of the six provinces and two municipal councils in Port Vila and Luganville are still managed at a national level. Funds therefore being transferred from central government represent only a small percentage (about 2.5%) of total government recurrent expenditure. Amounts are divided equally between the six provinces and do not bear any relation to the population to be served. Similarly the amount for the two municipal councils is divided equally.

Allocations have remained unchanged for some time and so from this perspective are known for purposes of sub national budgeting. Provincial governments share the same financial year as the central government, whilst the municipal councils have a July to June financial year. Theoretically therefore, central government contributions would not be known prior to the approval of the budget by the Council.

Currently the accounts of the provincial governments have not been prepared for some time. The Auditor General has advised the provinces to purchase MYOB software for the maintenance of their accounts. Luganville municipal council has not prepared accounts, whilst those for Port Vila are not up to date. The GoV does not prepare general government accounts and fiscal reports consistent with the central government reporting is not yet collected.

Score	Minimum requirements	Justification and cardinal data
A	i) of the horizontal allocation of transfers from central government is determined by transparent and rules based systems.	The allocation is divided equally between the six provinces and equally between the two municipalities. In terms of the PI this represents a transparent and rules based system. Source of information: Accounts.
B	ii) SN governments are provided reliable information on the allocations to be transferred to them ahead of completing their budget proposals, so that significant changes to the proposals are still possible.	Provincial governments share the same financial year and grants provided to them through the Ministry of Internal Affairs would be available to them following the budget hearings in August. This would not be the case for municipal governments whose FY is July – June Source of information: Interviews.
D	iii) Fiscal information that is consistent with central government fiscal reporting is collected and consolidated for less than 60% (by value) of SN government expenditure.	Provincial and municipal governments are not up to date with their accounts. Currently central government does not collect data from this level of administration. Source of information: Interviews.

### 3.3.5 PI-9 Oversight of aggregate fiscal risk from other public sector entities

This indicator reflects the extent to which central government monitors fiscal position of autonomous government agencies, public enterprises and SN governments. The government has a shareholding in 10 State Enterprises (SEs), and public interests in 7 statutory bodies. The performance of AGAs and PEs should be monitored by the Government Business Enterprise Unit (GBEU), a department within MFEM. However the GBEU does not receive regular up to date financial statements. As shown in table 3.4 most have not produced audited accounts for several years, e.g. Vanuatu Commodities Marketing Board, Vanuatu Maritime Authority and Vanuatu Financial Service Commission.

It is well known that a number of these entities are experiencing financial difficulties and in the past have had to request support from central government. Lack of up to date information on the true status of the state enterprise sector, consequently represents a major fiscal risk to the government.

Table 3.5 AGAs and SEs: Status of accounts

Company	Holding	Accounts status	Liability to government (million Vt)	Comments
Companies incorporated under Companies Act (CAP 191)				
Air Vanuatu (Operations) Limited	100%	2003	125,000,000	Presents fiscal risk to the government.
Airports Vanuatu Limited	100%	2002	678,400,000	Attempts to improve financial management. Produces accounts.



Company	Holding	Accounts status	Liability to government (million Vt)	Comments
Ifira Wharf & Stevedoring (1994) Limited	34%	2004 draft accounts	-	Has paid back the majority of its debt to Government. Makes attempts to improve financial management.
Metenesel Estates Limited	99.40%	2003 draft accounts	-	Poor performance but there exist signs of improvement; profitable; there is intention to sell 51% of assets.
Northern Islands Stevedoring Limited	10%	2001	-	
Telecom Vanuatu Limited	33.33%	2002	-	Audited accounts are produced, and reportedly sent to Minister for Public Utilities but they are not presented to MFEM.
Vanuatu Abattoirs Limited	85.40%	2003	-	Attempts to improve financial management. Produces accounts. Signs of profitability.
Vanuatu Internal Air Services Limited (Vanair)	100%	2003	-	
Vanuatu Livestock Development Ltd	100%	2002 draft accounts	-	
Vanuatu Post Limited	100%	2004	-	Profitable; produces accounts.
Statutory companies created under an Act of Parliament				
Asset Management Unit	100%	2004	132,500,000	Contingent liability of government.
National Bank of Vanuatu	100%	2004	3,634,845,000	Profitable; produces accounts.
National Housing Corporation	100%	2003	69,105,923	Re-started to produce financial accounts. Poor performance.
Vanuatu Broadcasting & Television Corporation	100%	2005 draft accounts	-	
Vanuat Commodities Marketing Board	100%	2001	45,000,000	Contingent liability of government.
Vanuatu Financial Services Commission	100%	2000	-	
Vanuatu Maritime Authority	100%	1999	-	
<b>Total</b>			<b>4,684,850,923</b>	

Source: GBEU data as of May 2006.

Contingent liabilities and contingent assets, as a total and separately for those greater than 10 million Vt, are disclosed in financial accounts. Unquantifiable contingent liabilities and assets, but which are considered material would also be included in the list<sup>24</sup>. A number of Court Orders, mainly resulting from human resource disputes have been awarded against the government and have to be paid from the government budget. Currently, no provision is made in the budget for honouring the court decisions, and in the past departments have had to pay the compensation imposed by the court decision from their recurrent budget.

There is no annual monitoring of the fiscal position of the provincial or municipal governments and as noted above, accounts are not up to date. Although provincial governments are allowed to raise taxes, they are not allowed to raise loans.<sup>25</sup>

Score	Minimum requirements	Justification and cardinal data
D	i). No annual monitoring of AGAs and PEs takes place, or it is significantly incomplete.	Monitoring of AGAs and PEs takes place to a limited degree, but it is incomplete. The main problem is related to the enforcement of compliance with the individual enterprises legislation in terms of reporting and production of audited accounts. Source of information: Interviews /GBEU report/ Financial accounts.
D	ii). No annual monitoring of SN governments' fiscal position takes place or it is significantly incomplete.	Monitoring of SN government's fiscal position does not take place. Source of information: Interviews and Financial Accounts.

#### *Ongoing and planned activities*

In order to improve compliance with existing legislation and improve reporting by state enterprises and statutory bodies to central government, GoV has prepared a first draft of a Public Enterprise Accountability Bill. ADB have offered assistance in finalising the draft so that it can be presented to Parliament in this financial year. Clearly however the resolution of the problem will depend on effective enforcement.

### 3.3.6 PI-10 Public access to key fiscal information

Transparency will depend on whether information on fiscal plans, position and performance of the government is easily accessible to the general public or at least interested groups.

Currently there is no Freedom of Information Act and public access to information is limited. At the same time, demand for government accountability by the public in Vanuatu is not well developed. The PFEM Act (9.3) stipulates that any member of the

<sup>24</sup> Accounts for the period 2002 – 2004 have no unquantifiable contingent liabilities, all contingent liabilities included show a related amount e.g. guarantee for Vanair of Vt 125 million.

<sup>25</sup> Ref PFEM Act.

public may make inquiries with the PAC within 14 days of notice of the Budget Policy Statement. However as the PAC has not been operational, this avenue has not been open to the public.

The FSR is published yearly in November and the Half-Year Economic and Fiscal Update, covering the first 6 months of the year, is published once a year in July. Both documents (and the approved budget) are available from the MFEM but due to the relatively high price is not affordable for the majority of the public. Currently, the MEFM website does not contain any essential information and the media lacks technical capacity to initiate budget discussion. The importance of information dissemination is not well recognised amongst politicians.

Elements of information for public access	Availability and means
Annual budget documentation when submitted to the legislature	Documentation is provided free to public bodies e.g. universities, libraries. Other copies are sold at cost (printing and translation), for individual members of the public, the price is high.
In-year budget execution reports within one month of their completion	Half yearly updates should be available from the MFEM (as above)
Year-end financial statements within 6 months of completed audit	Due to delays in the finalisation of audits, these have not been available to the public.
External audit reports within 6 months of completed audit	Once tabled in the Parliament; the reports should be available on request. However audit reports have not been tabled since 2000.
Contract awards (app. USD 100,000 equiv.) published at least quarterly	Not publicly available.
Resources available to primary service unit at least annually	Not publicly available.

Score	Minimum requirements	Justification and cardinal data
C	i) The government makes available to the public 1-2 of the 6 listed types of information.	Only budget documentation has been made available to the public over the period. Part of the reason is that audited accounts and audit reports have not been produced. Some reports are provided free to public bodies, other copies are sold at cost (printing and translation) which is quite high for local people.

#### *Ongoing and planned activities*

The MFEM website is being improved to facilitate the publishing of more financial information including the budget, half yearly update and audited accounts. The website for the CIRDC is also being improved to facilitate access by taxpayers on tax related issues. The local chapter of Transparency International is in the process of drafting a Freedom of Information Bill.

## 3.4 Policy-based budgeting

The indicators in this group assess to what extent the budget is prepared with due regard to government policy. The table below summarises the assessment of indicators relating to the “policy-based budgeting” dimension of PFM performance.

No.	C(i) Policy-based Budgeting	Score	Dimensions	Scoring methodology
PI-11	Orderliness and participation in the annual budget process	B+	i) B ii) A iii) B	M2
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	D+	i) C ii) D iii) D iv) C	M2

### 3.4.1 PI-11 Orderliness and participation in the annual budget process

This indicator reflects the organisation, clarity and comprehensiveness of the annual budget process as well as participation of ministries, departments and agencies (MDA)<sup>26</sup>. It is assessed against the following dimensions: i) existence of and adherence to a fixed budget calendar; ii) political involvement in the guidance on the preparation of budget submissions; and iii) timely budget approval by the legislature.

The budget preparation process is clearly articulated in the legislative and regulatory framework of Vanuatu. The PFEM Act spells out the roles and responsibilities of different players in the budget process. MFEM is responsible for preparation of operational regulations and guidelines consistent with the PFEM Act. The Budget preparation process is a top-down approach. The budget ceilings are determined by the MFEM. The resource envelopes are then presented and endorsed first by the Ministerial Budget Committee (MBC) and after that by the Council of Ministers (CoM). The ceilings are set on the basis of the macroeconomic framework and to a certain extent takes into account the government’s policy objectives. The Budget Circular including ceilings by Ministry, is then distributed to line ministries. It is then the responsibility of the line ministries to prepare their budgets within their overall ceiling. The calendar, as set out in financial regulations allows sufficient time for the line ministries to prepare their budget submissions. In practice there are delays but it is understood that there is still more than a month for the ministries to prepare their submission. Line ministries have the opportunities to defend their budget at the MBC hearings in August<sup>27</sup>. Agreed budget submissions are approved by the CoM before their submission to the Parliament.

<sup>26</sup> The scope of PEFA assessment covers only those MDAs which are directly responsible for implementing the budget and receive funds or authorisation to spend from the Ministry of Finance, rather than through a parent ministry.

<sup>27</sup> The Line ministry present their budget submission which includes their corporate and business plans incorporating the detailed budget figures and service targets.

Whilst the PFEMA sets out the general calendar for the budget preparation process, the detailed budget timetable is set out on annual basis. The PFEMA (33.1) allows for the first Appropriation Bill to be introduced into Parliament before the end of the first month of the financial year. In practice for the period 2003 - 2005 the budget was approved before the start of the fiscal year, with one exception (the 2005 budget) because of the election. The next table summarises the scores for indicator PI-11.

Score	Minimum requirements	Justification and cardinal data
B	i) A clear annual budget calendar exists, but some delays are often experienced in its implementation. The calendar allows MDAs reasonable time (and at least four weeks from receipt of the budget circular) so that most of them can meaningfully complete their detailed estimates on time.	The budget process is clearly set out. On the basis of the ceilings provided by MFEM, the line ministries prepare their submissions. Whilst there are some delays, there is sufficient time for the ministries to complete their submissions, particularly as many of them start the process before the receipt of the ceilings. Source of information: Budget calendar/circular/ interviews.
A	ii) A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by Cabinet (or equivalent) prior to the circular's distribution to MDAs.	The Budget Circular is comprehensive and clear and reflects the ceilings. The budget ceilings for the last three years were approved by the MBC and COM before the distribution of the circular to line ministries. Source of information: Interviews.
B	iii) The legislature approves the budget before the start of the fiscal year, but a delay of up to two months has happened in one of the last three years.	The Budget was approved as follows: 2003 – 31/12/2002 2004 – 18/12/2003 2005 – 8/3/2005 Source of information: Official government gazette.

### 3.4.2 PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting

This indicator looks at the link between budgeting and policy priorities from the medium-term perspective and the extent to which costing of the implications of policy initiatives are integrated into the budget formulation process. In particular, it assesses the following: i) multi-year fiscal forecast and functional allocations; ii) scope and frequency of debt sustainability analysis; iii) existence of costed sector strategies; and iv) linkages between investment budgets and forward expenditure estimates.

Multi-year budgeting is in its infancy. There is no medium term strategic framework. At present fiscal forecasts of revenue and expenditure aggregates are presented for the two years following the budget year based on GFS standards. The link between forward estimates and subsequent budget ceiling is weak, since the estimates are based on historical information rather than on an assessment of policy implications for the budget. In addition, the accuracy of forecasts has been questioned in a number of recent reports and indicates the need for improving the reliability of data used in the forecasting methods. No debt sustainability analysis has been carried out.

The Government's priority objectives, along with sectoral policies and priorities, are set out in the Priorities and Action Agenda (PAA). Three ministries have sector plans (medium term), none are costed. New policy initiatives contained in the budget submission are not properly costed, and expenditure patterns are not analysed in order to improve the efficiency and effectiveness of public spending. Since 1999 the Government has presented an integrated recurrent and development Budget. The development budget is based on the Government Investment Programme (GIP) which is almost entirely funded by donors. Although the process of obtaining approval for inclusion of a project in the GIP should be based on the PAA, actual selection is based on donor willingness to fund rather than a prioritisation of investment plans interventions according to resource availability and recurrent cost implications.

The table below summarises the assessment for the indicator PI-12.

Score	Minimum requirements	Justification and cardinal data
C	i) Forecasts of fiscal aggregates (on the basis of main categories of economic classification) are prepared for at least two years on a rolling annual basis.	Forecasts of fiscal aggregates are prepared for three years, including the budget year. The forecasts however are not linked to subsequent budget ceilings. Source of information: Fiscal strategy report.
D	ii) No DSA has been undertaken in the last three years.	No DSA carried out. Source of information: Interviews.
D	iii) Sector strategies may have been prepared for some sectors, but none of them have substantially complete costing of investments and recurrent expenditure.	Only 3 line ministries have a medium-term Sector Strategy. All line ministries have one-year corporate plans (and business plans) based on which the ministerial budgets are developed. None of the strategies has been properly costed so far. Source of information: Interviews.
C	iv) Many investment decisions have weak links to sector strategies and their recurrent cost implications are included in forward budget estimates only in a few (but major cases).	The link between sector strategy and sector budget is poor. Investment decisions are selected based on donor funding rather than on a conscious process of prioritisation of investment decision according to the sector strategy and availability of resources. Source of information: GIP/Interviews.

#### *Ongoing and planned activities*

At the moment there is no Medium Term Expenditure Framework (MTEF) in place. The Government, with foreign assistance, is currently developing an MTEF and sectoral resource ceilings that are in line with Government's policy priorities. A significant amount of baseline data (for the period 2000-2004) has already been assembled for the total resource envelope and expenditure by sector with assistance from the EC.

In addition, the government is receiving assistance to clean and reconcile the GIP databases<sup>28</sup> and to improve the GIP process.

<sup>28</sup> Two databases are currently maintained, one by the Ministry of Foreign Affairs and one by DESP.

### 3.5 Predictability and control in budget execution

This set of indicators reviews the predictability of funds for budget execution and the internal controls and measures in place to ensure that the budget is executed in an accountable manner.

No.	C(ii) Predictability, Control and Budget Execution	Score	Dimensions	Scoring methodology
PI-13	Transparency of taxpayer obligations and liabilities	C+	(i) C (ii) C (iii) B	M2
PI-14	Effectiveness of measures for taxpayers registration and tax assessment	B	(i) C (ii) B (iii) B	M2
PI-15	Effectiveness in collection of tax payments	D+	(i) D (ii) A (iii) D	M1
PI-16	Predictability in the availability of funds for the commitment of expenditures	C+	(i) B (ii) C (iii) A	M1
PI-17	Recording and management of cash balances, debt and guarantees	C+	(i) C (ii) B (iii) C	M2
PI-18	Effectiveness of payroll controls	C+	(i) A (ii) B (iii) A (iv) C	M1
PI-19	Competition, value for money and controls in procurement	D+	(i) D (ii) C (iii) D	M2
PI-20	Effectiveness of internal controls for non salary expenditure	C+	(i) B (ii) C (iii) C	M1
PI-21	Effectiveness of internal audit	D+	(i) C (ii) C (iii) D	M1

#### 3.5.1 PI-13 Transparency of taxpayer obligations and liabilities

The assessment of tax liabilities is subject to the overall control environment that exists in revenue administration but is also dependent on the involvement and co-operation of taxpayers. This indicator assesses the transparency of tax administration by reviewing: i) clarity and comprehensiveness; ii) taxpayer access to information; and iii) functioning of a tax appeals mechanism.

The Customs and Inland Revenue Department (CIRD) is responsible for the collection of tax revenue (import duties, VAT and other rates and taxes) in Vanuatu. Other fees and charges are collected by individual ministries and monitored by the Revenue section of the Department of Finance.

Taxpayers' liabilities are set out in the VAT and the Import Duties Act (as amended). Legislation for VAT is relatively straight forward, however exemptions in relation to import duties do allow a degree of discretion and are being reviewed. For import duties, GoV has implemented Ayscuda software and major importers have access to the system. Information on VAT liabilities is available from the VAT office and awareness campaigns have been conducted in the past on Efate. An advisory service is offered in conjunction with the registration process. Access to information on tax liabilities and administrative procedures is recognised to be poor in some of the outer islands.

Under the VAT Act, a VAT tribunal has been established, although members have been appointed, the tribunal is yet to consider any cases. For disputes over import duties Taxpayers only have recourse to the Court system (magistrate, supreme) in appealing against their tax assessment.

Score	Minimum requirements	Justification and cardinal data
C	i) Legislation and procedures for some major taxes are comprehensive and clear, but the fairness of the system is questioned due to the substantial discretionary powers of the government entities involved.	Whilst VAT legislation is relatively clear, the import duty act does allow a significant degree of potential discretion in administering exemptions. Source of information: VAT Act and Consolidated Import Tariffs schedule.
C	ii) Taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of information is limited due to coverage of selected taxes only, lack of comprehensiveness and/or not being up to date.	Information on tax liabilities and procedures is provided directly by the Customs department and through limited awareness programmes. However it is recognised that in the outer islands there is a need for education and awareness programmes. Source of information: Interviews.
B	iii) A tax appeals system of transparent administrative procedures has been established but it is too early to assess its effectiveness.	A VAT tribunal has been established and members appointed but no cases have been considered. Taxpayers can appeal against a tax assessment through the independent court system. Source of information: VAT Act; Interviews.

#### *Planned activities*

The department is improving its website to increase access to information on VAT liabilities and procedures.

### 3.5.2 PI-14 Effectiveness of measures for taxpayer registration and tax assessment

Effectiveness is determined by reviewing; i) controls in the taxpayer registration system; ii) penalties; and iii) conduct of tax audits.



Whilst import duties are administered through the Ayscuda system, VAT and other rates and taxes are maintained on a windows based Customs and Taxes System. Although manual checks are made, currently, there is no direct link between the two systems and there is no unique Tax Identification Number (TIN). The CTS does allow officials to check on e.g. business licenses as well VAT liabilities. The implementation of VAT in Vanuatu faced a number of challenges including the non maintenance of records by businesses, it is understood that the situation is now improving. Penalties exist for non compliance with VAT registration and for non filing of VAT returns. Non filing of returns incurs a 10% percent penalty for month 1 and a further 2% for every subsequent month.

Tax audits and fraud investigations are carried out by the VAT audit section of the CIRD. This section carries out a number of different types of audits which are based on specific reports produced by the CTS e.g. refunds. Other tax audit and fraud investigations are planned on the basis of an assessment of risk and value for money, concentrating on the high value taxpayers. In terms of auditing customs duties, a system of post importation checks is carried out again concentrating on high value importers.

Score	Minimum requirements	Justification and cardinal data
C	i) Taxpayers are registered in database systems for individual taxes which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys.	Currently there is no single TIN. Taxpayers may be registered on both the Ayscuda system as well as the CTS system. The latter does however hold details of e.g. business licenses in addition to VAT registration details. Source of information: Interviews.
B	ii) Penalties for non compliance exist for most relevant areas but are not always effective due to insufficient scale and/or inconsistent administration.	Penalties exist for non registration/non filing but have not been consistently applied to date, as taxpayers were not experienced in maintaining records. Source of information: Interviews/ VAT Act.
B	iii) Tax audits and fraud investigations are managed and reported on according to a documented audit plan with clear risk assessment criteria for audits in at least one major tax area that applies self assessment.	The CTS system identifies 4 categories for further audit including refunds. Post importation checks on import duties is based on an assessment of likely returns. Source of information: Interviews.

#### *Planned activities*

The CIRD is seeking assistance to help it set up a large taxpayers unit. The Assistance for Strengthening Management in the Pacific (ASMP) centre in Fiji, which was established to provide support to Ayscuda users in the Pacific (Fiji, Vanuatu and Samoa), has indicated its willingness to support the integration of the two databases.

### 3.5.3 PI-15 Effectiveness in collection of tax payments

Collection efficiency is determined by reviewing; i) collection ratio for gross tax arrears; ii) transfer mechanism of funds to the Treasury; and iii) frequency of complete accounts reconciliation.

In the last few years, greater emphasis has been placed on compliance and in addition to normal compliance officers, from 2006, the CIRD has a special enforcement unit to follow up on outstanding VAT arrears. In 2005, approximately 25% of arrears were collected, whilst in the first five months of 2006, approximately 30% of arrears have been collected. For non tax revenues, collection of certain fees and charges, e.g. wharfage charges and land rents is causing the government significant problems.

In terms of timely deposit of funds, VAT revenue is banked directly with the Reserve Bank of Vanuatu (RBV) in Vila and with the NBV in Santo. In Vila, collections of import duties and other rates and taxes are cashed with the MFEM chief cashier by the CIRD cashier on a daily basis. In Santo import duties are deposited on a daily basis with the NBV. In outlying islands revenue is deposited monthly. There are no links between the tax systems and the FMIS, complete reconciliation between data held by the Treasury and information maintained by the CIRD is currently not done.

Score	Minimum requirements	Justification and cardinal data
D	i) The average debt collection ratio for the <u>last two years</u> is not available. The debt collection ratio in the latest year was below 60% and arrears are more than 2% of total annual collections.	Information on collection vis-à-vis arrears has only been collected <u>since 2005</u> , it is understood that arrears for VAT was about 100 million (or 2.5% of total collections). Collection ratio for the first 5 months of 2006 has been about 30%. Source of information: Interviews.
A	ii) All tax revenue is paid directly into accounts controlled by the Treasury or transfers to the Treasury are made daily.	The majority of tax revenue collected is transferred daily or banked directly with the Reserve Bank. Source of information: Interviews.
D	iii) Complete reconciliations of tax assessments, collections, arrears and transfers to Treasury does not take place annually.	No reconciliation takes place of tax assessments, collections, arrears and transfers to (and receipts) by Treasury takes place. Currently debts are not taken onto the financial accounts. Source of information: Interviews.

### 3.5.4 PI-16 Predictability in the availability of funds for commitment of expenditures

Budget execution is more effective when there is a reasonable degree of predictability in the availability of funds, this indicator therefore assesses: i) cash flow forecasts; ii) in year information to MDAs on funds available; iii) frequency and transparency of adjustments to budget allocations above the level of MDAs.

Annual cash outflows are prepared by Ministries as part of their budget submission. Expenditure is increasingly being profiled across the year to reflect spending levels rather than a simple 1/12<sup>th</sup> allocation. The ministries have the power, and often do, request

changes in their cash flows. The Government cash flow committee<sup>29</sup> meets on a monthly basis to assess the liquidity situation and to decide on action to be taken with respect to maturing loans. At this meeting, updated cashflows are regularly presented.

The GoV operates a monthly warrant<sup>30</sup> system for some ministries and a quarterly warrant system for other ministries. For the period under review, in year budget adjustments above the level of management have taken place only once or twice in a year and have been done in a transparent way. Financial regulations require that budget adjustments above the level of management are approved by the CoM.

Score	Minimum requirements	Justification and cardinal data
B	i) A cash flow forecast is prepared for the fiscal year and is updated at least quarterly.	Ministries prepare cash flows as part of their budget submission. This then forms the basis for their allocations. A consolidated cash flow is then prepared on the basis of the expenditure estimates and past trends in revenue inflows. The cash outflow is update monthly. The cash inflow is also updated. Source of information: Interviews.
C	ii) MDAs are provided reliable information for one or two months in advance.	In the period under review, cash releases did not differ significantly from the budgeted appropriations, although the GoV operates a monthly warrant system (actual authorisation for release of funds )for some Ministries and a quarterly warrant system for other ministries. Source of information: Interviews.
A	iii) In year budget adjustments take place regularly but are undertaken with some degree of transparency.	Significant in year adjustments above the level of MDAs have only taken place once or twice and appear to have been carried out in a transparent way as they have to be approved by the CoM. Source of information: Interviews.

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

This indicator assesses overall fiscal management by reviewing the recording and management of cash, debt and guarantees. In particular it assesses: i) the quality of debt recording and reporting; ii) the extent of consolidation of cash balances; iii) systems for contracting loans and issuing guarantees.

The records for the GoV's external debts (central government) are maintained by the Department of Finance using the Windows based version of the Commonwealth Secretariat's Debt Recording and Management System (CSDRMS). The CSDRMS at the Reserve Bank is not being used. Information on Domestic Debt is also maintained in

<sup>29</sup> Members of the Government Cash flow Committee include the Director of Research – RBV, DESP, Department of Finance and Customs.

<sup>30</sup> The warrant system authorises the release of funds from the Consolidated Fund for the meeting of budget obligations.

CSDRMS. However debt forecasting, calculation of interest accruals and foreign exchange gains/losses (for external debt) are calculated in Excel using information extracted from CSDRMS. Other assessments have noted that the facilities within the CSDRMS have not been fully utilised and there is scope for more pro-active use of the information that can be generated. The CSDRMS database is considered to be too complicated and too comprehensive given that the number of debts (external and domestic) maintained by the GoV is very small.

The MFEM have an electronic interface with the RBV and can therefore access the balances on the two main accounts as required. Some donor Project accounts are held at commercial banks, in 2005 information was requested by the DG from the Commercial Banks on all accounts held by the Ministries, but this has not been forthcoming.

According to the PFEM Act, a loan can only be raised by the Minister of Finance and Economic Management, who is required to obtain minuted approval from the Council of Ministers. Guarantees and indemnities can only be considered by the Finance Minister and all guarantees need to be approved by a simple majority in Parliament. In both cases, decisions should be made in consultation with the DG of Finance, ensure that it is fiscally responsible in accordance with the Act and in the case of loans after discussion on legal implications with the Attorney General.

Score	Minimum requirements	Justification and cardinal data
C	i) Domestic and foreign debt records are complete, updated and reconciled at least annually. Data quality is considered fair, but some gaps and reconciliation problems are recognised. Reports on debt stocks are produced only occasionally or with limited content.	There are only a very limited number of external and domestic debts, some concerns however have been raised on the need to manage borrowing more effectively. It has also been noted that the CDRMS is too cumbersome for effective use. Source of information: Domestic debt spreadsheet/IMF report/interviews.
B	ii) Most cash balances are calculated and consolidated at least weekly, but some extra budgetary funds remain outside the arrangement.	MFEM and RBV have an electronic interface so that cash balances for the two key accounts (recurrent and development funds) are known on a daily basis. Donor project accounts remain outside the system as do a few line ministry accounts. Source of information: Interviews.
C	iii) Central government's contracting of loans and issuance of guarantees are always approved by a single responsible entity but are not decided upon the basis of clear guidelines, criteria or overall ceilings.	The requirements of the PFEM Act ensures that only a single entity can raise loans or approve guarantees and requires CoM or Parliamentary approval. Loans are required to be within the 40 % debt stock limit but there is no overall ceiling for guarantees. Source of information:PFEM Act.

#### *Ongoing and planned activities*

The feasibility of linking the CDRMS with the FMIS is being assessed.

### 3.5.6 PI-18 Effectiveness of payroll controls

As a major component of expenditure, effective control of the payroll is an important indicator of sound financial management. The assessment looks in particular at: i) the degree of integration/reconciliation between personnel and payroll databases; ii) timeliness of changes; iii) adequacy of internal controls; and iv) the existence of payroll audits which identify control weaknesses and/or ghost workers.

#### *Current status*

All permanent and contract employees (approx 4,800) are paid via the integrated SmartStream Human Resource Management Information System (HRMIS) module. Payments are made on a fortnightly basis and all payments are made through bank accounts. An employee's payroll number is based on their Vanuatu National Provident Fund number to minimise duplicate payments. Letters of appointment and a salary authority form are the prime documents for inclusion in the HRMIS database. Audit trails are automatically created by the system and line managers are required to check payroll listings before the payroll is run.

Procedural delays in the service commissions/line ministries can result in delays in personnel being included in the payroll. In some instances, this has been estimated to be up to three months. In addition, similar delays in the Service Commissions e.g. Police and Teachers means that termination of employment (retirement, death, alternative employment) can take some time to be processed. Where feasible, the budgetary implications are minimised by deducting overpayments from terminal benefits.

No complete payroll audit and physical count of personnel has been conducted. However as part of the school audit programme, physical numbers are being compared with establishment figures.

Score	Minimum requirements	Justification and cardinal data
A	i) Personnel database and payroll are directly linked to ensure data consistency and monthly reconciliation.	Payroll and HR modules are linked.
B	ii) Up to three months delays occurs in updating of changes to the personnel records and payroll but affects only a minority of changes. Retroactive adjustments are made occasionally.	There are delays in putting people on the payroll and taking people off the payroll due to delays in hr procedures at the teachers and police and public services commission Source of information: Interviews/ internal audit report – MoE.
A	iii) Authority to change records and payroll is restricted and an audit trail is created.	The payroll system has inbuilt controls to indicate when changes have been made. Source of information: Interviews / payroll manual.
C	iv) Partial payroll audits or staff surveys have been carried out in the last three years.	As part of the school internal audit programme, personnel and payroll data is being reconciled. No external audit of the payroll has been conducted Source of information: Interviews/ internal audit report – MoE.

### 3.5.7 PI-19 Competition, value for money and controls in procurement

Significant public spending takes place through the public procurement system, this indicator assesses; i) the use of open competition; ii) justification for use of less competitive methods; and iii) operation of a procurement complaints mechanism.

All purchases in excess of VT5 million are required to be processed and approved through the Tender Board. Tender regulations prohibit the splitting of a contract. Regulations under the Government Contracts and Tenders Act 1998 provide that all tenders must be called by open and competitive bidding unless another process is approved by the Tenders Board, but make explicit provision for alternative methods such as two stage tendering, selective tendering and period contracts for repetitive purchases.

There is however no regular maintenance of information maintained which analyses the number of contracts which are actually submitted for open competition or justification for use of less competitive methods. Although decisions to use less competitive methods are minuted at Tender Board meetings, this data is not regularly analysed. There are no standard bidding documents available. A managing disputes section is included in the purchasing manual but no clearly recognised process is available that enables the submission and timely resolution of complaints submitted by private sector participants. Complaints are therefore processed through the court system.

Score	Minimum requirements	Justification and cardinal data
D	i) Insufficient data exists to assess the method used to award public contracts.	Use of open competition for contracts that exceed the nationally established monetary threshold cannot be assessed as data is not maintained or analysed to facilitate the calculation. Source of information: Purchasing Manual/ Interview/Internal report.
C	ii) Justification for use of less competitive methods is weak or missing.	Use of less competitive methods should be minuted by the Tender Board, however this information is not regularly analysed to ensure that it is in accordance with regulations. Source of information: Purchasing Manual/ Interviews, Internal report
D	iii) No process is defined to enable submitting and addressing complaints regarding the implementation of the procurement process.	There is no procurement complaints mechanism.  Source of information: Interviews, report. legislation

### 3.5.8 PI-20 Effectiveness of internal controls for non-salary expenditure

This indicator assesses the internal control mechanisms in place by reviewing: i) the effectiveness of expenditure commitment controls; ii) comprehensiveness, relevance and understanding of procedures; and iii) degree of compliance.

### Current status

The FMIS does not permit the issuing of a local purchase order (LPO) without budgetary provision. A financial circular issued in 2002 advised all local businesses that payment for supplies ordered without an official LPO would not be honoured. It was reported that in a few instances where Ministries tried to circumvent this stance, it was resisted by the MFEM. Telephone accounts are prepaid<sup>31</sup> and other utility arrears are monitored by the MFEM.

In terms of financial duties and responsibilities, financial delegations, payment procedures, e.g. coding, authorisation, fixed asset procedures, financial reporting, imprest regulations, journal entries and revenue collection and receipts, the financial regulations and accompanying circulars are considered to be generally comprehensive. Some amendments to the legislation are to be introduced in the November parliamentary session with respect to virements.

On the basis of the Information Technology audit report, the control environment (e.g. access / back up generation) is considered to be generally sound. The understanding of the rules is recognised to vary between Ministries and the level of compliance in some ministries/ departments is a concern. There has been lack of enforcement of the disciplinary clause relating to behaviour of public officials. Regulations require each Ministry to maintain an asset register and the basis for such a register was established under the ISP. Degrees of compliance with this requirement are understood to vary. Maintenance of a government wide register is complicated by Aid in Kind and offshore purchases without supporting documentation.

Score	Minimum requirements	Justification and cardinal data
B	i) Expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations for most types of expenditure with minor exceptions.	The FMIS system does not allow the generation of LPOs without adequate funds. Expenditure on utilities is controlled by a system of prepayments for telephones and a clear disconnection policy by water and electricity providers. Source of information: FMIS manual/interviews.
C	ii) Other internal controls and procedures incorporate a comprehensive set of controls, which are generally understood but may be in some areas either be excessive or in some rural areas not understood.	Internal controls, rules and procedures (for the areas described above) are considered to be generally comprehensive and understood by the majority of those directly involved in their application. In some ministries (at the rural level), poor application is the result of the need for greater training, whilst in other areas e.g. remote schools some requirements e.g. reporting are viewed as excessive. Source of information: Manuals/interviews/internal audit reports.
C	iii) Rules are complied with in a significant majority of transactions but	Rules are complied with in a significant majority of transactions but there are concerns over

<sup>31</sup> Line rentals are not prepaid.

	use of simplified/emergency procedures in unjustified situations is an important concern.	compliance at some line ministries and departments. Source of information internal audit reports and interviews.
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### 3.5.9 PI-21 Effectiveness of internal audit

Internal control mechanisms can be improved through the effective use by management of internal audit. Internal audit capability is assessed by reviewing: i) its coverage and quality; ii) frequency and distribution of reports; ii) extent of management response.

The internal audit function in Vanuatu is in its relative infancy. Prior to the 2005 amendment to the financial regulations, the internal audit function did not have its own mandate and operated under section 62 of the PFEM Act. The internal audit unit in Finance now has additional powers to carry out audits in other Ministries. An internal audit unit has been established within the Ministry of Education (MoE) with the support of the EC. The restructuring of the Ministry has resulted in the doubling of the establishment in the internal audit unit from 2 to 5 with direct reporting to the Director General. The Ministries of Health and Internal Affairs have also recently appointed an internal auditor, whilst the Ministry of Lands is in the process of recruitment.

Internal audit manuals exist but require refinement. Reports are being prepared (three in the last twelve months by the internal audit unit for finance.) and several by the MoE internal audit function. All reports have concentrated on an assessment of systemic issues. However, it is recognised that the standard of reporting does not yet meet international standards. Capacity is limited and the ability to recruit additional personnel constrained.

Score	Minimum requirements	Justification and cardinal data
C	i) The function is operational for at least the most important government entities and undertakes some systems reviews, although these may not meet recognised professional standards	The internal audit function has been operational in Finance and Education for the last 12 - 15 months It is in its infancy and does not yet meet international standards. Source of information: Interviews/internal audit reports.
C	ii) Reports are issued regularly for most government entities but may not be submitted to the MoF and the SA	In the last year three reports have been prepared by the MoF internal audit unit. MoE with support from a technical advisor has also prepared a number of reports. These have been shared with MoF. Source of information: interviews/ internal audit reports.
D	iii) Internal audit recommendations were not being followed.	The "new style" internal audit function has been "operational" for only a limited time and therefore an assessment of management response to these recommendations is rather premature. It is understood that responses in the past were poor. It should be noted however that the DG is actively



		promoting the function in MoE and the establishment has been more than doubled in the restructuring process.
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### *Ongoing and planned activities*

The GoV has recognised the importance of internal audit and is actively seeking support for the development of the internal audit function in the MFEM. This would include training to meet the requirements of the Institute of Internal Auditors.

## 3.6 Accounting, recording and reporting

This set of indicators assesses the quality and timeliness of accounting, recording and reporting. A summary of the scores are set out in the table below.

No.	Accounting, Recording and Reporting	Score	Dimensions	Scoring Methodology
PI-22	Timeliness and regularity of accounts reconciliation	B	(i) B (ii) B	M1
PI-23	Availability of information on resources received by service delivery units.	C	(i) C	M1
PI-24	Quality and timeliness of in year budget reports	B+	(i) A (ii) A (iii) B	M1
PI-25	Quality and timeliness of annual financial statements	B+	(i) A (ii) B (iii) A	M1

### 3.6.1 PI-22 Timeliness and regularity of accounts reconciliation

This is assessed on the basis of regularity of bank account reconciliations and regularity and clearance of suspense and imprest accounts.

#### *Current status*

There are two main treasury managed bank accounts, one for recurrent expenditure and one for development expenditure. Both accounts are held with the RBV and reconciliations for these accounts is carried out manually on a regular basis. For expenditure on these accounts, incurred in Vila, there is a weekly reconciliation of bank statements against cash books, whilst for Santo expenditure, the bank reconciliations are conducted monthly following the receipt of the relevant information from the MFEM's cashier in Santo. As noted earlier, information on project accounts maintained at commercial banks was requested but not forthcoming.

In terms of imprest accounts, standing imprests are reconciled at the end of the year, with documentation to be submitted prior to year end. Temporary advances are acquitted within a specified period, deductions being made from pay for non return of receipts. Suspense accounts are cleared annually.

Score	Minimum requirements	Justification and cardinal data
B	i) Reconciliation of all Treasury managed bank accounts takes place at least monthly	Bank reconciliations between the cash book and bank statements is carried out on a weekly or monthly basis for the two main treasury managed accounts. Source of information: Interviews <sup>32</sup> .
B	ii) Reconciliation and clearance of suspense accounts and advances takes place at least annually within two months of end of period. Some accounts have uncleared balances brought forward.	Suspense accounts and advances take place annually. Some advances have uncleared balances. Source of information: Interviews and Accounts

#### *Ongoing and planned activities*

Under the SERP assistance to the internal audit function in the MoE, efforts are being made to facilitate improved bank reconciliations. Access to the schools bank accounts by the MFEM has been requested. Both NBV and ANZ banks have expressed their agreement, WESTPAC agreement is awaiting a State Law Office pronouncement that schools are government agencies.

### 3.6.2 PI-23 Availability of information on resources received by service delivery units

Information on total resources received by service delivery units e.g. schools and health centres has been limited and not received on a timely basis. The school audit programme supported by the EC over the last eighteen months has started to gather information on resources received by primary and secondary schools. It is understood that accounts from secondary schools are now being received.

Score	Minimum requirements	Justification and cardinal data
C	i) A special survey (schools audit) has been conducted in the last eighteen months which is providing information on resources received by schools (primary and secondary).	The school audit programme which is supported by the EC is gathering information on resources received by primary and secondary schools. Additional information will also be collected by the national survey.

#### *Ongoing and planned activities*

In preparation for the establishment of a Sector Wide Approach to Planning (SwAP) in Education, the MoE is about to start a national survey. In addition the French Embassy is supporting a schools administration project. The GoV is also about to start to use its GIS system for maintaining information on the location of schools, In the future, it is likely that some information from the Education Management Information System (EMIS) (supported by NZAid) will be incorporated into the GIS to facilitate improved planning.

<sup>32</sup> No internal or external audit reports existed to corroborate or contradict this statement.

### 3.6.3 PI-24 Quality and timeliness of in-year budget reports

This indicator assesses the scope of reports, their timeliness and the quality of information on actual budget implementation.

Line ministries, as well as the MFEM have access to the FMIS and through the FRX (an off the shelf reporting system) can produce up to date reports on actual expenditure as and when required. At the end of each month, the Budget section of the MFEM also issues standard reports to the Ministries which show actual, commitment and budget by programme/activity, whilst customised reports for e.g. Health shows the same information by cost centre. These reports allow management at line ministries to monitor their activities on a regular basis. A monthly report on fiscal data (for economic reporting purposes ) is prepared by the Budget Section. This report covers revenue and expenditure in GFS format for central government. Monitoring of operational plans and activities and the associated achievement of targets is poor.

Score	Minimum requirements	Justification and cardinal data
A	i) Classification of data allows comparison with budget, includes all items of budget expenditure and covers both commitments and actual payments.	Standard and customised reports are produced by the FMIS which show actual, commitment and budget for cost centre/programme/activity. Source of information: FMIS reports.
A	ii) Reports are available quarterly or more frequently.	Physical reports are produced at the end of the month. The current position can however be viewed on line at any time through the FRX reporting tool. Source of information: FMIS reports.
B	iii) There are some concerns about data accuracy but these are not considered to compromise overall usefulness.	Expenditure data is considered to be generally of good quality. There were some concerns about the accuracy of coding by line ministries. However, the frequency of miscoding is reported to be diminishing and although there is no independent verification available, steps have been also put in place at the MFEM to check correctness. Source of information: FMIS reports – exception reports.

#### *Ongoing and planned activities*

A new reporting tool is to be introduced in 2006.

### 3.6.4 PI-25 Quality and timeliness of annual financial statements

Dimensions used for this indicator include: i) completeness; ii) timeliness; and iii) accounting standards used.

#### *Current Status*

According to the PFEM Act, annual financial statements prepared in accordance with International Federation of Accountants (IFAC) standards should be prepared within

three months of year end. In 1999, the Institutional Strengthening Project (ISP) assisted in the preparation of accounts for the period 1986 – 1997. In 2003, accounts were prepared for the period 1998 – 2001 on the basis of historical cost convention and modified cash basis.

Financial statements for 2002, 2003 were prepared on the same basis in 2004 and for 2004 in 2005. The introduction of a new format for 2005 statements led to a decision to redo the statements for FY 2002 – 2004 according to the new format. Financial statements for 2002 – 2004 were therefore prepared on an accrual basis and under the historical cost convention except for the revaluation of certain fixed assets and were completed in 2006.

For FY 2005, financial statements have not yet been finalised as they are awaiting the incorporation of any audit adjustments for prior years. It is anticipated that these statements will be presented to the Auditor General before August 2006. The ability of MFEM to meet the legal requirement of submitting the accounts to the Auditor General within 3 months of year end are constrained by the delays incurred in obtaining the required statements of responsibilities from line Ministries and financial statements from government business enterprises.

Score	Minimum requirements	Justification and cardinal data
A	i) A consolidated government statement is prepared annually and includes full information on revenue, expenditure, financial assets and liabilities.	Consolidated government statements have been prepared on an annual basis. The statements for 2002 – 2004 have however been re done on an accrual basis. Source of information: Financial statements 2002 – 2004.
B	ii) Statements are submitted to the Auditor General within 10 months of year end.	The legal requirement is for statements to be submitted within 3 months of year end. Original financial statements for 2003 and 2004 were submitted to the AudGen in the subsequent year. Source of information: Financial statements 2002 – 2004.
A	iii) IPSAS or corresponding standards are applied.	IPSAS standards have been applied, in those instances where the standards have not been met, an explanation is provided e.g. physical assets. Source of information: Financial statements 2002 – 2004.

#### *Ongoing and planned activities*

MFEM plan to meet GFS 2001 standards by 2008.

### 3.7 External scrutiny and audit

This set of indicators looks at the quality and timeliness of external scrutiny of the government's estimates as well as the public accounts. The following table provides a summary of the scores for the individual indicators.

No	External scrutiny and audit	Score	Dimensions	Scoring Methodology
PI-26	The scope, nature and follow up of external audit.	D	(i) D (ii) D (iii) D	M1
PI-27	Legislative scrutiny of the annual budget law.	C+	(i) C (ii) C (iii) C (iv) B	M1
PI-28	Legislative scrutiny of external audit reports.	D	(i) D (ii) D (iii) D	M1

### 3.7.1 PI-26 Scope, nature and follow-up of external audit

Greater transparency in the use of public funds is provided through an effective external audit, this is assessed on the basis of: i) scope of audit; ii) timeliness; iii) follow up or recommendations.

#### *Current status*

As noted in section two, the Auditor General's mandate is derived from the Constitution and the Expenditure Review and Audit Act 1998 (amended 2000) and covers financial, compliance and performance audit. Audit scope includes all central government bodies as well as schools, state enterprises, provincial and municipal bodies. There is a requirement in the law that at least 20% of audits are contracted out. The independence of the audit function envisaged by INTOSAI is not being achieved.

Efforts are currently being concentrated on the completion of the financial audits for the 1998 – 2001 and 2002 – 2004 accounts, Compliance audits which ensure that financial regulations are being complied with are not receiving the same level of attention. It is understood that the Auditor General has undertaken a number of audits of central government departments on a rotational basis as well a number of special investigations. However, reports on general audits and any associated recommendations have not been routinely presented to the auditee and no reports have been presented to Parliament. Although there is a requirement for the Auditor General to present an audit report annually to Parliament, there is no specified timetable. The last reports/accounts to be submitted were for the period 1992 – 1997 It is understood that in prior years, as a direct result of the audit report, personnel were dismissed at the Housing Corporation. However in the period of the review, it is understood that no recommendations or feedback have been issued.

As noted in PI 9, accounts for many of the statutory bodies and state enterprises have not been prepared in a timely manner, audits are therefore overdue and submission to legislature has not taken place. Accounts for provincial governments are also not up to date. Municipal accounts for Luganville and Port Vila have not been prepared.

Score	Minimum requirements	Justification and cardinal data
D	i) Less than 50% of central government entities (by value) are audited annually.	Audits of central government departments/other institutions have taken place but do not represent a significant proportion of entities to be audited.
D	ii) Audit reports are submitted to the legislature more than 12 months after the end of the period under review (and for the audit of financial statements from their receipt by the auditor).	The last Audit reports and audited accounts tabled with Parliament were for the period 1994- 1997. 1998 – 2001 accounts were sent to the Auditor General in 2003.
D	iii) There is little evidence of response or follow up.	In the period under review there have been no clear responses to audits. Audit reports have not been issued. Signed management letters have not been routinely submitted to the auditee.

### *Ongoing and planned activities*

The Auditor General is finalising the review of the 1998 – 2001 and 2002 – 2004 financial statements for tabling with Parliament in June 2006.

### 3.7.2 PI-27 Legislative scrutiny of the annual budget law

In order to assess the role of the legislature in the annual budget process, this indicator reviews the following: i) the scope of the legislature’s scrutiny; ii) the procedures followed; iii) the time allowed; and iv) the rules for in year budget amendments.

#### *Current Status*

Currently, the legislature’s review (i.e. Parliament) is focussed primarily on the individual estimates. It is not involved in reviewing fiscal policy or medium term priorities. Under the revised Expenditure Review and Audit Act, Parliament has delegated detailed review to the Public Accounts Committee (PAC). The PAC has the responsibility to review the estimates and other budget documentation in detail but this procedure has not been followed. However, for the period under review, Parliament has received and reviewed the Appropriation Bill. This has to be submitted to Parliament by early October, debate on the detailed estimates then commences in November.

Detailed rules exist for in year budget amendments both within a Ministry and between Ministries. All intra ministry amendments require the Minister of Finance and Economic Management to obtain the approval of the CoM. Internal adjustments within a Ministry can be carried out by the DG but also require authorisation from DESP. Concern has been raised that funds are transferred without sufficient cause between certain departments within a Ministry and this is to be addressed in amendments to the financial legislation.

Score	Minimum requirements	Justification and cardinal data
C	i) The legislatures review covers details of expenditure and revenue but only at a stage where detailed proposals have been finalised.	Although Volumes 1 – 3 of the budget documentation submitted to Parliament include fiscal strategy, programme budget estimates and narrative. Legislative review concentrates on the detailed estimates and is not involved at a prior stage of the budget process. Source of information: Volumes 1 – 3 of Budget documentation/Interviews/ ER&A Act.
C	ii) Procedures exist for the legislature's review but they are not comprehensive or only partially respected.	The PAC has not been carrying out its mandate with respect to the budget process, although review by the legislature has been followed. Source of information: PFEM Act/Expenditure Review and Audit Act and accompanying regulations.
C	iii)The legislature has at least one month to review the proposal	The appropriation bill is submitted in October and debate starts in November, thus allowing at least one month for debate. Source of information: PFEM Act and accompanying regulations/Interviews.
B	iv) Clear rules exist for in year amendments by the executive and are usually respected but they do allow extensive administrative reallocation	Rules for in-year amendments to the budget without ex-ante approval by the legislature are set out in the financial regulations. Source of information: PFEM Act and accompanying regulations/Interviews.

### 3.7.3 PI-28 Legislative scrutiny of external audit reports

The effectiveness of legislative scrutiny is assessed by: i) timeliness of audit reports; ii) extent of hearings; and iii) issuance and response to recommendations.

#### *Current status*

The Public Accounts Committee (PAC) has the mandate to review external audit reports<sup>33</sup>. In 2000, the PAC met to review the audited accounts from 1986 – 1994. Political instability meant that it did not meet again until 2003, when it continued with the review of the 1994 – 1997 audit reports. The PAC has recently reconvened. In the period 2003 – 2005, there has therefore been little activity of the PAC.

<sup>33</sup> The amendment to the Expenditure Review and Audit Act has transferred the mandate of the Expenditure Review Committee to the Public Accounts Committee.

Score	Minimum requirements	Justification and cardinal data
D	i) Examination of audit reports does not take place or usually takes more than 12 months to complete.	The last meeting of the PAC was in 2003 at which time it started the review of accounts for 1994 – 1997. Since the elections in 2004, the PAC has not been meeting, a new committee has however recently been convened.
D	ii) No in depth hearings are conducted by the legislature	No PAC meetings – no in depth hearings.
D	iii) No recommendations are being issued by the legislature	The PAC has not met since 2003 and no report has been issued since 2000.

### 3.8 Donor practices

The indicators in this group assess the extent to which donor practices impact the performance of country PFM system. The table below summarises the assessment of indicators relating to the “donor practices” dimension of PFM performance.

No.	D. Donor practices	Score	Dimensions	Scoring methodology
D-1	Predictability of Direct Budget Support	D	i) D ii) D	M1
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	D	i) D ii) D	M1
D-3	Proportion of aid that is managed by use of national procedures	D	i) D	M1

#### 3.8.1 D-1 Predictability of Direct Budget Support

This indicator assesses the extent to which inflows of budget support affect the government’s ability to formulate its budget and consequently implement it as planned. The assessment is based on the following dimensions: i) deviation of actual budget support from the forecasts; iii) in-year timeliness of donor disbursements (on quarterly basis).

The EC is the only donor providing planned budget support at the moment, although China has provided GoV with general support in both 2004 and 2005. In 2005 the inflow of unplanned budget support from China compensated for non-disbursement of the EC funds. The background to EC Budget Support is included as Annex 7.

The EC’s budget support component of SERP should have been delivered in two tranches each of Euro 0.65 million. The first tranche was released in 2005 (expected in November 2004); and the second tranche was planned for September 2005 but has not yet been released. The 2<sup>nd</sup> tranche of the EC budget support has been delayed awaiting GoV compliance with the conditions for its disbursement. Since the 2<sup>nd</sup> tranche was expected to be delivered in September 2005, as at June 2006, disbursement has been delayed by 9 months. It is expected that the 2<sup>nd</sup> tranche will be released by the end of 2006.



The table below summarises the assessment for the indicator D-1.

Score	Minimum requirements	Justification and cardinal data
D	i) In at least two of the last three years did direct budget support outturn fall short of the forecast by more than 15% OR no comprehensive and timely forecast for the year(s) was provided by the donor agencies.	In two of last three years the direct budget support fall short of the forecast; in 2003 by 100%, and in 2005 by 37%. Source of information: Financial accounts and Budget Documents.
D	ii) The requirements for score C (or higher) are not met.	Disbursements estimates of the EC budget support were agreed upon before the beginning of the respective fiscal year, China budget support was not planned as part of the budgetary process. The 2 <sup>nd</sup> tranche of the planned EC support is more than 8 months late due to GoV not meeting conditions.

### 3.8.2 D-2 Financial information provided by donors for budgeting and reporting on project and program aid'

This indicator reflects the quality and timeliness of the information provided by the donors on their budget estimates for disbursement of project aid as well as actual disbursements made. It is assessed against the following dimensions: i) completeness and timeliness of budget estimates by donors; ii) frequency and coverage of reporting by donors on actual donor flows.

In recent years, the major donors have been AusAID, NZAID, EU, ADB and the Chinese Government. Substantial assistance is also provided by AFD and the French Embassy, JICA, WHO and other UN agencies such as UNICEF. Further assistance is provided by other charitable organisations, the Volunteer Service Overseas (VSO) and the Peace Corps and regional bodies such as the Forum, South Pacific Commission, French Pacific Fund. At the moment the GoV does not have a donor co-ordination strategy and reliable and comprehensive information on the on the actual value and composition of all donor assistance provided to the Government is not available. Donor assistance to Vanuatu can be classified as follows: funds for GIP projects on budget, funds for GIP projects which are not directed through the Development Fund, aid-in-kind which is on-budget but not going through DF and not recorded in the financial statements, other funds off-budget including aid-in kind/TA and other funds.

As noted earlier, the reliability of the GIP database is weak, so the value of GIP funds of just over Vt 4 billion must be treated with some caution. According to the Financial Statements (2002-2004) the off-budget donor funds amount to a further Vt 2 billion and would include Global Funds, Regional Funds and some non-traditional donors. Although there is uncertainty about the true extent of donor assistance, the Vt 708 million shown in the 2004 accounts as going through the Development Fund can be estimated at about 15%-20 % of overall assistance, a substantial increase on earlier years.

The most accurate data provided to the government by the donors is at the outset of a project, as cash flow requirements form part of the GIP approval process. Annual updates of these figures are not provided by all donors, so the cash contributions for the particular year, shown in the GIP may be incorrect. The reliability of the information held by the government is further complicated by the maintenance of two GIP databases, one at foreign affairs and one at DESP.

Most donors provide quarterly reports on actual disbursements to the Reserve Bank of Vanuatu. RBV collects information for Balance of Payments purposes using the Donors/Embassy Survey Form (DSF). Information collected includes aggregate information on grants provided, including technical assistance, aid-in-cash, aid-in-kind (for capital projects and small scale assistance/cyclone relief without cash), education scholarship, and other expenditures for Vanuatu.

Information collected is now shared with MFEM but the aggregate nature of the information (and the fact that it is only collected for Balance of Payments purposes) means that it is not sufficiently comprehensive or in the right format e.g. by sector, individual capital purchase for management, budgeting (recurrent cost implications), and technical accounting purposes (e.g. depreciation).

The table below summarises the assessment of this indicator.

Score	Minimum requirements	Justification and cardinal data
D	i) Not all major donors provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least three months prior to its start.	The Government of Vanuatu does not have comprehensive and reliable information on the value and composition of all donor assistance provided to the Government. Many donors do not provide budget estimates for disbursement of project aid after the initial project approval process. Source of information: Budget documentation/ interviews.
D	ii) Donors do not provide quarterly reports within two month of end-of-quarter on the disbursements made for at least 50% of the externally financed project estimates in the budget.	Donors provide quarterly reports on actual disbursements only to the RBV; but for other purposes than budgeting. Attempts in the past to collect data have proved difficult. Source of information: Budget documentation/ interviews.

#### *Ongoing and planned activities*

In addition to the improvement of the GIP database, ADB assistance is being provided to develop a donor co-ordination strategy, which should help to clearly identify the information requirements and procedures.

### 3.8.3 D-3 Proportion of aid that is managed by use of national procedures

This indicator relates to the proportion of donor aid funds that are managed through national procedures (i.e. banking, authorisation, procurement, accounting, audit, disbursement and reporting). Direct and general budget support is considered by definition to follow the national procedures. On the basis of the figures provided in the financial statements for 2002 – 2004, between 10 and 20% of funds used national procedures i.e. were processed through the development fund.

Score	Minimum requirements	Justification and cardinal data
D	i) Less than 50% of aid funds to central government are managed through national procedures.	Donor contributions are estimated at between 4- 6 billion Vt per year (Financial Accounts 2002-2004). Funds through the development fund were 708 million in 2004 (or between 15 – 20 %) of estimated donor funds. This figure has improved over the years. Source of information: Financial statements 2002 - 2004.

#### *Ongoing and planned activities*

Both New Zealand and Australian Aid are considering the provision of budget support in the next few years. A SwAP arrangement is also being developed for the education sector which should improve the effectiveness of donor support to the sector and mitigate the existence of a large number of “information silos”.

## 3.9 Country specific issues

### 3.9.1 Sub-national governments

Currently local government does not play a significant role in Vanuatu. In theory, local government is responsible for a wide range of activities, e.g. preschool and primary education, primary health care, regional planning, roads, refuse collection and disposal, cemeteries and crematoria, parks and open spaces and the promotion of tourism. However in practice many of these activities are currently administered through the central government. Revenue for local government is from central government transfers, revenue from various taxes and charges. Expenditure is mainly on personal emoluments, administrative expenses and small capital projects. Independent scrutiny is provided by two bodies – the Ombudsman and the Auditor General.

However, both local government and decentralisation are enshrined in the constitution. Section 82 states the “Republic of Vanuatu, conscious of the importance of decentralisation to enable the people fully to participate in the government of their Local Government Region, shall enact legislation necessary to realize that ideal.” Section 83 provides “for the division of the Republic of Vanuatu into Local Government Regions and for each region to be administered by a Local Government Council on which shall be representatives of custom chiefs.” The main piece of legislation pertaining to local government is the Decentralization and Local Government Regions Act 1994 (amended).

Currently there are two municipalities that govern the two urban centres and six provincial councils. Each has a central administration, plus local areas headed by an area secretary who resides in the villages and reports to the secretary general (chief executive officer) of the provincial council.

### 3.9.2 Public enterprises

As noted in PI-8, corporate governance in the state enterprises is a cause of concern. Most enterprises have not produced accounts on a regular basis and some are not financially viable. Boards of Directors are not fulfilling their management role. In the past, this has meant that central government has had to “step in” and support operations/pay liabilities e.g. Vanuatu National Provident Fund (VNPF). The proposed Public Enterprises Accountability Bill would provide MFEM increased powers of oversight. Whilst a functioning PAC should also place pressure on entities not fulfilling their legal obligations.

## 4 Government reform process

### 4.1 Description of recent and on-going assistance to support reforms

As set out in section 2.2, the focus of the government's reforms in PFM have been to improve the legal and regulatory framework in line with international best practice. Donors have supported the government reform programme by concentrating on the actual implementation of this improved legal and regulatory framework. In particular, Australian Aid's institutional strengthening project provided significant support to the finance function in implementing the FMIS, training staff both in the MFEM and in line ministries. Assistance to the CIRD was also provided by New Zealand Aid through the secondment of personnel from the New Zealand Customs and Inland Revenue Department.

Currently, ADB through its institutional strengthening support is providing assistance to the DESP in improving aid effectiveness and revenue forecasting. Whilst a number of donors are providing support to the NSO in carrying out agricultural and household income and expenditure surveys to improve government's knowledge on key statistics. The EC support to the development of the medium term expenditure framework has provided a sound basis for the establishment of a medium term planning perspective. Support to internal audit in the Ministry of Education is also ongoing and working closely with the Department of Finance on a number of internal audit issues, as well as providing some technical guidance to the National Audit Office. Australian Aid's new Governance for Growth programme is to provide flexible support to governance issues which are aimed at improving growth. The New Zealand government through NZAID provides support to governance and economic development issues focusing on growth particularly in the rural areas.

Whilst the various projects have made (are making) a positive contribution in their own right, at times the lack of co-ordination and prioritisation has resulted in less than optimal results.

### 4.2 Institutional factors supporting reform planning and implementation

#### 4.2.1 Government leadership and ownership

The process of approving reforms is well established. Bi annual national summits on the overall CRP filter down to the presentation of three year medium term plans, which should identify both government priorities, actions and performance indicators to measure

progress. The PAA 2006 was submitted to the Council of Ministers at the beginning of June for approval before dissemination to donors.

#### 4.2.2 Coordination across government

A central committee of DGs was established under the CRP to review and make recommendations on all aspects of Government policy and reform. This Committee is responsible for advising the Council of Ministers and is supported by the Department for Strategic Management (DSM) and the Department of Economic and Sector Planning (DESP) in the co-ordination of the reform process.

#### 4.2.3 Sustainability of the reform process

Sustainability of the reform process is dependent upon a number of factors. Training of personnel both in house and formal training in accounting and financial management at the Vanuatu Institute of Technology formed an important element of the AusAid's Institutional Strengthening Project.

Issues remain however in terms of capacity constraints, the ability of the government to attract qualified personnel and the time required to restructure and appoint permanent staff. The Public Service Reform Programme is reported to have had an important effect on improving the transparency of the recruitment process. Capacity is a particular constraint for the National Audit Office, with very few qualified accountants in Vanuatu able under the current legislation to sign off the accounts.

# Annexes





# Annex 1: Terms of Reference

## *Assessment of Public Finance Management based on the Performance Measurement Framework of the PEFA (Public Expenditure and Financial Accountability) Public Finance Experts/Economists*

### **A. Background**

Vanuatu's economy is fragile with high dependency on a narrow range of foreign exchange earners (tourism, copra and beef), and is subject to shocks from changes in primary commodity prices and frequent cyclones and earthquakes. Despite instability at the beginning of the 21st century, the economy of Vanuatu has stabilised since 2003 with growth estimates averaging some 3% annually.

In 2003 the Government of Vanuatu launched a Prioritised Action Agenda (PAA) to raise the general welfare of the total population; to reduce poverty; and to achieve the Millennium Development Goals in collaboration with the civil society and international donors.

The main objectives of the PAA can be summarised as follows:

- Raise the economy to a higher and more sustainable growth path through a series of actions ordered in terms of priority;
- Maintain macroeconomic stability with the aim of achieving a surplus budget in each financial year;
- Ensure better coordination of donor resources so that external assistance is realigned with the Government's priorities and more resources are directed to the priority areas for maximum impact, and
- Promote policy stability by setting priorities beyond a twelve-month budget cycle.

Consistent with these goals the Public Finance and Economic Management Act 1998 requires the Government to report annually on its economic and financial policies; including those relating to key economic and fiscal variables; to state its **long-term objectives** for fiscal policy in terms of major economic and fiscal variables; and to indicate the **Government's intentions** (or **targets**) for economic and fiscal variables.

Currently, the Government is in the process of preparing baseline data (2000-2005) that will show recent trends in the size and composition of public expenditures. This information will form the basis for a comprehensive analysis of public expenditures leading to the development of a Medium Term Expenditure Framework (MTEF). The intention is that the MTEF will be considered by the Council of Ministers (COM) in 2006. The MTEF covering the period 2006-2008 is to be consistent with the Annual Budget, and with the Corporate and Business Plans and other policy documents of each Ministry. The MTEF will act as a catalyst for a description of agreed Government and

donor public expenditure priorities over a three-year period, including the use of budget resources and aid in kind.

AusAid (Aid Agency of Australia) and the European Commission are the main donors involved in supporting economic reforms. They meet and participate in bilateral meetings with officials of the Ministry of Finance and Economic Management and other central and service ministries regularly.

### ***B. Objective of the mission***

The **overall objective** of the mission is to produce a report on Public Finance Management (PFM) based on the PEFA methodology which could provide an assessment of the performance of the PFM system in Vanuatu.

The **objectives** of the mission are twofold:

- In the short-term, the PEFA exercise will provide relevant information to orient dialogue between the government and main donors on Public Finance Management and to help facilitate improved donor coordination;
- The findings of the exercise will also contribute to determining the eligibility of the country to further budget support in line with article 61(2) of the Cotonou Agreement.

### ***C. Main actors of the mission***

- The donor community:  
The main donors involved in the sector are AusAid and the European Commission. New Zealand Aid and the French Embassy should also be informed and consulted during the exercise. The Asian Development Bank (ADB) and the World Bank desk officers for Vanuatu (based in Sydney) may be informed via e-mail during the field phase of the mission.

The EC Delegation in Vanuatu will be the *chef de file* of the mission and will provide logistical support throughout its duration. The EC Delegation will disseminate the information and consolidate and coordinate donors' comments on preliminary findings. The EC Delegation will distribute the draft report and the final report amongst donors.

- The Government of Vanuatu:  
The Mission will report to the Director-General, Ministry of Finance and Economic Management through the Directors of the Department of Economic and Social Planning and the Department of Finance.
- The Auditor General and the Director of the Reserve Bank will be contacted and informed.

Government officials of, and principal technical advisers to, the Ministry of Finance and Economic and other relevant government ministries and agencies will be consulted.

The EC Delegation in Vanuatu and the National Authorizing Officer (NAO) office will send an official communication to donors and other stakeholders informing them of the Terms of Reference, name(s) of the experts and dates for the field mission. This letter should reach the authorities at least two weeks prior to the field mission.

#### ***D. Methodology***

The primary reference for the exercise will be the PEFA PFM Performance Measurement Framework (English version). Annex 1 and 2 of the document approved by the Steering Committee of PEFA will constitute the guidelines for the fieldwork and reporting. This Performance Measurement Framework aims to support integrated and harmonized approaches to assessment and reform in the field of public expenditure, procurement and financial accountability. Relevant documentation can be found on [www.pefa.org](http://www.pefa.org). This Performance Measurement Framework has never been used in any Pacific ACP country and the experts may propose adaptations in indicators based on strong justifications. It is expected that adaptations to the Performance Measurement Framework would be very limited and would need the formal approval from the donor chef de file after consultation of the Secretariat of PEFA.

An indicative work plan should be presented by the experts to donors and the Government at the start of the field phase. The work plan will need to summarise the principal stages of the Mission, include a list of people to be consulted and also preview of the information to be collected from stakeholders.

The work plan should also include a mid-term meeting with donors and Government officials. There should be a further meeting between experts, donors and Government officials at the completion of the of the field stage of the mission.

Reports should indicate clearly the information sources and documents used for the assessment of indicators. Difficulties in the assessment of each indicator and/or suggestions for further investigation should also be mentioned.

#### ***E. Reporting***

During the meeting at the end of the field mission, the experts should present an *aide-mémoire* (maximum 10 pages) containing a summary of the points that will be developed further in the draft report. This *aide-mémoire* (transmitted to the Government and the Delegation of the Commission) will be complemented by the assessment of the 28 indicators included in the PEFA PFM Performance Measurement Framework.

Within one week after completion of fieldwork the experts will submit a **draft report** (in English) complying with the ***PEFA PFM Performance Measurement Framework*** - English version, cf. Annex 1 and 2- (it may be that the experts will be able to submit a draft report to the chef de file before the end of the field work stage of the Mission. If so, this would be preferable) The draft report will be sent -in hard and electronic copies- to the Delegation of the Commission in Vanuatu, to the Ministry of Finances, to the services of the Commission (AIDCO/E/1 and DEV/B/2) in Brussels and to the PEFA Secretariat in Washington.

Comments from the Government, donors and PEFA Secretariat will be forwarded to the experts within three weeks of receipt of the draft report. The donor *chef de file* will consolidate the comments from donors.

The experts will have one week from the receipt of feedback about the draft report to submit **the final report**. Comments from the Government will be attached in full in an annex. The final report will contain separate executive summaries in English and in French. The final report will be sent -in hard and electronic copies- to the Delegation of the Commission in Vanuatu, to the Ministry of Finances, to the services of the Commission (AIDCO/E/1 and DEV/B/2) in Brussels and to the PEFA Secretariat in Washington.

#### ***F. PEFA training and Dissemination***

The experts will conduct a two-day workshop in Vanuatu for all the stakeholders at the beginning of the field mission. The core material for the preparation of the workshop can be found on the website of the PEFA Secretariat ([www.pefa.org](http://www.pefa.org)) and the experts will beforehand take contact with the PEFA Secretariat to crosscheck their presentation. This workshop will include two types of session: one providing a brief overview including general information about PEFA and the Mission, the other detailing the techniques to be applied and the indicators directed at government representatives and their advisers.

#### ***G. Experts' profile, timetable and duration***

- *Composition*: The team of experts will comprise **two members**, a team leader and a team member. The team leader should possess at least 10 years experience in public finance and practical experience in developing countries (experience of working within small and developing Pacific Island states is desirable).

Both experts should possess at least 5 years experience in the analysis of regional, national and international public finance / statistics / economics. Both experts should also have good writing ability and good communication skills.

- *Duration* : the total assignment is **31 days** according to the following schedule :
  - The overall field phase of the mission is estimated at **21 days**
  - The additional **7 days** for reporting include a day for briefing and a day for debriefing at Headquarters. Before the mission, one day briefing will be organised in Brussels (Cooperation Office Europe Aid 41 rue de la Loi) with a representative of the Unit AIDCO/E/1. Furthermore, one day debriefing will take place in AIDCO/E/1 after the mission, to discuss the draft report.
  - Furthermore, **3 days** of fees can be charged for the days travelling.

Vanuatu is a multi-lingual country. English, French and Bislama (Melanesian pidgin) are the three official languages. However, as English is the working language in MFEM (NSO, DESP and DoF), the expert(s) must be fully fluent in English. A working knowledge of French would be considered an asset.

#### ***H. Starting of the Mission***

The indicative date for the starting of the mission in Vanuatu is the 15/05/2006

## Annex 2 List of documents consulted

### *MFEM*

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GoV, Payroll Section Operations Manual.

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Review of the Public Finance and Economic management Act, AusAID Institutional Strengthening Project Con. 7894, PDP Australia Pty. Ltd, October 2004.

### *Other publications*

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Financing Agreement between the European Commission and the Republic of Vanuatu, Support to Economic Reform Programme (SERP) 2004-2006 VA/001/04 EDF IX.

PEFA, Public Finance management Performance Measurement Framework, June 2005, PEFA Secretariat, WB, Washington DC, USA.

Reserve Bank of Vanuatu, Quarterly Economic Review, December 2005.

World Bank, Regional Engagement Framework FY2006-2009 for Pacific Islands, May 3, 2005.

Vanuatu, Selected Issues and Statistical Appendix, December 2002.





## Annex 3: List of people interviewed

Institutions	Name	Position
<b>Ministry of Finance and Economic Management</b>		
Department of Finance	Benjamin Shing	Director of Finance
Department of Finance	Betty Zinner-Toa	Budget manager
Department of Finance	Letlet August	Fiscal policy manager
Department of Finance	Leisongi Oscar	Acting principal internal auditor
Department of Finance	Lucy Simon	Debt Management
Department of Finance	Dorothy Erikson	Chief Accountant
Department of Finance	Jack Laoughman	Acting Exchequer Service Manager
Department of Finance	Nickdonald Tarco	Payroll accountant
Department of Finance	Kevin Kavsiama	Reconciliation officer
DESP	Frederick Hosea	Acting Director
DESP	Thomas Bangalini	Natural Resources Sector Analyst
DESP	Jerry Lapi	Sector analyst - Infrastructure
DESP	Collin Tavi	Economist
Customs and Inland Revenue Department	Ben Wotu Leeshi	Director
Revenue section	Jonseth Malkusum	Assistant revenue manager
VAT department	Benjamin Malas	VAT audit manager, Acting Deputy CIRD
VAT department	Ernestine Laurent	VAT Revenue manager
Government Business Environment Unit	Thomson Pakoa Matokai Kokona	Manager
National Statistics Office	Nancy Wells	Director
<b>Line ministries</b>		
Ministry of Lands	Mahit Kalouvai	Finance manager
Ministry of Lands	Mahit Kalorai	Senior Finance Officer
Ministry of Lands	Martin Sokomann	Corporate manager
Department of Strategic Management, Ministry of Comprehensive Reforms	Gregoire Nimbtk	Director
Department of Strategic Management, Ministry of Comprehensive Reforms	Bethuel Solomon	Assistant Director
Public Works Department	Toumet Carlo	Small public works controller
Ministry of Health	Jameson Mokoroe	Finance Manager
<b>Constitutional bodies</b>		
Ombudsman	Jan Dapang	Principal finance officer
Audit Office	Julie-Ann Rovo	Auditor general
Audit Office	Henrikson Malsokle	Auditor

<b>National Reserve Bank</b>		
Corporate Service Department	Nelson Shem	Director
Finance Markets	Michael Hililan	Director
Department of research and Statistics	Philip Arubilake	Director
Department of research and Statistics	Shadrack Welegtabit	Economist
Department of research and Statistics	Sylvain Kelsakau	Assistant Economist
Department of research and Statistics	Lynette Ragonmal	Assistant Economist
Accounts and Customer Service department	Florinda Avu	Accountant
Accounts and Customer Service department	Florinda Avu	Accountant
<b>Donors</b>		
EC EuropeAid Co-operation Office, Brussels	Antoine Gilbert	Administrator
EC EuropeAid Co-operation Office, Brussels	François Thiollier	Principal Administrator
EC Delegation	Aldo Dell'Ariccia	Ambassador, Head of Delegation
EC Delegation	Nicolás Berlanga-Martinez	Chargé d'Affaires a.i.
AusAID	Nicholas Cumpston	Finance & Economics Specialist
AusAID	Robert Tranter	Counsellor (Development Cooperation)
AusAID	Leith Veremaito	Project officer
NZAID	Mary Oliver	Deputy New Zealand High Commissioner
NZAID	John Colwick Tari	Project officer
French Embassy	Bernard Faro	First Counsellor
French Embassy	Bernard Séxé	French Cooperation
JICA	Yoshinori Ebata	Resident Representative
WHO	Dr. Corinne Capuano	Country Liaison Officer
Millennium Challenge Account	Lennox Vuti	Manager
<b>Civil society</b>		
Vanuatu Association of Non-governmental Organisations (VANGO)	Henri Vira	Secretary-general
Vanwods microfinance	Elrico V. Munoz	Managing director
Transparency International Vanuatu	Marie-Noelle Ferrieux Patterson	President
<b>Statutory bodies</b>		
Vanuatu Maritime Authority		
<b>Technical advisors</b>		
MFEM	Nikunj Soni	AusAid TA
Ministry of Education	Peter Murray	EC internal audit TA
Department of Finance	Branden Toner	Technical advisor
<b>Others not interviewed, but present at the workshops</b>		
EC Delegation	Adrien Mourgues	Proramme Officer
PSC	Mark B. Bekonu	PSC secretary
PSM	Bethuel Solomon	
Ministry of Trade	John Luen	Economist
Ministry of Education	Owen J. Sisi	Finance officer
DTCI	Danny Lui	ODI fellow
WB	David Chandler	Senior financial specialist

## Annex 4 Performance Indicators Summary

No.	Indicator	Scoring	Brief Explanation and Cardinal Data used
<b>A. PFM-OUT-TURNS: Credibility of the budget</b>			
PI-1	Aggregate expenditure out-turn compared to original approved budget	A	In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 5% of budgeted expenditure. Source of information: Accounts 2003 – 2005.
PI-2	Composition of expenditure out-turn compared to original approved budget	A	Variance in expenditure composition exceeded overall deviation in primary expenditure by no more than 5 percentage points in any of the last three years. Source of information: Accounts 2003 – 2005.
PI-3	Aggregate revenue out-turn compared to original approved budget	A	The actual revenue collection was 92%, 103% and 107% in 2003, 2004 and 2005 correspondingly. Source of information: Accounts 2003 - 2005.
PI-4	Stock and monitoring of expenditure payment arrears	A	Accounts payable figures in the accounts adjusted to reflect bills outstanding < 30 days and accrued expenses represents < 2% of total expenditure. GoV prepares accrual based accounts and operates a centralised payments system combined with a commitment control system which does not permit commitments without budgetary provision. Source of information: Accounts 2003 + 4.
<b>B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency</b>			
PI-5	Classification of the budget	B	The budget formulation and execution is based on economic, administrative and program classification using standards that can produce consistent documentation according to GFS/COFOG standards but program classification is not at sub functional level. Source of information: Government of Vanuatu, MFEM, Revenue and expenditure codes, Fiscal Framework Strategy, Financial Accounts.
PI-6	Comprehensiveness of information included in budget documentation	A	Budget documentation fulfils 7 of 9 benchmarks. The Budget documents are quite comprehensive. Limited information is included on financial assets, and the budget implications of new policies.

No.	Indicator	Scoring	Brief Explanation and Cardinal Data used
<b>A.</b>	<b>PFM-OUT-TURNS: Credibility of the budget</b>		
			Source of information: Budget documentation volumes 1 – 3.
PI-7	Extent of unreported government operations	D+	An estimated Vt 620 million is collected in school fees which are not routinely included in government budget/accounts reports, this represents between 5- 10% of total expenditure. In relation to information on donor projects, information was requested by MFEM from the commercial banks but has not been forthcoming. Project funds that fall into this category include .the global fund for tb, malaria and aids. Source of information. Interviews, MoE.
PI-8	Transparency of inter-governmental fiscal relations	B	The allocation is divided equally between the six provinces and is therefore for the purposes of this assessment seen to be done on a transparent and rules bases system. Although the allocation does not take into account requirements. Provincial governments share the same financial year and grants provided to them through the Ministry of Internal Affairs would be available to them following the budget hearings in August. This would not be the case for municipal governments whose FY is July – June. Provincial and municipal governments are not up to date with their accounts. Currently central government does not collect data from this level of administration. Source of information: Accounts/ Interviews.
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	D	Monitoring of AGAs and PEs takes place to a limited degree, but it is incomplete. The main problem is related to the enforcement of compliance with the individual enterprises legislation in terms of reporting and production of audited accounts. No monitoring of fiscal risk of SN government takes place. Source of information: Interviews /GBEU report/ Financial accounts.
PI-10	Public access to key fiscal information	C	Only budget documentation has been made available to the public over the period. Part of the reason is that audited accounts and audit reports have not been produced. Currently availability is also restricted by the relative high price, although it is only based on cost and free copies are provided to public bodies. Source of information: Interviews/documentation.
<b>C.</b>	<b>BUDGET CYCLE</b>		
<b>C(i)</b>	<b>Policy-Based Budgeting</b>		
PI-11	Orderliness and participation in the annual budget	B+	The budget process is clearly set out. On the basis of the ceilings provided by MFEM, the line ministries

No.	Indicator	Scoring	Brief Explanation and Cardinal Data used
<b>A.</b>	<b>PFM-OUT-TURNS: Credibility of the budget</b>		
	process		prepare their submissions. Whilst there are some delays, there is sufficient time for the ministries to complete their submissions, particularly as many of them start the process before the receipt of the ceilings. The Budget Ceilings/circulars for the last three years were approved by the MBC and COM before the distribution of the circular to line ministries. Budgets have been appropriated before the start of the fiscal year in two of the last three years. Source of information: Budget calendar/circular/ interviews.
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	D+	Forecasts of fiscal aggregates are prepared for three years, including the budget year. The forecasts however are not linked to subsequent budget ceilings. No DSA has been carried out. Only 3 line ministries have a medium-term Sector Strategy. All line ministries have one-year corporate plans (and business plans) on which the ministerial budgets are developed. None of the strategies has been properly costed so far. The link between sector strategy and sector budget is poor. Investment decisions are selected based on donor funding rather than on a conscious process of prioritisation of investment decision according to the sector strategy and availability of resources. Source of information: Fiscal strategy report and interviews.
<b>C(ii)</b>	<b>Predictability and Control in Budget Execution</b>		
PI-13	Transparency of taxpayer obligations and liabilities	C+	Whilst VAT legislation is relatively clear, the import duty act does allow a significant degree of potential discretion in administering exemptions. Information on tax liabilities and procedures is provided directly by the Customs department and through limited awareness programmes. However it is recognised that in the outer islands there is a need for education and awareness programmes. A VAT tribunal has been established and members appointed but no cases have been considered. Taxpayers can appeal against a tax assessment through the independent court system. Source of information: VAT Act and Consolidated Import Tariffs schedule.
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	B	Currently there is no single TIN. Taxpayers may be registered on both the Asycuda system as well as the CTS system. The latter does however hold details of e.g. business licenses in addition to VAT registration details. Penalties exist for non registration/non filing but have not been constantly applied to date, as taxpayers were not experienced in maintaining records. The CTS system identifies 4 categories

No.	Indicator	Scoring	Brief Explanation and Cardinal Data used
<b>A.</b>	<b>PFM-OUT-TURNS: Credibility of the budget</b>		
			for further audit including refunds Post importation checks on import duties is based on an assessment of likely returns. Source of information: Interviews/ VAT Act.
PI-15	Effectiveness in collection of tax payments	D+	Information on collection vis-à-vis arrears has only been collected since 2005, it is understood that arrears for VAT was about 100 million (or 2.5% of total collections). Collection ratio for the first 5 months of 2006 has been about 30% The majority of tax revenue collected is transferred daily or banked directly with the Reserve Bank. No reconciliation takes place of tax assessments, collections, arrears and transfers to (and receipts) by Treasury takes place. Source of information: Interviews.
PI-16	Predictability in the availability of funds for commitment of expenditures	C+	Ministries prepare cash flows as part of their budget submission. This then forms the basis for their allocations. A consolidated cash flow is then prepared on the basis of the expenditure estimates and past trends in revenue in flows. This is updated regularly by the cash flow committee. The GoV operates a monthly warrant system for some Ministries and a quarterly warrant system for other ministries Significant in year adjustments above the level of MDAs have only taken place once or twice and appear to have been carried out in a transparent way as they have to be approved by the CoM. Source of information: Interviews.
PI-17	Recording and management of cash balances, debt and guarantees	C+	There are only a very limited number of external and domestic debts, some concerns however have been raised on the need to manage borrowing more effectively. MFEM and RBV have an electronic interface so that cash balances for the two key accounts (recurrent and development funds) are known on a daily basis. Donor project accounts remain outside the system as do a few line ministry accounts. The requirements of the PFEM Act ensures that only a single entity can raise loans or approve guarantees and requires CoM or Parliamentary approval. Loans are required to be within the 40 % debt stock limit but there is no overall ceiling for guarantees. Source of information: Domestic debt spreadsheet/IMF report/interviews/ PFEM Act.
PI-18	Effectiveness of payroll controls	C+	Payroll and HR modules are linked. There are delays in putting people on the payroll and taking people off the payroll due to delays in hr procedures at the teachers, police and public services commission.

No.	Indicator	Scoring	Brief Explanation and Cardinal Data used
<b>A.</b>	<b>PFM-OUT-TURNS: Credibility of the budget</b>		
			The payroll system has inbuilt controls to indicate when changes have been made. As part of the school audit programme, personnel and payroll data is being reconciled. Source of information: Payroll manual / Interviews/ internal audit report – MoE.
PI-19	Competition, value for money and controls in procurement	D+	Use of less competitive methods should be minuted by the Tender Board, however this information is not regularly analysed to ensure that it is in accordance with regulations. There is no procurement complaints mechanism. Source of information: Interviews/Internal reports/ Purchasing manual.
PI-20	Effectiveness of internal controls for non-salary expenditure	C+	The FMIS system does not allow the generation of LPOs without adequate funds. Expenditure on utilities is controlled by a system of prepayments for telephones and a clear disconnection policy by water and electricity providers. Internal controls, rules and procedures are considered to be generally comprehensive and understood by those directly involved in their application. Whilst the controls are not viewed as generally excessive, their understanding in some of the rural remote areas is an area of concern. Rules are complied with in a significant majority of transactions but there are concerns over compliance at some line ministries and departments. Source of information: Cardinal data FMIS manual/interviews.
PI-21	Effectiveness of internal audit	D+	The internal audit function has been operational in Finance and Education for the last 12 - 15 months It is in its infancy and does not yet meet international standards. In the last year three reports have been prepared by the MoF internal audit unit. MoE with support from a technical advisor has also prepared a number of reports. These have been shared with MoF. The internal audit function has been “operational” for only a limited time and therefore an assessment of management response to internal audit recommendations is rather premature. It should be noted however that the DG is actively promoting the function in MoE and the establishment has been more than doubled in the restructuring process. Source of information: Interviews/internal audit reports.
<b>C(iii)</b>	<b>Accounting, Recording and Reporting</b>		
PI-22	Timeliness and regularity of accounts reconciliation	B	Bank reconciliations between the cash book and bank statements is carried out on a weekly or monthly basis for the two main treasury managed accounts. Suspense accounts and advances take place

No.	Indicator	Scoring	Brief Explanation and Cardinal Data used
<b>A.</b>	<b>PFM-OUT-TURNS: Credibility of the budget</b>		
			annually. Some advances have uncleared balances. Source of information: Interviews.
PI-23	Availability of information on resources received by service delivery units	C	The school audit programme which is supported by the EC is gathering information on resources received by primary and secondary schools. Additional information will also be collected by the national survey. Source of information: Interviews.
PI-24	Quality and timeliness of in-year budget reports	B+	Standard and customised reports are produced by the FMIS which show actual, commitment and budget for cost centre/programme/activity. Actual reports are produced at the end of the month. The current position can however be viewed on line at any time through the FRX reporting tool. Expenditure data is considered to be generally of good quality. There are some concerns about the accuracy of coding by line ministries. The frequency of miscoding is reported to be diminishing but there is no verification available. Source of information: FMIS reports.
PI-25	Quality and timeliness of annual financial statements	B+	Consolidated government statements have been prepared on an annual basis. The statements for 2002 – 2004 have however been re done on an accrual basis. The legal requirement is for statements to be submitted within 3 months of year end. Original financial statements for 2003 and 2004 were submitted to the AudGen in the subsequent year. IPSAS standards have been applied, in those instances where the standards have not been met, an explanation is provided e.g. physical assets. Source of information: Financial statements 2002 – 2004.
<b>C(iv)</b>	<b>External Scrutiny and Audit</b>		
PI-26	Scope, nature and follow-up of external audit	D	Audits of central government departments/other institutions have taken place but do not represent a significant proportion of entities to be audited. The last Audit reports and audited accounts tabled with Parliament were for the period 1994- 1997. 1998 – 2001 accounts were sent to the Auditor General in 2003. Audit reports have not been issued. Signed management letters have not been routinely submitted to the auditee. Source of information: Interviews.



No.	Indicator	Scoring	Brief Explanation and Cardinal Data used
<b>A. PFM-OUT-TURNS: Credibility of the budget</b>			
PI-27	Legislative scrutiny of the annual budget law	C+	Although Volumes 1 – 3 of the budget documentation submitted to Parliament include fiscal strategy, programme budget estimates and narrative. Legislative (parliamentary) review concentrates on the detailed estimates and is not involved at a prior stage of the budget process. The PAC has not been carrying out its mandate with respect to the budget process, although review by the legislature has been followed. Rules for in-year amendments to the budget without ex-ante approval by the legislature are set out in the financial regulations. Source of information: Volumes 1 – 3 of Budget documentation/Interviews/ ER&A Act./ PFEM Act.
PI-28	Legislative scrutiny of external audit reports	D	The last meeting of the PAC was in 2003 at which time it started the review of accounts for 1994– 1997. Since the elections in 2004, the PAC has not been meeting, a new committee has however recently been convened. No PAC meetings – no in depth hearings. The PAC has not met since 2003 and no report has been issued since 2000. Source of information: Interviews.
<b>D. DONOR PRACTICES</b>			
D-1	Predictability of Direct Budget Support	D	In two of last three years the direct budget support fall short of the forecast; in 2003 by 100%, and in 2005 by 37%. Disbursements estimates of the EC budget support were agreed upon before the beginning of the respective fiscal year, China budget support was not planned as part of the budgetary process. The 2nd tranche of the planned EC support is more than 8 months late due to GoV not meeting conditions. Source of information: Financial accounts and Budget Documents.
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	D	The Government of Vanuatu does not have comprehensive and reliable information on the value and composition of all donor assistance provided to the Government. Many donors do not provide budget estimates for disbursement of project aid after the initial project approval process. Donors provide quarterly reports on actual disbursements only to the RBV; but for other purposes than budgeting. Attempts in the past to collect data have proved difficult. Source of information: Budget documentation/ interviews.
D-3	Proportion of aid that is managed by use of	D	Donor contributions are estimated at between 4- 6 billion Vt per year (Financial Accounts 2002-2004).

No.	Indicator	Scoring	Brief Explanation and Cardinal Data used
A.	<b>PFM-OUT-TURNS: Credibility of the budget</b>		
	national procedures		Funds through the development fund were 708 million in 2004 (or between 15 – 20 %) of estimated donor funds. This figure has improved over the years. Source of information: Financial statements 2002 - 2004.

## Annex 5: Budget and Actual 2003 - 2005

	2003	2004	2005	2003	2004	2005
	Original Budget	Original Budget	Original Budget	Actual	Actual	Preliminary
<b>TOTAL REVENUE AND GRANTS</b>	<b>7,758.1</b>	<b>7,483.9</b>	<b>8,096.0</b>	<b>7,056.1</b>	<b>8,241.6</b>	<b>8,584.2</b>
<b>Total recurrent revenue</b>	<b>7,190.6</b>	<b>7,091.4</b>	<b>7,406.3</b>	<b>6,623.6</b>	<b>7,330.2</b>	<b>7,952.5</b>
<b>Tax revenue</b>	<b>6,469.5</b>	<b>6,394.2</b>	<b>6,610.7</b>	<b>6,021.7</b>	<b>6,621.8</b>	<b>7,095.2</b>
Taxes on income and profit	0.0	0.0	0.0	0.0	0.0	0.0
Taxes on property	50.0	104.0	110.0	74.8	106.5	154.5
Taxes on the use of goods	3,910.0	4,066.5	4,241.7	3,663.5	3,995.6	4,526.1
VAT	2,295.1	2,509.3	2,568.6	2,358.6	2,475.4	2,780.3
Business license	140.8	149.2	205.0	124.7	150.1	185.3
Turnover tax	116.9	105.0	155.0	98.1	122.8	146.5
Internet Casino	13.0	13.0	7.8	6.6	4.1	0.2
Debits tax	0.0	38.4	0.0	17.4	37.7	4.9
Service taxes	105.6	85.0	100.0	85.3	99.2	103.3
Excise	461.0	350.0	368.0	322.7	392.0	444.3
Other	777.6	816.6	837.3	650.1	714.3	861.3
Taxes on international trade	2,509.5	2,223.7	2,259.0	2,283.4	2,519.7	2,414.6
Export duty	0.0	0.0	0.0	0.1	0.0	0.0
Import duty	2,509.5	2,223.7	2,259.0	2,283.3	2,519.7	2,414.6
<b>Non-tax recurrent revenue</b>	<b>721.1</b>	<b>697.2</b>	<b>795.6</b>	<b>601.9</b>	<b>708.4</b>	<b>857.3</b>
Entrepreneurial and property income	365.1	370.1	430.1	200.9	220.5	267.6
Dividends	200.0	205.0	205.0	101.3	83.2	168.1
Property income	80.0	80.0	140.0	68.0	73.4	74.4
Other	85.1	85.1	85.1	31.6	63.9	25.1
Administrative fees and charges	337.5	308.6	344.5	380.2	468.1	563.8
Other non-tax revenue	18.5	18.5	21.0	20.8	19.8	25.9
<b>Non-recurrent revenue</b>	<b>567.5</b>	<b>392.5</b>	<b>689.7</b>	<b>432.5</b>	<b>911.4</b>	<b>631.7</b>
Sales of fixed assets	17.5	17.5	2.7	51.0	59.9	49.5
Grants from abroad	550.0	375.0	687.0	381.5	851.5	582.2
Project grants	375.0	375.0	375.0	381.5	615.3	384.5
Budget support	175.0	0.0	312.0	0.0	236.2	197.7
<b>OTHER RECEIPTS</b>	<b>1,911.2</b>	<b>1,276.1</b>	<b>1,141.1</b>	<b>1,659.9</b>	<b>476.1</b>	<b>320.0</b>
Gross borrowing	1,834.2	1,276.1	1,141.1	1,536.1	476.1	320.0
Domestic	1,834.2	1,276.1	876.1	1,536.1	476.1	320.0
External	0.0	0.0	265.0	0.0	0.0	0.0
Sales of financial assets	77.0	0.0	0.0	123.8	0.0	0.0
Principal receipts from lending	0.0	0.0	0.0	0.0	0.0	0.0
<b>TOTAL RECEIPTS</b>	<b>9,669.3</b>	<b>8,760.0</b>	<b>9,237.1</b>	<b>8,716.0</b>	<b>8,717.7</b>	<b>8,904.2</b>

	2003	2004	2005	2003	2004	2005
	Original Budget	Original Budget	Original Budget	Actual Budget	Actual Budget	Preliminary Budget
<b>TOTAL EXPENDITURE &amp; LENDING</b>	<b>7,606.0</b>	<b>7,340.0</b>	<b>8,188.8</b>	<b>7,628.7</b>	<b>7,915.0</b>	<b>8,225.4</b>
<b>Total expenditure recurrent budget</b>	<b>7,231.0</b>	<b>6,965.0</b>	<b>7,812.8</b>	<b>7,192.5</b>	<b>7,331.4</b>	<b>7,566.6</b>
Goods and services	5,809.0	5,776.4	6,244.0	5,638.1	5,624.2	5,967.0
<i>Salary and wages</i>	4,077.9	4,063.9	4,311.0	4,070.1	4,098.8	4,221.8
<i>Other contributions</i>	269.0	269.3	241.8	256.3	209.7	251.9
<i>Other goods and services</i>	1,462.1	1,443.2	1,691.2	1,311.7	1,315.7	1,493.3
Interest payments	308.2	405.7	412.1	352.7	377.5	349.5
<i>Domestic</i>	195.4	305.1	315.1	241.5	266.1	272.1
<i>External</i>	112.8	100.6	97.0	111.2	111.4	77.4
Subsidies and other transfers	1,074.2	744.3	812.9	1,116.8	1,160.6	893.7
<i>Subsidies and other transfers</i>	240.0	0.0	0.0	283.0	301.1	0.0
<i>Transfers to government bodies</i>	490.9	373.8	383.4	429.4	465.7	463.5
<i>Transfers to provinces and municipalities</i>	207.3	206.8	206.8	206.8	197.2	200.6
<i>Transfers to households</i>	136.0	147.7	103.7	141.8	135.0	81.0
<i>Transfers abroad</i>	0.0	16.0	119.0	55.8	61.6	148.6
Acquisition of fixed capital assets	39.6	38.6	343.8	84.9	169.1	356.4
<b>Total capital expenditure</b>	<b>375.0</b>	<b>375.0</b>	<b>376.0</b>	<b>436.2</b>	<b>583.6</b>	<b>658.8</b>
Non-recurrent transfers to gov. bodies	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure development budget	375.0	375.0	376.0	436.2	583.6	658.8
<i>Salary and wages</i>	na	na	na	60.3	101.1	67.3
<i>Other goods and services</i>	na	na	na	211.5	371.1	201.8
<i>Acquisition of fixed capital assets</i>	na	na	na	156.8	110.8	85.0
<i>Other expenditures</i>	na	na	na	7.6	0.6	304.7
<b>Lending minus repayments</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>ADJUSTMENTS</b>	<b>2,063.3</b>	<b>1,420.2</b>	<b>1,049.5</b>	<b>1,087.2</b>	<b>802.4</b>	<b>678.7</b>
<b>Amortisation</b>	<b>2,022.4</b>	<b>1,441.3</b>	<b>1,047.4</b>	<b>1,597.8</b>	<b>646.9</b>	<b>589.6</b>
<i>Domestic</i>	1,834.2	1,276.1	876.1	1,484.2	476.1	476.1
<i>External</i>	188.2	165.2	171.3	113.6	170.8	113.5
<b>Change in balances</b>	<b>40.9</b>	<b>-21.1</b>	<b>2.1</b>	<b>-510.6</b>	<b>155.5</b>	<b>89.1</b>
<i>Currency</i>	0.0	3.1	1.0	0.0	0.0	0.0
<i>Operating</i>	40.9	-24.2	1.1	-455.9	123.9	363.4
<i>Development</i>	0.0	0.0	0.0	-54.7	31.6	-274.3
<b>TOTAL PAYMENTS</b>	<b>9,669.3</b>	<b>8,760.2</b>	<b>9,238.3</b>	<b>8,715.9</b>	<b>8,717.4</b>	<b>8,904.1</b>
<b>BALANCE</b>	<b>152.1</b>	<b>143.9</b>	<b>-92.8</b>	<b>-572.6</b>	<b>326.6</b>	<b>358.8</b>
<b>TOTAL FINANCING</b>	<b>-152.1</b>	<b>-144.1</b>	<b>91.6</b>	<b>572.6</b>	<b>-326.4</b>	<b>-355.1</b>
External financing	-188.2	-165.2	93.7	-113.6	-170.8	-113.5
Domestic financing	36.1	21.1	-2.1	686.2	-155.6	-241.6

## Annex 6: Individual deviations by Ministry

	Deviation (% of original budget)		
	2003	2004	2005
Constitutionals	4.5%	3.7%	0.5%
Prime Minister	5.8%	22.7%	35.1%
Min. of Comprehensive Reform program	4.6%	4.6%	4.7%
Minister of Foreign Affairs, External Trade & Telecommunications	6.8%	5.0%	3.2%
Ministry of Internal Affairs	0.2%	3.5%	5.1%
Ministry of Finance & Economic Management	29.7%	7.4%	17.8%
Ministry of Industry & Commerce <sup>34</sup>	2.5%	6.8%	3.0%
Ministry of Ni-Vanuatu Business	1.8%	2.9%	2.6%
Ministry of Health	0.1%	0.5%	1.0%
Ministry of Education	0.3%	5.2%	1.4%
Minister of Youth and Sports <sup>35</sup>	6.5%	1.9%	13.9%
Ministry of Agriculture, Forestry and Fisheries	2.0%	0.4%	2.4%
Ministry of Lands, Geology & Mines and Water Resources	4.1%	12.2%	1.2%
Ministry of Infrastructure and Public Utilities	5.0%	1.0%	5.1%
Total (absolute) expenditure deviation (%)	4.8%	1.2%	1.5%
Total composition variance	5.8%	4.3%	5.4%
Variance in excess of total deviation	1.1%	3.1%	2.9%

Source: Author's calculation based on data from MEFM, Financial Statements of the Government of the Republic of Vanuatu for the Years Ended 31 December 2002, 31 December 2003, 31 December 2004.

<sup>34</sup> Ministry of Industry & Commerce was used to be Ministry of Trade, Tourism and Business Development prior to 2004.

<sup>35</sup> Ministry of Youth and Sports used to be Ministry of Education, Youth and Sports prior to 2004.



## Annex 7 Background to the Budget Support in Vanuatu

The history of the EU budget support goes back to 2001 and 2002. Through the Structural Adjustment Support Programme (SASP) facility under the Lome Convention, EC provided budget support in amount of Euro 1.6 million from the 8<sup>th</sup> EDF Funds (8ACP VA 012, 8ACP VA 013). It was disbursed in two tranches each of Euro 762,500<sup>36</sup>. The funds were *targeted* for the *education* and *health* sector, particularly for the payment of salaries and wages. The SAF has been satisfactory audited in May 2003.

As part of the SERP Program the EC agreed to provide Euro 1.3 million budget support from 9<sup>th</sup> EDF Funds (9 ACP VA 06) to enable reform efforts in Vanuatu to continue. The Program involves budget support directed at reducing structural deficit, and technical assistance to improve capacity in PFM and SERP monitoring. This budget support and associated technical assistance provides support to EU's focal area of support for the 9<sup>th</sup> EDF which is *education*. According to the Financial Agreement, the technical assistance is directed to:

- preparation of a MTEF;
- capacity building in Customs and Inland Revenue;
- assistance to PAC;
- preparation of internal audit and control, procurement and virements;
- support to monitoring of key social sectors performance indicators of the CRP.

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<sup>36</sup> In addition, the Structural Adjustment Facility included a provision of Euro 75,000 for Technical Assistance.